Going Global…

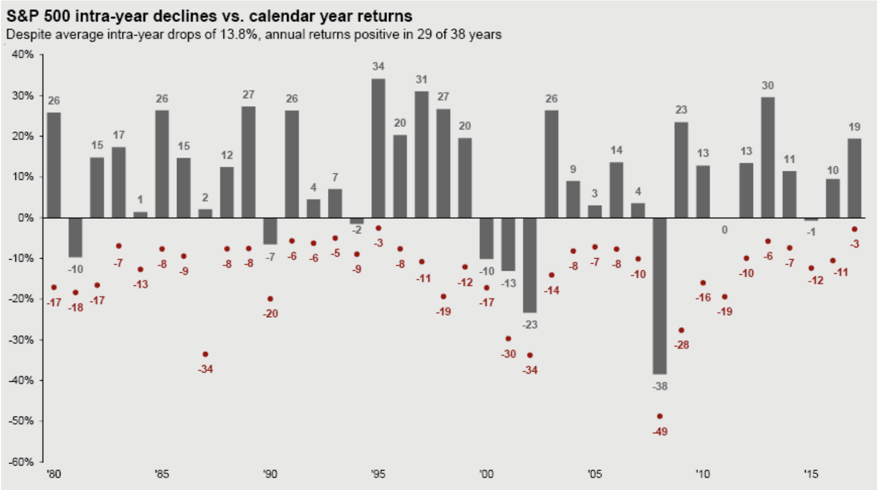
“The world is a book and those who do not travel read only one page” ***– Saint Augustine***

At Canal Capital, we echo the sentiment of Saint Augustine, not only in life but also in investing. Those investors that take a myopic approach and only invest in the US, are reading but only one page in the book of investment opportunities. Yes, the US Market has led the charge for the last 8 years and investors have been hurt by diversifying, but a shift is beginning to happen and it is our belief that those investors willing to read past the first page and ***go global***, will be rewarded moving forward.

Looking back at 2017

For the first time since the Great Recession, economies around the world grew in synchronization, lifting markets across the globe. International and Emerging Markets led the way for the first time since 2012 with all major world indices up over 21%. The earnings recovery that began in the second half of 2016 continued in 2017 with the S&P 500 posting back to back quarters of double digit growth in Q1 and Q2 for the first time since 2011. Additionally, corporate executives continued their optimistic tenor on earnings calls with expectations the recovery will continue. The Fed continued its’ tightening this year, but monetary policy remains accommodative and Congess was finally able to get something passed with the first landmark bill in some time: Tax Cuts. All of this provided for a positive backdrop in 2017 leading to a continuation of the bull market.

2017 was a crazy year in that there was a lack of volatility in the market. The S&P 500 went up slowly and steadily throughout the entire year without wild swings one way or the other, and every month ended in positive territory, going a perfect 12/12. Investors kept waiting for “the drop” to occur, but it never came. The largest drawdown for the year was just over 3%. Because of the overall calm, there remains some skepticism among investors. Everyone is always fearful about getting in at the wrong time and a market that hasn’t had a correction for this long feels like the wrong time to a lot of people. That said, while a correction will happen at some point in the near future, the



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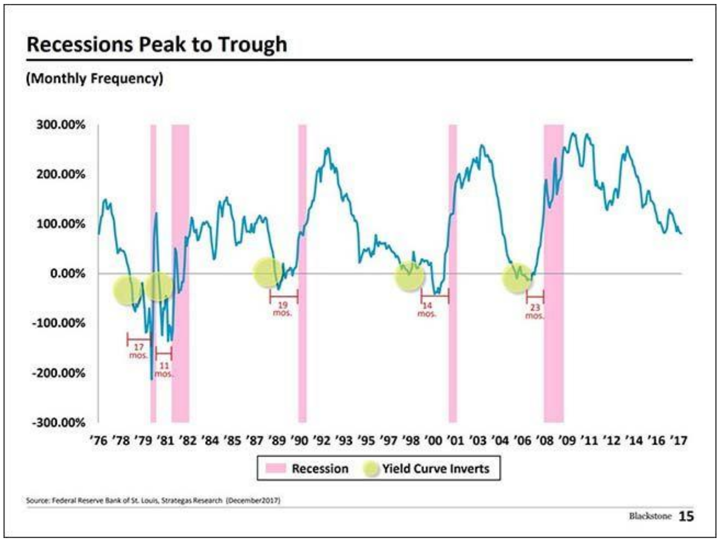
developments of 2017 have helped set up tailwinds for the market as we enter 2018, and, at this point, it is our belief that those positive attributions outweigh the affects of any potential pullback.

Looking ahead to 2018

It is our expectation for more of the same in 2018 because of the following:

1.) **Tax Cuts:** The affects of tax cuts on earnings should continue the positive trend of earnings growth. UBS estimates the impact of the major tax provisions should boost S&P 500 earnings by 9.1%, and that we should expect a surge in buybacks, M&A Activity and dividends.
2.) **Low Interest Rates:** Rates remain historically low and monetary conditions remain loose. We believe rates are a year or two away from the point of causing headwinds. Additionally, there are no real signs of inflation, which continues to hamstring the Fed's ability to raise rates significantly.
3.) **Valuations:** Despite what some pundits may be saying, valuations are not excessive and are still very much inline with historical averages. Taking into account the low interest rate environment and the affect of tax cuts, some might say valuations are slightly low.
4.) **No Recession:** We are still a ways away from any type of slow down. Typically, recessions and market drops are preceded by the inversion of the yield curve (*2 year bonds pay more than 10 year bonds*). As shown in the graph below, there is still room to run before that happens:



All that being said, we are still cognizant that it is late in the cycle and that this bull market run is becoming extremely extended. While we do not anticipate the run to end in 2018, we do expect for volatility to pick up and a drawdown in 2018 to exceed the 3% experienced in 2017. It's been 381 days (at the end of 2017) since the last 5% correction and we expect that streak to end. Additionally, rates will rise in 2018 with

Goldman Sachs predicting 4 hikes with the ultimate terminal rate at 3.25%-3.5%. While still in the "positive for equities" territory, rates will be approaching a level where they have historically been problematic. It will be interesting to see how investors react to increased volatility and rising rates, an environment that hasn't been seen in quite some time.

Despite expectation of a new market environment, we go into 2018 with a positive outlook, remaining overweight stocks. In particular, we are continually adding to our international exposure. It is our belief that the outperformance of 2017 should continue because of:

1.) **Growth:** World economies are finally growing in sync and while the US is in the later innings, most international countries are in the early stages.
2.) **Earnings:** International companies are now growing faster than the US as evident in corporate profits.
3.) **Valuations:** Relative to the US, international stocks look the cheapest they've been in 15 years.
4.) **Currency:** After years of outperformance, the dollar is losing ground and it looks like this trend is just beginning, which is a major positive for foreign stocks.

This chart says it all:

Hot Topics of 2017

Cryptocurrencies became one of the greatest speculative crazes of all time in 2017. The most well known, Bitcoin, gained 1,375%. Despite the polarizing debate about the future of certain currencies, it is becoming clear that that the ecosystem is growing and becoming more prevalent. In order to better understand the value in these cryptocurrencies, you first must understand the technology that allows for the digital transactions and transfers: The Blockchain.

Simplistically, the Blockchain is "a public ledger where transactions are recorded and confirmed anonymously. It's a record of events that is shared between many parties. More importantly, once information is entered, it cannot be altered." (Source: www.dataconomy.com). The transactions that are currently being recorded are cryptocurrencies, like Bitcoin. Bitcoin, which is a digital form of currency, is a decentralized network, meaning that no single institution or person controls it. They can't be printed and the amount is finite – only 21 million Bitcoins can ever be created. The Blockchain's technology has many potential uses besides recording cryptocurreny transactions, like identity management and all sorts of complicated bank transactions, but at this time, it has yet to realize it's real importance. Therefore, we continue to doubt the long term viability of cryptocurrencies in their current form. That said, we are cognizant that traditional currencies and modes for transactions, are ripe for disruption and the Blockchain Technology is only at it's beginnings.

The **Tax Cuts and Jobs Act** was signed into law by President Trump in the final week of 2017, arguably the most consequential tax "reform" in thirty years. At over 400 pages, with a host of qualifiers around which taxpayers certain provisions apply to, we are not yet convinced that the Act actually simplifies the tax code, but rather from the shuffle we see clear winners and losers emerging. Most changes took effect January 1st and are set to expire in 2025.

Overall, the impact of the legislation is a marginal reduction in taxes for individuals but a significant reduction for businesses. At least in the short-term this should have a positive impact on the economy and corporate balance sheets: through increased incentivies for capital spending, improved earnings from the reduction in the top corporate rate from 35% to 21%, repatriation of foreign profits, and cash-flush companies faced with the opportunity to continue share buybacks, increase dividends, and invest in their employees.

Key provisions of the Act:

- Reductions in most individual tax brackets, including a drop in the top rate from 39.6% to 37%
- A flat 21% corporate tax rate, replacing the previous top rate of 35%
- Increase Section 179 expensing of business capital assets to $1 million (from $500,000)
- Cap on the individual deduction for state and local income and property taxes at $10,000

Take a look at Our Insights for a more comprehensive overview of the Act.

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All indices are unmanaged and investors cannot invest directly in an index. Unlike investments, indices do not incur management fees, charges or expenses.
Investing in alternative investments may not be suitable for all investors and involves special risks, such as risk associated with leveraging the investment, potential adverse market forces, regulatory changes, and potential illiquidity. The purchase of bonds is subject to availability and market conditions. There is an inverse relationship between the price of bonds and the yield: when price goes up, yield goes down, and vice versa. Market risk is a consideration if sold or redeemed prior to maturity. Some bonds have call features that may affect income.
Treasury bonds are guaranteed by the U.S. government as to the timely payment of principal and interest, and, if held to maturity, they offer a fixed rate of return and fixed principal value. U.S. Treasury bonds do not eliminate market risk.
The precious metals, rare coin and rare currency markets are speculative, unregulated and volatile and prices for these items may rise or fall over time. The commodities industries can be significantly affected by commodity prices, world events, import controls, worldwide competition, government regulations, and economic conditions.

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