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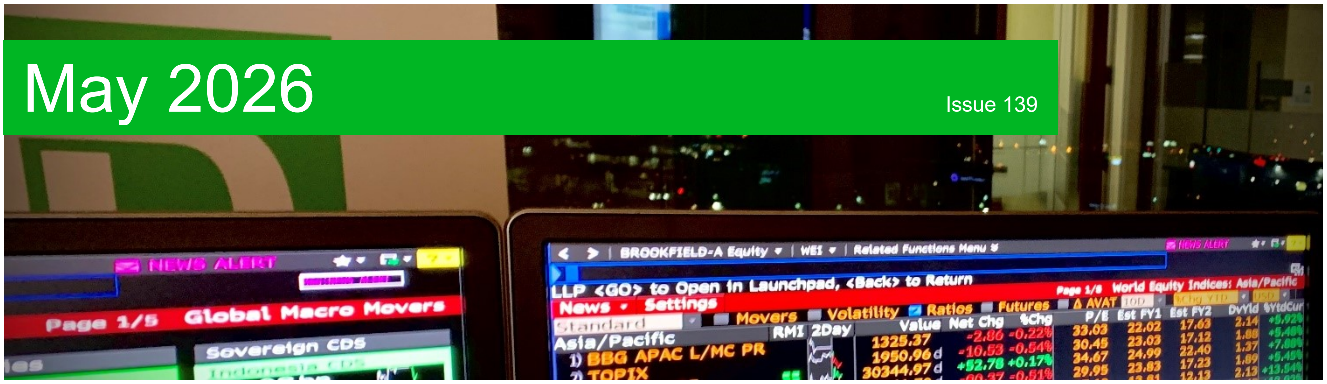


Mark Jasayko, MBA, CFA
Senior Portfolio Manager & Senior Investment Advisor
TD Wealth Private Investment Advice
The Charter Group, Langley, BC

Economic & Market Update

Wasted Capital

Over a couple editions of this newsletter and during our October update events, I have touched on the global battle for capital. The hostilities in the Persian Gulf are not helping.

For a couple of decades, an abundance of capital was taken for granted. There was a surplus of savings, growing baby boomer wealth, and a "peace dividend" following the Cold War which all helped to provide capital at relatively low cost. It was simple supply and demand. An excess of supply of anything tends to lower the cost assuming demand stays steady.

The reliability of that supply of capital is gone. Capital is still available, but it goes to the highest bidder. That could be a company looking to borrow or issue equity and promising to pay more in interest or dividends in order to attract the attention of an investor.

To make matters worse, the line up of bidders is growing, increasing the demand for that unreliable supply. The new kid on the block is Artificial Intelligence (AI). As I have discussed recently, it has elbowed its way into the line seeking upwards of $7 trillion in

The global demand for capital continues to escalate.

So now is not a good time for a disruption in the supply of that capital.

However, that is something that often results from military hostilities like we are seeing in the Persian Gulf.

capital between now and 2030. Leading sovereign governments (federal governments that have the right to print money) continue to be at the head of the line. Although being able to print money invites a whole host of potential longer-term problems, it is a feature that attracts lenders. It is always helpful to be able to print money to pay off debts if one becomes insolvent! That might cause some devaluation of the currency, but at least the lender gets back the money owed.

The demand for capital is coming from the Artificial Intelligence infrastructure buildout as well as increasing government budget deficits which need to be financed.

The AI overlords soliciting the markets for capital likely won't be able to displace governments doing the same thing. But at the margin, they will likely make it more expensive for governments and even more so for everyone else down the capital-seeking food chain (corporations, small businesses, and consumers like you and me).

Before the disruption on the supply side of the capital markets over the last few years, I had written extensively about my concerns regarding government budget deficits which adds to the demand side. If demand increases while supply remains constant, that can also increase the cost of capital. Going forward, this source of demand is only set to grow more.

The battle in the Persian Gulf has the potential of disrupting both the supply *and* demand sides of the capital markets.

First off, the intended and unintended consequences of military action is to waste capital. In preparing for battle, the costs of building up offensive and defensive power might be considered an economic waste from both altruistic and productivity perspectives. Money spent on militaries is diverted from doing good in the economy (social programs) and from producing wealth (investing in people and businesses). Building and maintaining militaries tends to be a sinkhole for capital without much return on investment (although it does produce the occasional blockbuster like the internet – which was originally built as a system to facilitate digital communications during a nuclear attack).

Building and then maintaining military readiness consumes tremendous amounts of capital. Some might see this as a bit of a waste when that capital could be used for productive or altruistic reasons.

Then, when battle ensues, the intended objective is to waste capital, like firing off expensive munitions in an attempt to "waste" the military capital of the enemy. So lots of waste all around.

However, the "wasting" of capital really begins when the battle starts. One is trying to "waste" the enemy while the enemy is trying to "waste" things by counterpunching.

And all of this just when AI and governments are looking for capital.

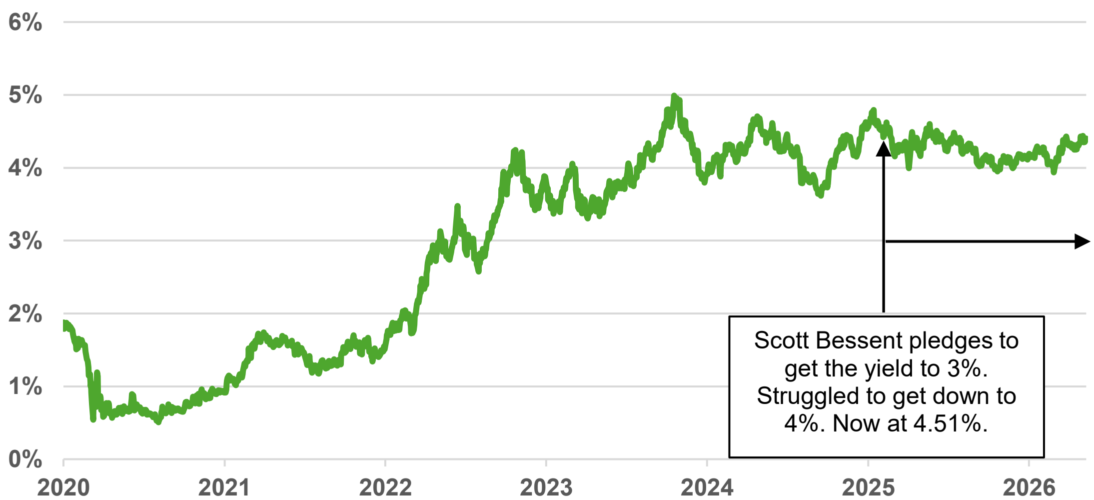
Over the last couple of months there has been some financial media coverage of Gulf countries pulling back capital from the rest of the world to address the economic and infrastructure uncertainties that they are facing at home.[1] One estimate puts this figure at $6 trillion.[2] Much of that capital might have found its way into AI or needed government infrastructure projects (Canada for example). Now it may not be available for years.

Hostilities in the Gulf region can be especially detrimental to the availability of capital as many of those countries there routinely invest their surplus oil wealth around the globe.

Now they are recalling that capital to address uncertainties stemming from the war.

A good measure of the cost of capital resulting from all these global capital supply and demand disruptions is the rate of interest that leading governments need to pay on their 10-year benchmark bonds. The number that I most closely look at is for the U.S. 10-year Treasury bond. President Trump's Treasury Secretary Scott Bessent promised a year and a half ago to get the yield on that 10-year bond down to 3%. Trump wants that. Bessent wants that. The U.S. Federal Reserve would be delighted with that. Yet, despite the wishes from all those powerful sources, the bond market (a supplier of capital) currently demands 4.51%.[3] (**Chart 1**) The realities of the global demand for capital are dictating that. And if the U.S. can't avoid this, we can be assured that other governments can't either (**Chart 2**).

Chart 1
U.S. 10-year Treasury Bond Yield



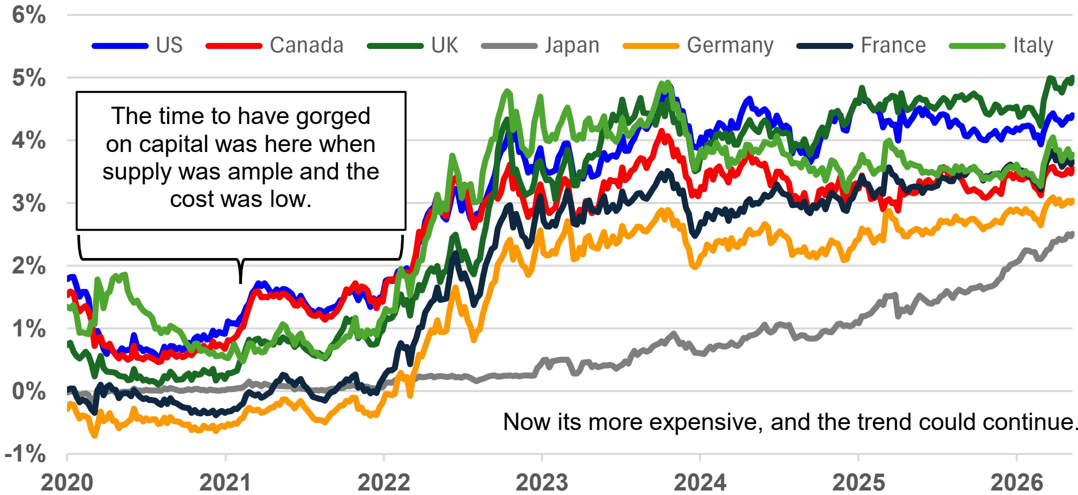
Source: Bloomberg Finance L.P. as of May 15, 2026

For a decade now, a prominent theme in my newsletters and update events has been the departure from the halcyon holiday era that followed the Cold War. Globalization and cooperation were ascendant. Geopolitics, inflation, and interest rates were ebbing. The hope was that the new era would become the new normal and, by lasting so long, it felt like that.

[1] Infrastructure needs include rebuilding oil and gas facilities damaged by Iranian drones and to build pipeline diversions to bypass the Strait of Hormuz.
[2] "War will drain the Gulf's $6trn treasure chest." *The Economist*, April 15, 2026.
[3] Source: Bloomberg Finance L.P. as of May 11, 2026.

Chart 2:

G7 Nation Sovereign 10-year Benchmark Bond Yields



Source: Bloomberg Finance L.P. as of May 15, 2026

My portfolio response to all this is to minimize exposure to companies that are most impacted by a higher cost of capital. Often these are companies that don't produce enough cash flow to be self-funding and need to shore up deficiencies by borrowing or issuing more equity.

A higher cost of capital (higher interest rates) is a potential outcome when the demand for capital collides with a disruption in the supply of capital.

A higher cost of capital also devalues the corporate promises of profitability further out into the future. In a higher cost environment, investors start demanding more nearer term results. The result is often higher current interest and dividend yields imposed by the market.

The model portfolios focus more on companies which don't depend on getting access to cheap capital or those that routinely return capital back to the investor.

However, if a company suggests that breakthroughs and profitability are a number of years away, it could impact its present value which is the foundation of its stock price. Instead, companies with profitable and steady current operations may begin to trade at better values versus something like an innovative tech firm that eats through capital rather than paying some of it back.

Model Portfolio Update[4]

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

	Target Allocation %	Change
Equities:		
Canadian Equities	15.0	None
U.S. Equities	34.0	None
International Equities	11.0	None
Fixed Income:		
Canadian Bonds	18.2	None
U.S. Bonds	9.8	None
Alternative Investments:		
Gold	7.5	None
Commodities & Agriculture	2.5	None
Cash	2.0	None

There have been no changes to the asset allocations or the holdings in any of the model portfolio during April and into May. All the positions were rebalanced back to their targets for the first time since early January. Clients might notice the recent related transactions.

No changes to the asset allocations or the individual securities in the model portfolios over the last month.

The last five weeks have seen an impressive bounce back in AI and semiconductor stocks. From what I can see, this has been driven by two things. First, earnings appear to be better than expected. However, it should be noted that these earnings are not mainly the result of end-user demand. Instead, much of it stems from the buildout of AI infrastructure. As I have written previously, the cost of the buildout likely exceeds the available global capital. This point seemed to be making inroads last fall. However, as the market is apt to do, the argument has been cast aside for now.

AI enthusiasm has reemerged. This has reignited the speculation that fizzled last fall when questions around AI buildout spending emerged.

Secondly, the market is working hard to look past the war in the Persian Gulf. For that, it needs something to focus on. The seductiveness of AI with all its imagined potential provides that.

Markets are likely hoping to look past the hostilities in the Persian Gulf.

[4] The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of May 15, 2026. 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.

Needless to say, the model portfolios don't have a heavy direct weighting towards AI beyond the positions in Microsoft and IBM. The portfolios do have exposure to energy-related companies which have a role in powering AI, but they have generally not captured as much of the recent enthusiasm that pure AI stocks have.

We are underweight with respect to pure AI and semiconductor stocks. As a result, the portfolios have lagged a bit over the past month.

Looking forward, the markets overall face a couple of hurdles. Despite the optimism for a conclusion, some level of hostilities in the Persian Gulf look set to persist. Also, the impact of this will likely last months longer even if there is a workable agreement between the U.S. and Iran.

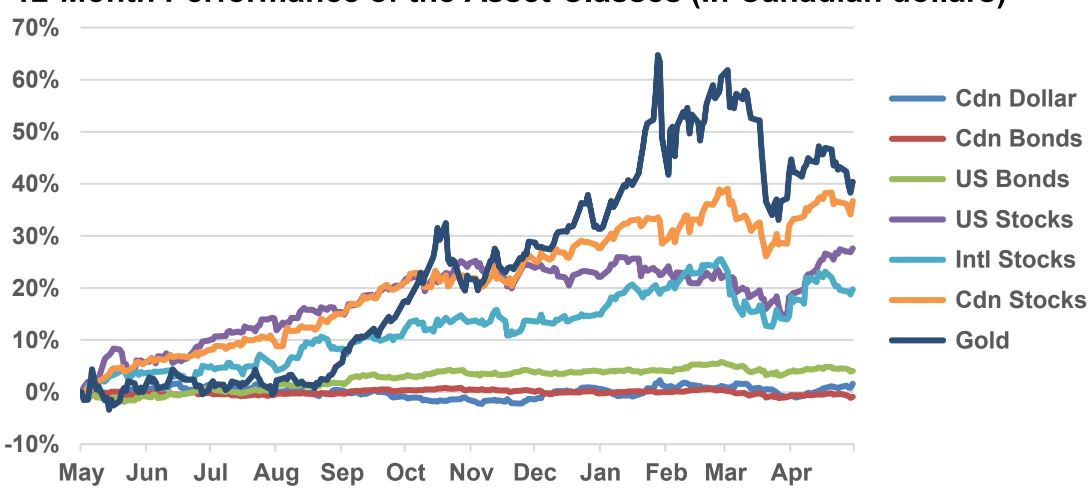
Markets also may be ignoring that the once hoped for interest rate cuts likely won't materialize this year. Investors may have to wrestle with this when the reality can no longer be ignored.

The other hurdle concerns the direction of interest rates for the rest of the year. As discussed in the first section of this newsletter, a global lack of capital supply in the face of growing demand can increase the cost of capital which is reflected by higher interest rates. Plus, inflationary effects of the Strait of Hormuz blockade have reduced the probability of short-term central bank rate cuts for the remainder of the year.[5]

Below is the 12-month performance of the asset classes that I have used in the construction of The Charter Group's model portfolios. (**Chart 3**).[6]

Chart 3:

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



Source: Bloomberg Finance L.P. for the interval from May 1, 2025 to April 30, 2026

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[5] Source: Bloomberg Finance L.P. as of May 15, 2026 – as implied by the trading in interest rates futures contracts.
[6] 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[7]

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. Tariffs: Slowing Economic Growth	Moderate	Negative
5. Canadian Dollar Decline	Medium	Positive
6. U.S. Fiscal Spending Stimulus	Medium	Positive
7. Growing U.S. Credit Risks	Medium	Negative
8. Canadian Federal Economic Policy	Medium	Positive
9. China's Economic Growth	Light	Negative
10. Long-term U.S. Interest Rates	Light	Negative

[7] 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.

The Charter Group

Mark Jasayko, MBA, CFA | Senior Portfolio Manager & Senior Investment Advisor
Keith Henderson, BBA, CIM®, CFP® | Associate Portfolio Manager & Senior Investment Advisor
Laura O'Connell, CFP®, FMA | Associate Investment Advisor
Nadia Azam, BA | Associate Investment Advisor
Kelsey Sjoberg | Administrative Associate
Amrit Senghera, BBA | Administrative Associate
Roberto Gomez | Client Service Associate

604 513 6218
8661 201 Street, Suite 410
Langley, British Columbia V2Y 0G9

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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 May 15, 2026.

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 from The Charter Group at TD Wealth

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

The Charter Group

8661 201 Street, Suite 410
Langley, BC V2Y 0G9
Tel: 604-513-6218
Toll free: 855-822-8921 | Fax: 604-513-6217
TD.thechartergroup@td.com
advisors.td.com/thechartergroup

The Charter Group

TD Wealth