

Chaos is inherent in all compounded things. Strive on with diligence.

-Buddha

Dear Clients:

The third quarter ended much like the second quarter, with geopolitical uncertainty and market volatility continuing to dominate the headlines. The story lines have remained unchanged:

- Will there be a recession?
- How extreme a bear market will we have to endure?
- Will we be dragged into the Ukrainian war?
- Will covid continue to impact the global economy?
- How high will inflation and interest rates go?

For all intents and purposes, chaos seems to be ruling the day. According to Buddha, chaos is part of the natural order, and therefore, we need to continue to persevere. This advice seems a tall order in the face of today's issues.

History often provides helpful perspective. In the 1950s we faced a remarkably similar set of geopolitical and capital market stresses:

- U.S. endured recessions in '53/'54 and '57/'58.
- U.S. stocks delivered negative returns in '53 and '57.
- We entered the Korean War in 1950.
- The H2N2 pandemic killed a similar number of people as Covid on a population equivalent basis.
- During the decade, the 10-year Treasury yield more than doubled, rising from 2.32% to 4.75%.

How did stocks perform over that decade of turmoil? The S&P 500 Index compounded annually at 19%. As you can see from the chart, while the S&P 500 rose over the decade, there were dips along the way. The advice to "strive on with diligence" proved to be extremely profitable.



Source: Bloomberg

While we are not expecting returns on par with the 1950's (we are in a slower economic growth environment than during post-WWII), we believe in advocating to take Buddha's counsel.

We are heartened by the overall quality of bank, corporate and consumer balance sheets. In the wake of the Great Financial Crisis bank capital requirements were tightened meaningfully to withstand future financial stresses. Corporations have used the last decade to reduce debt and consumers, in many cases, refinanced mortgages at historically low interest rates. While there are certainly specific instances of financial stress in each of these areas, taken together their aggregate strength should act as a cushion to prevent the U.S. from experiencing anything like the recession of 2008.

Looking ahead, the stock market has already priced in a meaningful reduction in company's future earnings under the weight of higher interest rates and the expectation of a recession. The forward-looking nature of the market also means that it will start to rise well before the news is uniformly positive. Our focus is to continue to patiently observe the economy and the Federal Reserve's actions, while positioning portfolios to benefit from the market's eventual recovery. The indiscriminate nature of the market sell-off affords us the opportunity to consider the purchase of stocks, which in the past may have looked out of reach. It also provides us the ability to increase exposure to our traditional holdings that we know well and may feel have become deeply undervalued. The current market environment creates opportunities. Our long-term philosophy and partnership with our clients affords us the potential to take advantage of times like these. As the old saying goes: "you make your money in bear markets, you collect it in bull markets."

The uncertainty of the current market environment is not pleasant for anyone. If your financial circumstances have meaningfully changed, we are available to review them and help to ensure you navigate your situation successfully. And even if they have not, we are always available to review and discuss your portfolio.

Please do not hesitate to reach out for a meeting.

Thank you for your continued confidence.

Sincerely,

The Partners of CANNELL & CO.