F&A
FOSTER & ASSOCIATES
Quarterly Report
First Quarter Report 2021

Approaching China

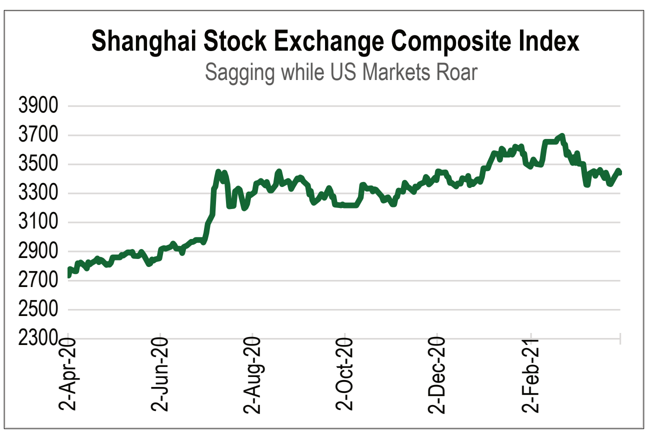
Unfortunately, we can't ignore China even if we wanted to.

In our previous Quarterly we discussed the crypto-currency conundrum. This quarter we're going to tackle another thorny subject, namely China.

It's easy to recoil at the thought of investing directly in China. It's a brutal police state, no question. They don't seem to care about human rights, and they don't even give lip service to democracy, the way Russia likes to do.

So, for the increasing number of ESG (Environmental, Social and Governance) and SRI (Socially Responsible Investing) investors, who weigh not just the economic but the moral implications of their investments, it's easy to think of China as a no-go-zone.

But not so fast. Unfortunately, we can't ignore China even if we wanted to. North American companies like the Wal-Marts and Amazons of the world provide significant indirect exposure through their trade dealings. This is not surprising as China has been going through a significant boom for a long period. From 1980-2020 China's share of world GDP grew from 2% to approximately 16%, second only to the United States. World exports grew from 1% to 13% over the same period.



Not investing in China just because of its totalitarian leadership might be a mistake. China is a newly industrialized country going through massive change. Holding them to the same kinds of standards to which we hold our domestic leaders is unfair. Moreover, the tenets of ESG and SRI are meant to drive change, not just to reward countries or companies that have already achieved it. Denying the better people and companies in China access to our capital will not help China get to where it should be going.

It's completely understandable, for example, that Canadian investors would want nothing to do with exploiting the Uyghur minority in Xinjiang province. But this is easily avoidable. There are already more than half a dozen ETFs that cater to investors who wish to invest in China with an ESG focus. A western ETF provider that inadvertently held a company in its portfolio that was secretly connected to the forced labour of the Muslim minority would quickly find its shares under pressure. This happened recently to a Chinese polysilicon manufacturer Daqo Inc (NYSE: DQ). Daqo's price has declined sharply over the past few months as it became known they were simply profiting from the cheap energy in Xinjiang province.

		2021 Q1	12 Month Returns
S&P/TSX*	18701	7.3%	39.8%
S&P 500	3973	5.8%	53.7%
Dow Jones	332982	7.8%	50.5%
Nasdaq	13247	2.8%	72.0%
$CAD	$0.7961	1.4%	12.0%
Crude Oil	$59.16	21.3%	144.7%
Gold	$1,707.70	-10.0%	8.3%

**The S&P/TSX, the S&P500, the Dow Jones and Nasdaq indices are not investable indices, and as such are not a direct comparison to any investment product available at Foster & Associates Financial Services Inc, and therefore should therefore be considered hypothetical in nature and for illustrative purposes only.*

At the best of times, Canadian investors suffer from moderate home bias – they prefer to invest in Canadian companies and markets. But taking the trouble to invest in China could check a couple of different boxes at the same time. On top of the geographic diversification it could offer, there is exposure to industries where Canada has few leading companies. Popping up in many of the lists of ESG holdings in China are big tech names such as Tencent and Baidu, dominant China media and internet search companies.

Becoming familiar with investing in China now could also pay dividends down the road. China is committed to being carbon neutral by 2060, which may be a tough target to meet, but at least it's an indication that opportunities for ESG investments may broaden over coming years. As well, digitization and the adoption of technology across all sectors - part of the Great Leap

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Continued from previous page

Forward - enhances reach into remote communities that otherwise wouldn't have access to certain goods and services, which will likely keep growth brisk.

China is certainly facing some headwinds at the moment. Their increasingly isolated and ideological leadership is making their neighbours, and markets, nervous. Donald Trump's absence from the world stage is allowing China's Western rivals to align more clearly against them. In response, China has been getting more cozy with the likes of North Korea and Russia, probably an ill-advised path for them over the long term. But missteps like this are possibly how opportunities are created. Over the past month, Chinese stocks have declined about 10.8% based on the Shanghai Composite (see chart on Page 1).

So, the next question an investor should ask themselves is, "If I want to gain exposure, how do I do it while managing the risks in my portfolio?"

Owning individual companies wouldn't be the wisest way to manage overall risk in your portfolio so, to start with, choosing between an exchange traded fund or mutual fund manager with a global team would probably be best. Mackenzie Global Environmental Equity fund has a team with experience managing equities in China while focusing on ESG qualified companies. However, Mackenzie's allocation to China only makes up 6% of their fund. If a more aggressive stance is preferred, Vanguard's emerging markets all cap equity ETF has a 43% weight to China.

It's a big decision to start investing in China. Speak with your Investment Advisor to see if it's an appropriate move for you.

Philip Marion, Portfolio Manager

The 12-Month Market Outlook

Stocks (U.S.)	▲
Stocks (Canadian)	▲
Bonds (US)	▼
Bonds (Canadian)	▼
Canadian dollar	--
Crude Oil	▼

This table represents the way the firm is leaning in particular market sectors over the next 12 months. It does not represent a trade recommendation, nor does it play a major role in our portfolio construction, which involves much more than having a view on a particular market index, currency or commodity.

Touch Wood, If You Must

If you're reading this note, you have managed to make it through this interminable pandemic thus far. But that doesn't mean you're going to live forever. So, before we all get distracted by life as we knew it, now is the time to look at your registered plans with your advisor.

Are the beneficiaries set up correctly? Do all your registered plans have beneficiaries listed? Is there a chance to change your beneficiary to a Successor Holder? For the unfamiliar, a Successor Holder can only be a spouse, and offers a simpler rollover option vs just a spousal beneficiary.

Investors tend to ignore these issues for the same reason that so many people die without having prepared a will. Nobody likes to contemplate their own mortality. Even for those not paralyzed by a fear of dying, it can feel like bad karma to think about one's own passing – as though just mentioning it can hasten its arrival!

Unfortunately, pragmatists can be just as negligent about dealing with estate issues. To their credit, while the heirs might benefit, putting their affairs in order isn't going to make them any money or make them live any longer.

But a little focus on this unpleasant subject can make life easier for your executors, enrich your heirs and maybe keep a few dollars out of the hands of the Taxman. Speak to your Investment Advisor today.

Out of the Driver's Seat

Briar Foster
is a retired Portfolio Manager and remains an active investor.

Back in November, the Governor of the Bank of Canada, Tiff Macklem, assured Canadians that interest rates "will be very low for a long time." No doubt he hopes this will be true. Low interest rates are an essential adjunct to running large deficits, since the most serious constraint in running deficits is the rising cost of borrowing. A mere one percentage point in the cost of borrowing more than doubles the annual cost of new borrowed money. Governor Macklem assured us this is not a problem.

In fact, Modern Monetary Theory (MMT) has grown in popularity in recent years and it has normalized deficit spending. MMT, in its simplest form, encourages government borrowing so long as the GDP growth rate is greater than the inflation rate. Presumably, the sky is the limit, especially if interest rates stay near zero. But Canadian investors should be skeptical. The extent of our control over inflation is perhaps overstated and exploding the deficit may ultimately force Canada to be even more beholden to the foreign investors footing the bill.

Making things more difficult, Canada is a trading nation, so our interest rates cannot stray far from US rates - otherwise large gobs of money will shift across the borders and upset the exchange rate. Trading nations like Canada depend on a stable exchange rate, as do foreign corporations thinking of investing in Canada. So when a central bank assures us that they have all the tools to deal with inflation – in this case raising rates - we might have reason to be worried more about the cure than the disease.

Unfortunately, the way markets are acting gives credibility to inflation fears. The prices of many materials have surged out of dormancy. Copper, silver, iron ore, gold, oil, natural gas, lithium, lumber -- all are significantly higher than a year ago. Bitcoin is trending higher and housing in many markets is bubbly. While we are a long way from the spiralling inflation of the 1970's, the phenomenon of rising prices is real and is likely to expand to such basics as food and, almost certainly, travel.

The inflation story has helped equity prices rise to record levels and has led to the saying "cash is trash". Banks pay no interest and with inflation eating away at Canadians' purchasing power it's no wonder investors are flailing about seeking something that will give them a real rate of return. The threat of inflation inevitably encourages risk taking, another unfortunately consequence of the current policy mix.

This said, Investors too young to remember the ravages that inflation can inflict on portfolios should be cautious. Income investments, including rental properties under rent control, can suffer mightily when inflation finally returns. In the late fifties, the federal government issued 25-year bonds at par yielding 4½ percent. In the late sixties, they were selling at 63 cents on the dollar. In the same period, Weston $100 par 3.5% preferred shares were selling at 50 on the TSX.

Clearly the Trudeau government has no plans to slow down government spending. Despite dishing out Covid support payments equal to 20% of GDP (Bloomberg), early indications are that the Liberal focus in the next budget will be a new national child-care program, rather than outlining a path to balancing the budget.

So this is a cautionary message to Prime Minister Trudeau and Finance Minister Freeland to be mindful of how inflation breeds instability and allows foreign investors to gain control over our economy. The perfect messenger might be Bank of Canada Governor Macklem…

The views as articulated in this article are those of Briar Foster alone and do not necessarily reflect the opinion of Foster, and do not constitute a solicitation to engage in any specific investment or strategy.

Our core beliefs

What defines the culture of a firm is what stays consistent no matter what's going on in markets. Politics, market trends, and the business cycle will cause us to think different about the way we invest our clients' money. However, there are a few things you can count on from us, through good markets and bad, through recessions and buoyant recoveries:

Asset Allocation is Key.

While some individual securities will do well, and some less well, most of what will make or break your portfolio over time is asset allocation. Of course, we all remember our great buys, and mourn our missteps, but the key to how well you do in the markets will come from how much you owned of various asset classes, and when you owned them.

We Love Canada.

But it's not where we want to put all your money. The Canadian stock market is heavy on banks and resource companies, making true diversification hard to achieve. Venturing abroad can improve returns and lower volatility. You'll also find companies where Canada isn't as strong, such as in consumer staples and biotechnology.

Alternatives aren't that Scary.

Sure, some hedge funds can be dangerous, but there's more to the Alternatives space than hedge funds. There's private debt, real estate, infrastructure and market-neutral funds, all of which can provide a place of refuge during periods of excessive market volatility.

Costs matter a Great Deal.

Over time, even small increases in costs can significantly lower returns. If you pay us to manage your money, we will pinch your pennies for you.

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