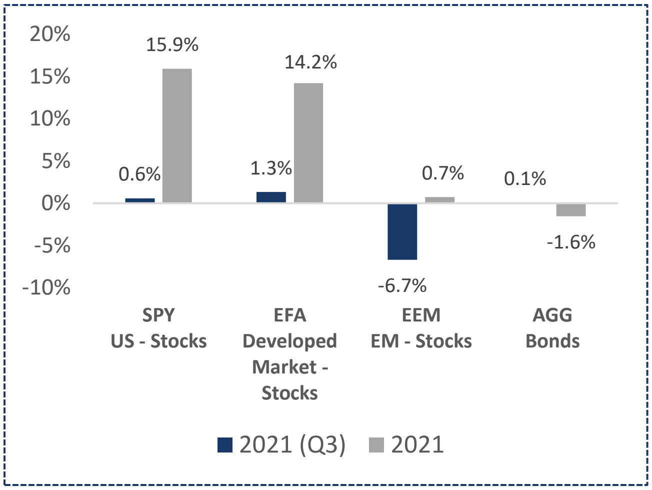
End of the Road?

"Bull Markets are born on pessimism, grow on skepticism, mature on optimism & die on euphoria"
– Sir John Templeton



The 3rd quarter managed a slim profit despite a pullback of over 5% from the market high on September 2nd. Stocks, as measured by the S&P 500, have returned nearly 15% through the first three quarters of the year. We went 211 trading days without a 5% correction, which is the 13th longest streak on record. Historically, these streaks have been positive, as 11 of the 12 streaks longer than the most recent one continued their positive trends over time. Despite great returns year to date and a trend that should remain positive, we are seeing a wall of worry not experienced since the depths of COVID-19 in 2020.

Although many of these concerns are real, much of this is just short-term noise. The pundits on the news seem to have an excuse for every small move in the markets, but the reality is that most are paid to sell advertisements and not designed to be investment advice. With that being said, there is genuine fear among many investors that this is the end of the ride. Over the past ten years, when faced with conflicting views we always go back to the basics, borrowed from Ned Davis: Don't Fight the Fed, Don't Fight the Trend & Don't Fight the Crowd.

Don't Fight the Fed

As we have discussed since the beginning of COVID-19, we believe the low interest rates have been the key variable to this economic recovery and global market rebound. The Fed's mandate is to keep inflation in check and unemployment low and their primary tool for this is the interest rate lever. The Fed Funds rate is close to zero today and projected to stay low for the foreseeable future.

During the financial crisis ('08-'09) and COVID-19 crisis, the Fed began to employ a series of new tools, which were essential to stabilizing the economy. These tools have allowed the Fed to increase its balance sheet by purchasing a variety of securities, including Treasuries, Mortgage-Backed Securities (MBS), Loans and even Corporate and Municipal Bonds (*see chart on next page*). Currently, the Fed is still purchasing $125 billion of Treasuries and MBS every month. The purchase of Treasuries keeps overall demand high and pushes down the rates that are controlled by outside market forces. This is important because mortgages, auto loans and many other forms of debt price off of treasuries.

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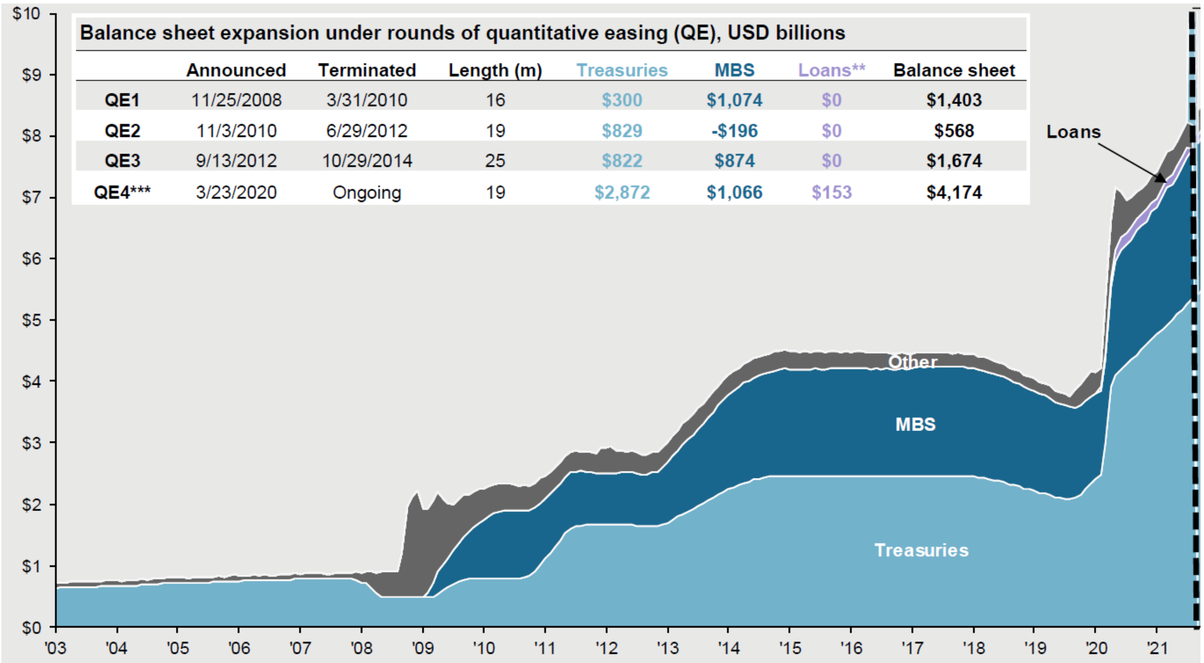
At some point, the Fed will reduce and eventually stop these monthly purchases, which is referred to as tapering. The last time the Fed tapered was in 2013 and markets reacted with a “Taper Tantrum.” Tapering is a major fear in the current environment, however, the Fed has been completely transparent about their plans and timing to taper, so this will not be unexpected and should be easily absorbed by the broader economy.



	Announced	Terminated	Length (m)	Treasuries	MBS	Loans**	Balance sheet
QE1	11/25/2008	3/31/2010	16	$300	$1,074	$0	$1,403
QE2	11/3/2010	6/29/2012	19	$829	-$196	$0	$568
QE3	9/13/2012	10/29/2014	25	$822	$874	$0	$1,674
QE4***	3/23/2020	Ongoing	19	$2,872	$1,066	$153	$4,174

Source: FactSet, Federal Reserve, J.P. Morgan Investment Bank, J.P. Morgan Asset Management.

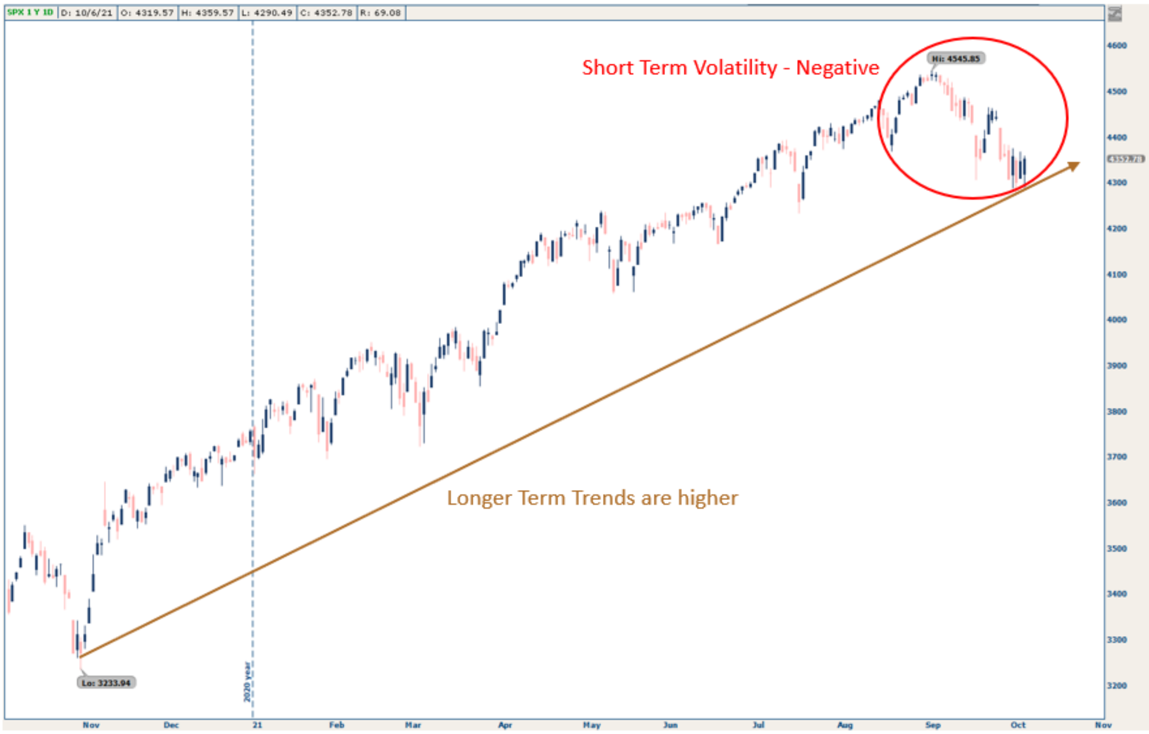
Based on current Policy, we believe the Fed will continue to be a positive catalyst for stocks. Low rates are the key and will probably be here for a very long time. We also hear that the Fed is out of bullets, which is just not the case. Many of the tools that the Fed readied during COVID-19 were never even used, which tells us there is plenty of ammunition should things worsen from here. (**Outlook – Positive)**

Don’t Fight the Trend

One of the top rules in investing is “don’t fight the trend”. This can be translated as staying the course when prices are going up and not trying to catch a falling knife when prices are going down. We like to break the trend down into three different time periods:

- Short-Term – Defined as 2-3 weeks (**Outlook – Negative**)
- Intermediate Term – Defined as 2-3 months (**Outlook – Positive**)
- Long-Term – Defined as 6 months + (**Outlook – Positive**)

As you can see on the following page, things don’t look very good in the Short-Term (defined as the next few weeks), however, we have comfort in knowing that the Intermediate and Long-Term trends are still in great shape. Research has shown that most investors have a greater negative emotion to losing money than to the positive emotions of making money. When it comes to the market, timing is very difficult and when our longer-term indicators still look great, it is not prudent to make large adjustments when the research indicates this volatility will be short lived. Another great rule in investing is to be flexible. Research and indicators change over time, so it is always important to not become fixated on a certain outcome.



Don't Fight the Crowd

Perhaps our favorite indicators relate to sentiment and investor psychology. Warren Buffet said, “Be fearful when others are greedy and greedy when others are fearful.” Although this quote goes back many years, it still rings true today. We have had many conversations over the past month with nervous investors regarding Evergrande in China, the debt ceiling, the tax proposal, and the new bills in Congress, just to name a few. These are all real risks, but all exaggerated by the media. When we look at our main sentiment indicator (*next page*), it shows that investor sentiment is at its' lowest levels since March 2020, which coincided the market lows.

When we look at that time period versus where we are today, it feels like today is a walk in the park, and thus gives us confidence that most of what we are hearing, and the recent volatility, is simply noise. Thus, we expect things to look strong heading into year-end. Historically when the sentiment indicator is at these levels, the market has some of its best returns. (**Outlook – Positive)**

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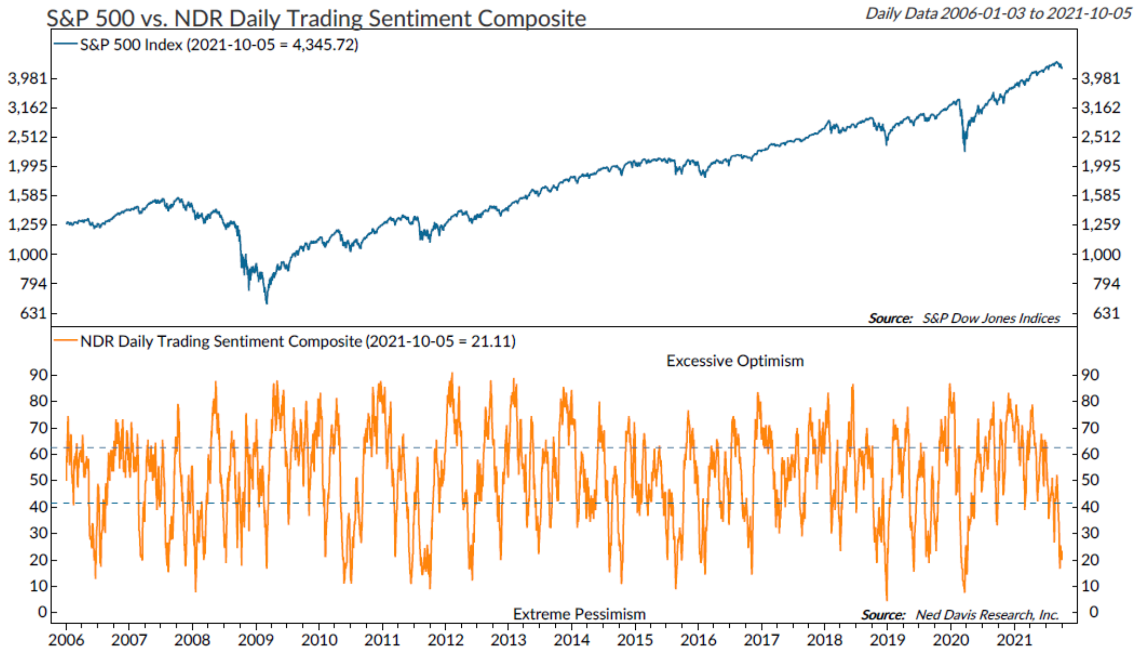
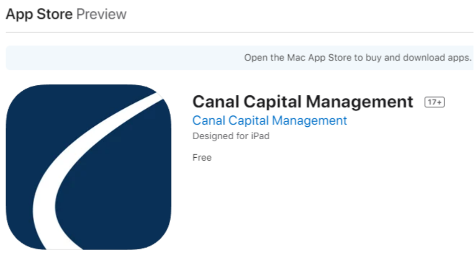


Client Update



Over the past quarter, we have been working diligently on our new phone app, which is available in the App Store. This app uses the same software as our web portal and provides a very nice mobile experience for users. To access, simply search for “Canal Capital Management” and your login credentials are the same as those used to access the Investment Portal. Please check it out and let us know if you have any questions.

Conclusion

Thank you for taking the time to read. As always, please let us know if you have any questions related to your investments, taxes, or general planning or if there have been any changes to your overall plan or risk tolerance.

Sincerely,

Canal Capital Management

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