

# The Charter Group Monthly Letter

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

## Economic & Market Update

### Autumnal Accidents

This September and October saw another episode of volatility similar to what we saw in January and February. I have written in previous issues of the *Monthly Letter* about how volatility might be in the process of returning to historical levels and 2018 appears to be living up to this.

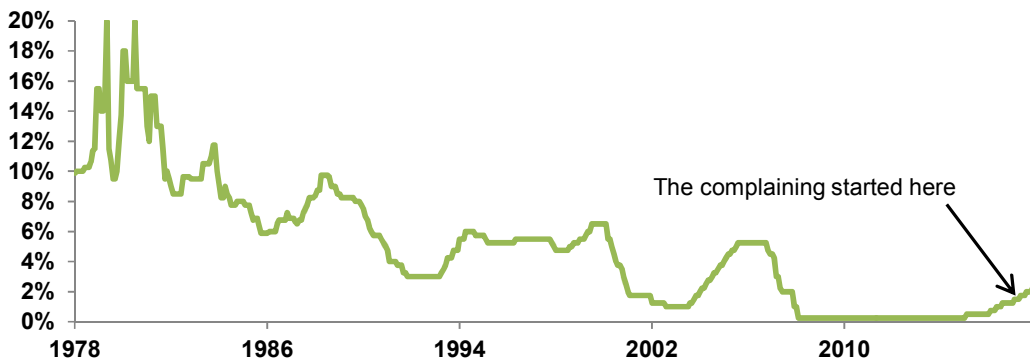
Similar to this year's earlier volatility, the main culprit this autumn was interest rates. Specifically, it is a fear that rates might rise faster than the economy can handle. For years now, interest rates have hovered near historical lows. It is understandable that investors and consumers got accustomed to very low interest rates and often behaved as though they would remain low forever. So, when rates finally looked set to rise again, consumers, investors, and even politicians, start to get agitated (**Chart 1**).

**Concern regarding the pace of interest rates increases triggered another episode of volatility, similar to what we saw earlier this year.**



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**Chart 1:**  
**US Fed Funds Rate - Set by the US Federal Reserve Board**



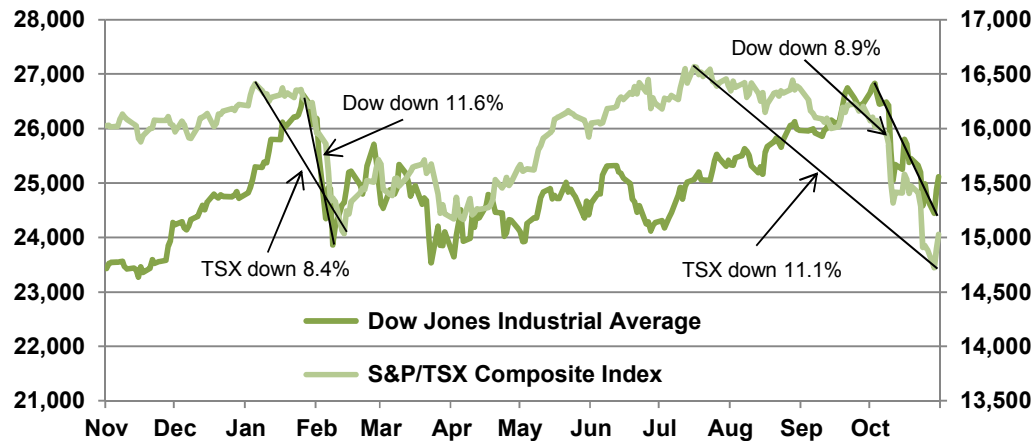
Source: Bloomberg Finance L.P. as of 10/31/2018

Consumers, investors, and politicians are no longer accustomed to normal levels of interest rates, so there is a lot of complaining when rates lift off of historic lows.

The fear surrounding US stock market volatility in January and February was greater than what we have seen this autumn (Charts 2 & 3). This time around, in addition to the concern over interest rates, there were other headlines regarding trade wars, corporate earnings, and the drama surrounding the US midterm elections, all of which appeared to have made things look worse. However, it is unlikely that any of these factors individually or together would present markets with an unsurmountable hurdle.

US political drama, slowing corporate earnings, and trade war rhetoric amplified the bad mood.

**Chart 2:**  
**Dow Jones Industrial Average (US)      S&P/TSX Composite Index**



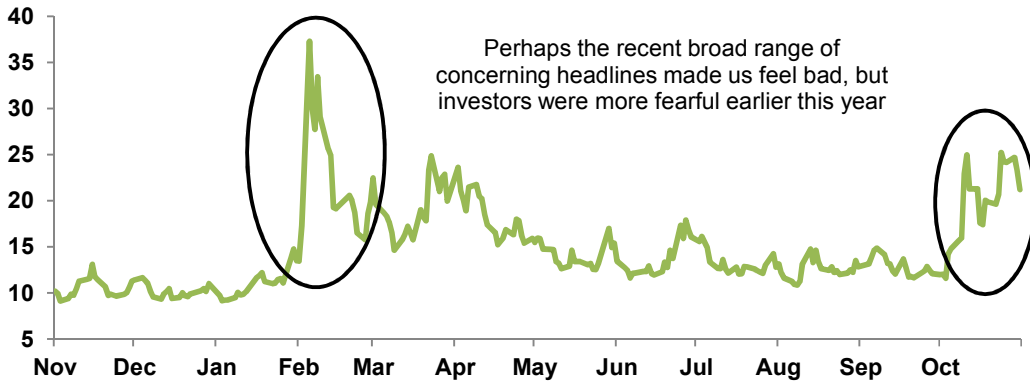
Source: Bloomberg Finance L.P. as of 10/31/2018

For some historical perspective, there have been four declines on the Dow Jones Industrial Average since the Great Recession and global credit crisis ten years ago (Chart 4). Those episodes lacked the extreme factors (record overvaluations, geopolitical crises, and failing financial institutions) that precipitated the major selloffs over the last three decades (Chart 5).

The recent volatility is relatively minor by historical standards and lacks the other extreme factors seen during major market selloffs.

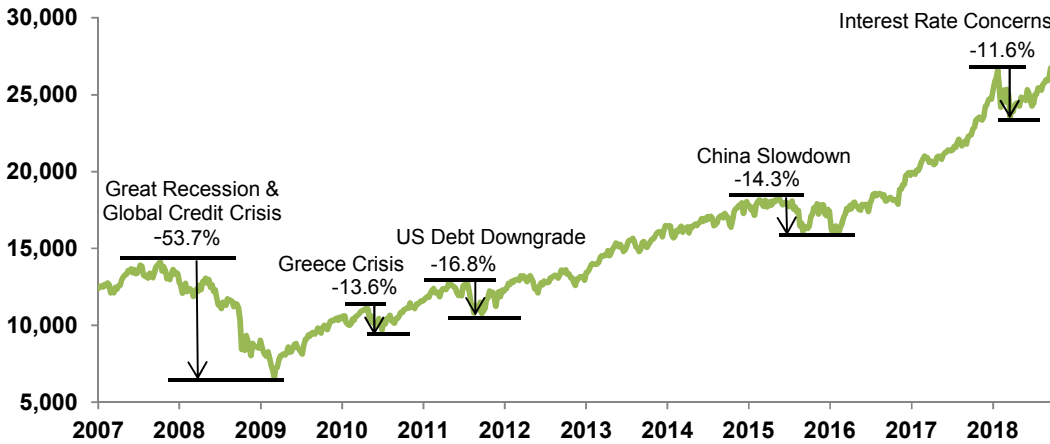
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**Chart 3:**  
**CBOE SPX Volatility Index - "The VIX" or "The Fear Gauge"**



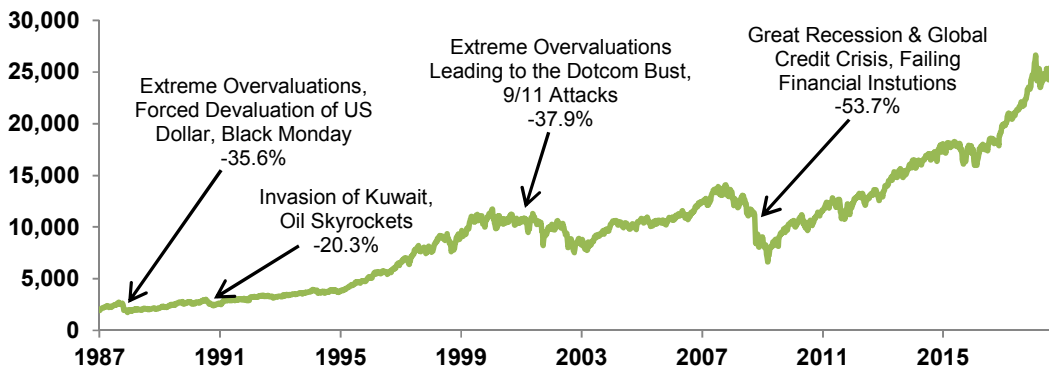
Source: Bloomberg Finance L.P. & The Chicago Board Options Exchange as of 10/31/2018

**Chart 4:**  
**Dow Jones Industrial Average**



Source: Bloomberg Finance L.P. as of 10/31/2018

**Chart 5:**  
**Dow Jones Industrial Average - Declines Greater Than 20%**



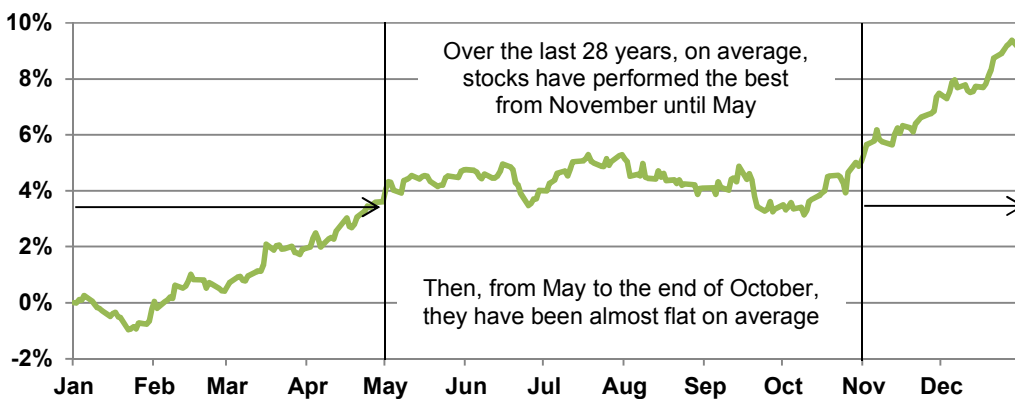
Source: Bloomberg L.P. as of 10/31/2018, Declines measured from a record peak to the next trough

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In conjunction with this autumn's selloff, valuations are only moderately above their long-term average, but not excessive. Separately, some technology stock valuations have reached concerning levels, but that risk should not necessarily have a direct impact on the prices of all other stocks. Also, the current condition of large international financial institutions is substantially better than it was during the last decade. And, things are relatively quiet on the geopolitical front.

**The US stock market should be able to navigate through most of the current factors worrying investors.**

**Chart 6:  
Dow Jones Industrial Average - Seasonal Average 1990-2017**



Source: Bloomberg Finance L.P. as of 10/31/2018

The other present factors are ones that the markets should be able to eventually digest.

Regardless of who controls the US Congress, it is unlikely that the massive and economically friendly federal spending will be scaled back. Democrats may love to spend just as much as President Trump does. The Democrats may want to raise taxes, but that might not be a good idea heading into the 2020 presidential election.

On the trade front, trade wars usually do shrink the overall level of trade and could induce some inflation. However, there is always the prospect that these skirmishes might lead to much more transparent trade relationships in the future, especially with China.

It is also worth noting that we are beginning to head into a better seasonal stretch for the stock markets (**Chart 6**). Although it does not always hold true, the period from November to May is historically the best time of year to be a stock market investor.

**Looking forward, we are entering into a time of year that is friendlier to stock market investors.**

**Model Portfolio Update<sup>1</sup>**

<b>The Charter Group Balanced Portfolio</b> (A Pension-Style Portfolio)		
	Target Allocation %	Change
<b>Equities:</b>		
Canadian Equities	15.0	None
U.S. Equities	35.7	None
International Equities	9.3	None
<b>Fixed Income:</b>		
Canadian Bonds	23.8	None
U.S. Bonds	2.5	None
<b>Alternative Investments:</b>		
Gold	7.5	None
Commodities & Agriculture	2.5	None
Cash	3.7	None

There were no changes to the asset allocation or the individual holdings in The Charter Group Balanced Portfolio model during October.

The cash balance continues to be slightly higher than its strategic target of 2% as we continued to leave the proceeds of a previous bond maturity in cash. The bond market has been unattractive over the past two months as interest rates moved higher. The iShares Core Canadian Universe Bond Index, a proxy for the Canadian bond market, was down again in October, falling 0.96% (and this was net of coupon interest income).<sup>2</sup> So, we're not missing much!

Gold and the decline in the Canadian dollar were the only general contributors to positive performance during October. Otherwise, all the other major asset classes (US

**No changes were made to the portfolio models during October.**

**Gold and a lower Canadian dollar helped the portfolios. Almost everything else hurt the portfolios.**

<sup>1</sup> The asset allocation represents the current *target* asset allocation of the Balanced Model Portfolio as of 7/16/2018. The asset allocations of individual clients invested in this Portfolio will 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.

<sup>2</sup> Bloomberg Finance L.P. as of 11/1/2018.

## TD Wealth

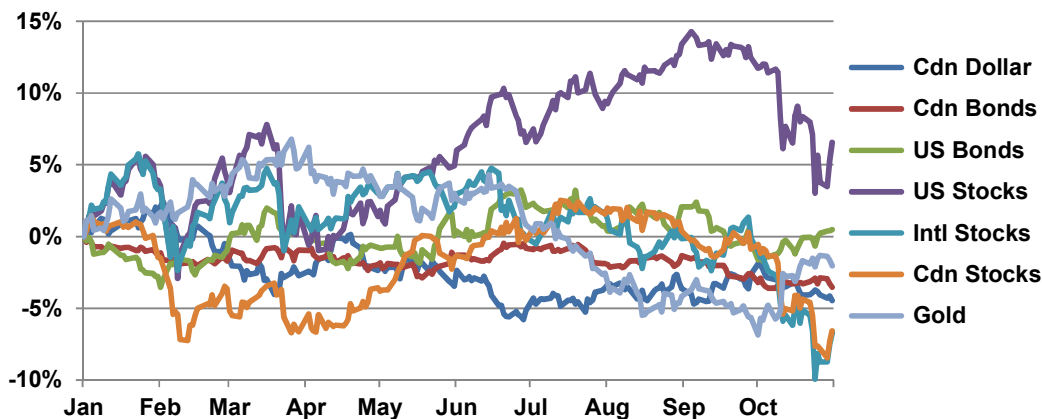
stocks, Canadian stocks, international stocks, and bonds) all detracted significantly from the portfolio results.

One area of misery that we have mostly avoided is the Canadian energy sector. We are underweight in the category, with Suncor Energy Inc. being our only pure energy holding. Earlier this year the optimism in the sector and how it would contribute to the overall Canadian economy was palpable. Then the price of Canadian oil began to collapse because of the difficulties of transporting it, falling over 65% from its peak in May to October 31. Then, the price of global oil began to slide in September and is now down over 14% to October 31 despite the previous hype about potential emerging market energy demand and sanctions on Iranian oil. The S&P/TSX Composite Energy Sector Index is now down over 16% from its July peak to October 31.<sup>3</sup>

With energy going back into hibernation, it looks like all the various levels of government in Canada might have to work on that Economic Plan B again; technology companies, cannabis, real estate, or whatever economic gimmick that is politically expedient!

Below is the Year-to-Date 2018 performance of the asset classes that we have used in the construction of The Charter Group Balanced Portfolio (Chart 7).<sup>4</sup>

**Chart 7:  
2018 Performance of the Asset Classes (in Canadian dollars)**



Source: Bloomberg Finance L.P. from 1/1/2018 to 10/31/2018

<sup>3</sup> Bloomberg Financial L.P. as of 10/31/2018.

<sup>4</sup> Bloomberg Finance L.P. – The Canadian dollar rate is the CAD/USD cross rate which is the amount of Canadian dollars per one US dollar; Canadian bonds are represented by the iShares Canadian Universe Bond Index (XBB); US bonds are represented by the iShares Core US Aggregate Bond Index (AGG); U.S. stocks are represented by the iShares Core S&P 500 Index (IVV); International stocks are represented by the iShares MSCI EAFE Index (EFA); Canadian stocks are represented by the iShares S&P/TSX 60 Index (XIU); Gold is represented by the iShares Gold Trust (IAU).

**Despite optimism earlier in the year, the energy sector took a drubbing. Thankfully, the model portfolios are underweight in this area.**

**Without energy, Canada's economic plan is a bit of a mystery.**

**Top Investment Issues<sup>5</sup>**

Issue	Importance	Potential Impact
1. China's Economic Growth	Significant	Negative
3. Canadian Dollar Decline	Moderate	Positive
2. Long-term U.S. Interest Rates	Moderate	Negative
4. U.S. Fiscal Spending Stimulus	Moderate	Positive
5. Global Trade Wars	Moderate	Negative
7. Short-term U.S. Interest Rates	Moderate	Negative
6. East Asian Geopolitics	Medium	Negative
8. Massive Stimulus in China	Medium	Positive
9. Canada's Economic Growth (Oil)	Medium	Negative
10. Middle East & Russia Geopolitics	Light	Positive

<sup>5</sup> 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](mailto:mark.jasayko@td.com) or call me directly on my mobile at 778-995-8872.

# TD Wealth



**Mark Jasayko**, MBA, CFA | Portfolio Manager & Investment Advisor  
**Mike Elliott**, BA, CIM, FCSI® | Portfolio Manager & Investment Advisor  
**Laura O'Connell**, CFP®, FMA | Associate Investment Advisor  
**Kelsey Sjoberg** | Client Service Associate

**604 513 6218**  
8621 201 Street, Suite 500  
Langley, British Columbia V2Y 0G9

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.







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The information contained herein is current as of November 7, 2018.

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