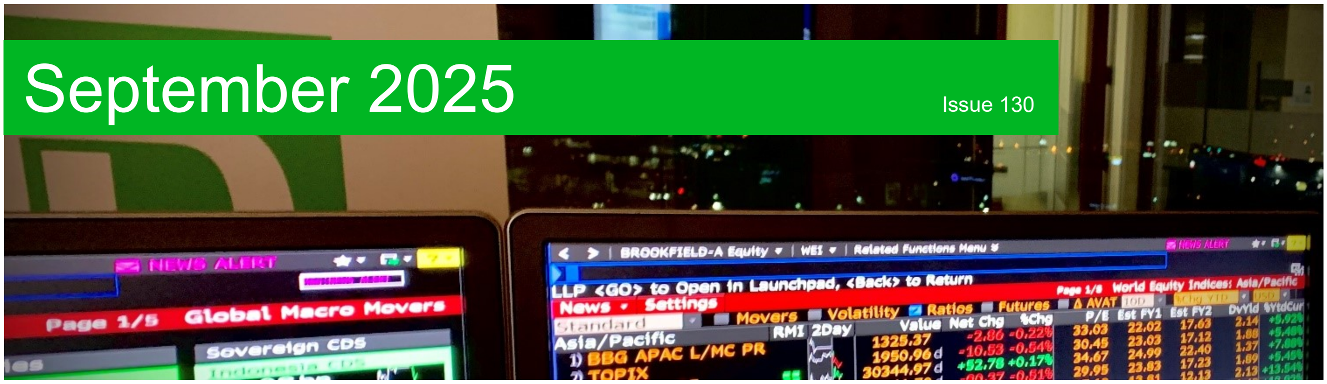
The Charter Group Monthly Letter



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Economic & Market Update

Separation of Monetary Church and State

The independence of the U.S. central bank is being challenged.

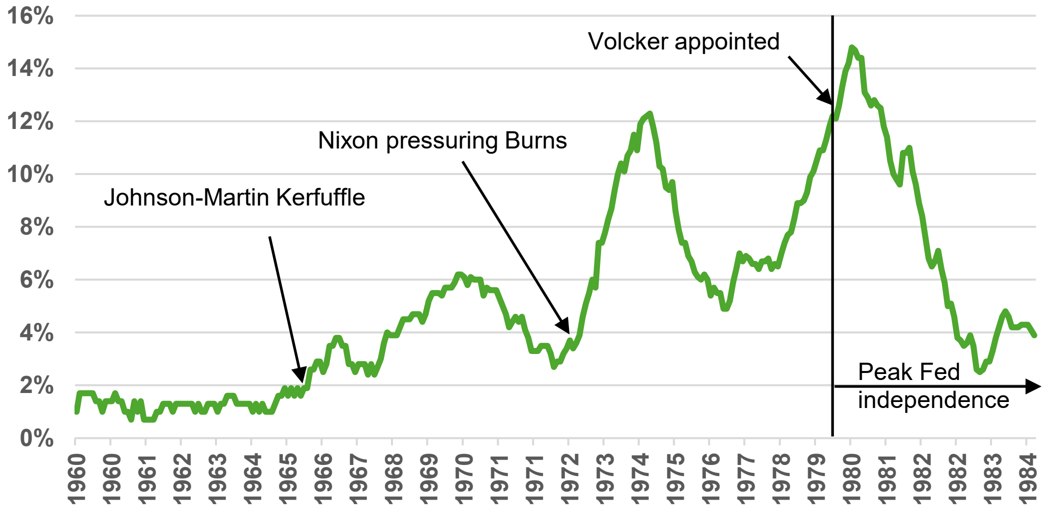
Should it be? And is it reasonably possible to eliminate the Federal Reserve's independence?

The topic of U.S. Federal Reserve Board (the Fed) independence has made headlines over the last number of weeks as the Trump administration muses on about attaining a majority on the Board to bring about significant interest rate cuts.

Before delving into this, it is important to note that the pressure to cut rates has a lengthy bipartisan history as a couple of examples will illustrate. President Nixon (a Republican) famously pressured the Fed Chair Arthur Burns into lowering rates to juice the economy as the 1972 presidential election approached. Even crazier, in late 1965 President Johnson (a Democrat) physically assaulted then Fed Chair William McChesney Martin, shoving him against a wall after Martin resisted Johnson's previous attempts at rate-cut bullying! Unlike recent events, these episodes in the past were mostly behind closed doors and didn't make news at the time.

The takeaway is that *all* presidential administrations want low interest rates. I can't think of a single occasion where a President has praised the Fed for hiking rates. Whether it involves an upcoming election or whether it's for posterity, Presidents want low rates in the hopes that this will grow the economy, allowing them to take credit. 😊

Chart 1:
U.S. Annual Inflation Rate



Source: Bloomberg Financial L.P. as of September 10, 2025.

Back to the matter at hand. Will the Fed lose its independence? Should it? Or shouldn't it?

The Fed has a history of making big policy mistakes.

Much of this is due to forecasting errors despite having hundreds of highly educated economists.

So, there is the question of competence.

The arguments as to why it should lose its independence might focus on competence or on fulfillment of duty. Long-time readers will know that I am a huge critic of central banks in general, and the Fed in particular. Do Fed Chairs and Governors make mistakes? Yes! And they make them almost continually. One reason is that the leaders at the Fed are human which make them prone to making mistakes just like you and me. Imperfect data is used to create forecasts upon which policy decisions are made. Despite having about 450 Ph.D.'s on staff across the system, the Fed has made monumental blunders which include not properly anticipating or addressing the impending Subprime mortgage crisis and Great Recession of 2007 to 2009. In March 2007, then Chair Ben Bernanke testified to the U.S. Congress that the housing crisis was "likely to be contained." Then, current Chair Jerome Powell's claim in early 2021 that the bump in inflation was only "transitory" led to one of the worst central banking policy mistakes in a generation when the Fed Funds Rates was kept too low for too long. Inflation kept rising until it peaked at over 9% in 2022 and is *still* above the Fed's 2% target to this day.

Being a central banker is not an easy job. That said, the well-documented hubris and conceit, aspects that I personally witnessed at conferences where Fed officials spoke, have not helped matters.

As far as fulfilling duties, there has been some drifting away from the original priorities to which the Fed was assigned by the U.S. Congress. Often referred to as "the dual mandate", the Fed has two imperatives: keep the prices stable and promote maximum employment. There have been times in the past when each of these objectives were at odds with each other. Policies that keep a lid on inflation tend to have an adverse effect on jobs. And policies that promote full employment run the risk of overheating the economy which can ignite inflation.

The Fed has also added new and wider aspirations to its official mandates.

This can reduce the focus of the Fed and sap its time and energy.

Could this impact the Fed's ability to fulfill its intended duties?

The drift away from what is already a challenging balancing act has often involved adopting unofficial mandates aimed at climate change, wealth inequality, or economic problems outside of the U.S.

As a portfolio manager, it can be frustrating when central banks like the Fed (and the Bank of Canada) commit policy errors, don't quickly correct the errors, or lose focus on the things that they have the ability and responsibility to address.

If an independent Fed is capable of all this, you might conclude that I would be in favour of reducing or eliminating its freedom.

However, in my opinion, a Fed run by elected politicians is a really bad idea. Much worse than the existing arrangement with all its flaws.

However, I think the alternative is many times worse. Having elected officials in charge could degrade the ability of a central bank from responding to a crisis. And I would expect a compromised central bank to downgrade the importance of price stability if more stimulus can accelerate the economy. Also, it has been so long since inflation has been a chronic nightmare that most of the voting public may not be persuaded by those who highlight the dangers. I would expect that voters would eventually call for tough measures to combat inflation, but it could take years of pain to arrive at that. By then, there is often a shift of relative wealth from the poorer to the more wealthy who have more options to navigate a rising-price environment. Economic total wealth is often reduced because of less investment, more uncertainty, more labour disruption, and more potential political volatility. The vision of a Lyndon Johnson or a Richard Nixon deftly guiding the Fed through such turmoil would beggar belief.

Fed independence is measured in degrees and it has oscillated over its history. It would be reasonable to argue that the Fed was not independent during World War II when it very clearly suppressed interest rates and worked with the U.S. Treasury Department to help finance the war effort. During this era the Treasury Secretary, who works closely with the President, was also the Chair of the Fed!

Then in 1951 an accord was reached between the Treasury and the Fed to end this provision and the Fed became a stand-alone institution that would focus on monetary policy and leave the federal debt management to the Treasury. So, more independence, although President Truman was famous for trying to persuade the Fed regardless.

The Fed has not done itself many favours in the last few decades as it has cozied up to the government by helping to facilitate the growth of debt to finance high levels of spending.

Peak level of independence occurred from the late 1970s to the mid-1980s.

Before and after that period, the degree of effective independence has fluctuated.

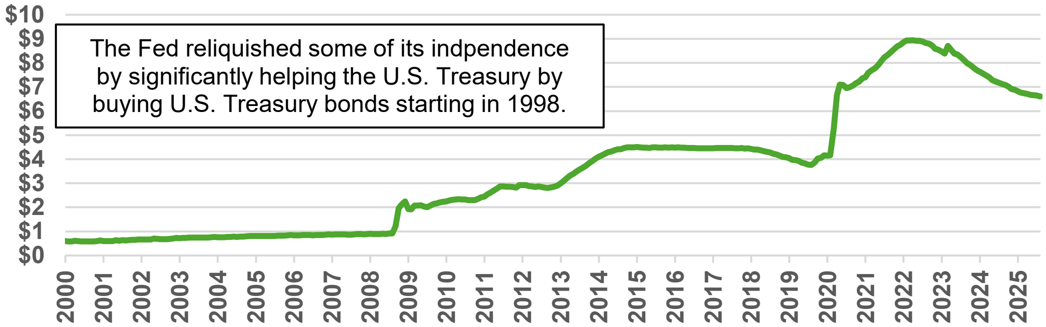
This more or less continued through to the 1970s with a few notable presidential temper tantrums like the ones involving Johnson and Nixon. However, it was Nixon's interference and the inflation that this precipitated that opened the door for an unprecedented level of independence starting in the late 1970s. Inflation was so bad and so persistent, and all the gimmicks to solve it had failed, that this led to the appointment of Paul Volcker as Chair. President Carter, who was encouraged to appoint Volcker, was astonished at the severity of Volcker's actions to fight inflation, which included skyrocketing interest rates and a tightened money supply. Volcker basically ignored pleas from the White House that these policies could cost Carter the 1980 election against Reagan. And then he mostly ignored Reagan and his Treasury Secretaries for the next seven years. Needless to say, the White House disdained Volcker. However, the bond market loved him as it had a champion that would look out for it by keeping inflation, which is like kryptonite for bond prices, restrained. Maximum independence!

Volcker's policies brought in decades of relative peace on the inflation front. However, none of his successors stood up to government officials like he did. From the mid-1980s through to the beginning of the Pandemic the trade-off between price stability and employment was dulled by the end of the Cold War, globalization, and demographics. In this economic landscape, central bankers were able to indulge governments by accommodating ever-increasing levels of spending with lower interest rates with little or no consequences. My belief is that independence began a slow deterioration during this era and emboldened elected leaders and partisan policymakers to press harder on monetary policy issues. The evidence was the Fed's overly helpful policies resulting in disruptive levels of excess stimulus and a bloated balance sheet conveniently holding trillions of dollars of bonds issued by the U.S. Treasury. (**Chart 2**).

Despite all the critiques the Fed deserves and all the recent political attempts to undermine it, I don't think a complete abolishment of Fed independence is likely. The bond market seems to agree in that it has not reacted much so far. It would be sensible to expect a dramatic bond market reaction if the Fed was indeed "captured."

Chart 2:

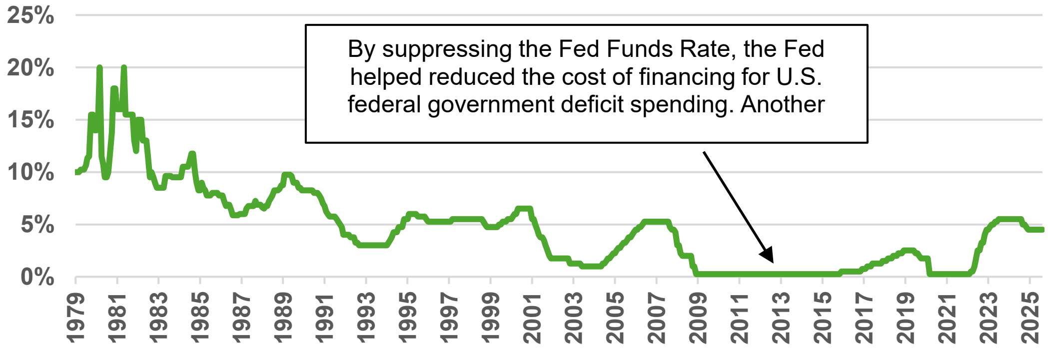
U.S. Federal Reserve Balance Sheet (in Trillions)



Source: Bloomberg Financial L.P. as of September 10, 2025.

Chart 3:

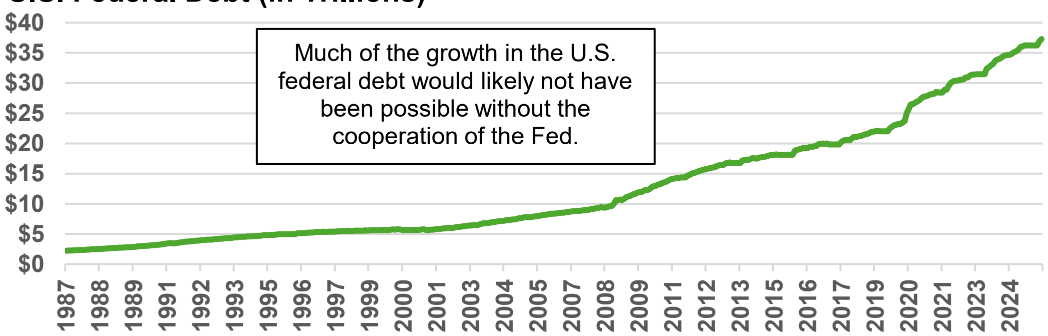
U.S Fed Funds Rate



Source: Bloomberg Financial L.P. as of September 10, 2025.

Chart 4:

U.S. Federal Debt (in Trillions)



Source: Bloomberg Financial L.P. as of September 10, 2025.

For a significantly indebted nation like the U.S., the bond market is the final judge and jury on matters of policy and independence. That doesn't preclude efforts to interfere with the Fed. But it makes successful interference exceedingly difficult. Thus, I will need to keep an eye on things surrounding the clash between the Fed and the Trump administration. It will have an impact on how much defense the portfolios might need in an environment with more inflationary uncertainty.

The bond market is the final judge and jury with respect to how much Fed independence can be eroded.

Depending upon how serious the attempts are to remove independence, investment markets could react adversely if investors fear any resulting price instability in the economy.

Model Portfolio Update[1]

The Charter Group Balanced Portfolio
(A Pension-Style Portfolio)

	Target Allocation %	Change
Equities:		
Canadian Equities	12.0	None
U.S. Equities	38.0	None
International Equities	8.0	None
Fixed Income:		
Canadian Bonds	22.0	None
U.S. Bonds	6.0	None
Alternative Investments:		
Gold	8.0	None
Silver	1.0	None
Commodities & Agriculture	3.0	None
Cash	2.0	None

No changes were made to the model portfolios in terms of the asset allocations or the investment holdings during August.

No changes made in the model portfolios during August.

It was a notably a good month for gold, Canadian stocks, and international stocks. The rest of the asset classes were slightly higher. Perhaps with investment professionals on summer vacation, things were on autopilot for the most part.

Gold was higher, perhaps because of concerns over Federal Reserve independence.

Gold likely benefitted from the increased uncertainty surrounding the independence of the U.S. Federal Reserve (as discussed in the first section above). The concern is regarding the potential for loose monetary policy (rates that are too low) to potentially increase inflation. Gold has been a traditional inflation hedge.

[1] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of September 10, 2025. The asset allocations of individual clients invested in this Portfolio may differ because of the relative performance of the asset classes since the last rebalancing and because of differences in the timing of deposits and withdrawals. The Balanced Model Portfolio is part of a sequence of five portfolios ranging from conservative to aggressive: Conservative, Balanced Income, Balanced, Balanced Growth, and Growth.

With growing pressure on the Fed, it feels like they are looking for reasons to cut rates. The U.S. economy and employment are still strong by historical standards, stocks are at record highs, and inflation is still bubbling. All this might suggest that a cut is not appropriate. But the Fed is run by humans who may find it hard to block out the pressure exerted by the Trump administration as well as trying to ignore those on Wall Street cheering on the possibility of lower rates.

A 0.25% rate cut from the Federal Reserve in September looks to be priced in.

A 0.25% rate cut on September 17th looks very likely at this point. However, if that meeting does not produce the language that implies further rate cuts, investors may look for an exit. And September is seasonally the worst month for U.S. stocks. That might add up to some turbulence as we head into the fall.

However, beyond that, the market is going to look for signs of continued rate cuts.

Volatility could erupt if those signs don't unfold.

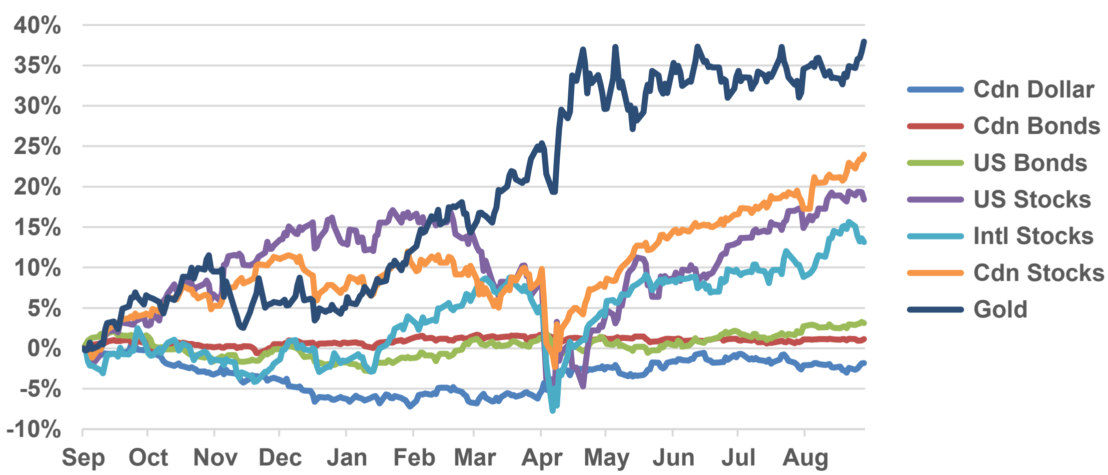
We could get another rate cut before the end of the year which would provide some ballast for stocks. However, beyond that, it might be something like persistent inflation which quashes the dreams of yet more rate cuts and puts some of the higher-valued areas of the market at risk. But that is likely more a concern for next year.

September is historically the worst month for U.S. stocks. That seasonality could also be a catalyst for volatility.

Below is the 12-month performance of the asset classes that we have used in the construction of The Charter Group's model portfolios. (**Chart 5**).[2]

Chart 5:

12-Month Performance of the Asset Classes (in Canadian dollars)



Source: Bloomberg Finance L.P. for the interval from September 1, 2024 to August 31, 2025

[2] Source: Bloomberg Finance L.P. – The Canadian dollar rate is the CAD/USD cross rate which is the amount of Canadian dollars per one U.S. dollar; Canadian bonds are represented by the current 3-year Government of Canada Bond; US bonds are represented by Barclays US Aggregate Bond Index; U.S. stocks are represented by the S&P 500 Index; International stocks are represented by the MSCI EAFE Index; Canadian stocks are represented by the S&P/TSX 60 Composite Index; Gold is represented by the Gold to US Dollar spot price.

Top Investment Issues[3]

Issue	Importance	Portfolio Impact
1. Global Geopolitics	Significant	Negative
2. Global Trade Wars & Alliances	Moderate	Negative
3. Inflation from Tariffs (Portfolio Impact)	Moderate	Positive
4. Canadian Federal Economic Policy	Moderate	Negative
5. Tariffs: Slowing Economic Growth	Moderate	Negative
6. Canadian Dollar Decline	Medium	Positive
7. China's Economic Growth	Light	Negative
8. Long-term U.S. Interest Rates	Light	Positive
9. Short-term U.S. Interest Rates	Light	Positive
10. U.S. Fiscal Spending Stimulus	Light	Positive

[3] This is a list of the issues that we currently deem to be the ten most important with respect to the potential impact on our model portfolios over the next 12 months. This is only a ranking of importance and potential impact and *not* an explicit forecast. The list is to illustrate where our attention is focused at the present time. If you would like an in-depth discussion as to the potential magnitude and direction of the issues potentially affecting the model portfolios, I encourage you to email me at mark.jasayko@td.com or call me directly on my mobile at 778-995-8872.

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The Charter Group is a wealth management team that specializes in discretionary investment management. For an annual fee, we manage model portfolios for private clients and institutions. All investment and asset allocation decisions for our model portfolios are made in our Langley, B.C. office. We do not outsource any of the decision-making for our model portfolios – there are no outside actively-managed products or funds. We strive to bring the best practices and the calibre of investment management normally seen in global financial centres directly to the Fraser Valley and are accountable for the results.

Accountability is further enhanced by the fact that we commit our own investable wealth to the same model portfolios in which our clients are invested.

The information contained herein is current as of September 10, 2025.

The information contained herein has been provided by Mark Jasayko, Senior Portfolio Manager and Senior Investment Advisor, TD Wealth Private Investment Advice, and is for information purposes only. The information has been drawn from sources believed to be reliable. Graphs and charts are used for illustrative purposes only and do not reflect future values or future performance of any investment. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance.

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Index returns are shown for comparative purposes only. Indices are unmanaged and their returns do not include any sales charges or fees as such costs would lower performance. It is not possible to invest directly in an index.

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Thank you to our clients and community for voting The Charter Group, your favorite for Investment Management and Financial Planning in Langley for the sixth year in a row.

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