

July 5, 2022

The stock market is a giant distraction from the business of investing.

-John C. Bogle

Dear Clients,

When the stock market is a major topic of the news media it is usually the result of extreme behavior by its participants. It could be the result of euphoria created by an explosion in stock prices that have become disconnected to the underlying companies' true earnings but, nonetheless, continue to rise. Or it could reflect the despondency of those same participants when the reality of economic conditions proves too challenging for those companies, and prices return to more rational levels.

We have witnessed both parts of this cycle in the last year. Nowhere has this been more clearly demonstrated than in the price of cryptocurrencies and most visibly by Bitcoin. Topping out at around \$67,000 at the start of November 2021, Bitcoin fell to about \$18,000 in the middle of June 2022. As one would expect, the news media spilled gallons of ink during both its 210% runup over the prior four months to its high and its 75% collapse in the following seven months.

To a less extreme degree, we have witnessed similar investor behavior in more traditional markets. The S&P 500 Index officially crossed into a bear market on June 14th, as defined by a 20% decline from its peak, after having had two remarkably strong years in 2020 and 2021. Investors and the press heralded the run up and bemoaned the reversal.

As we discussed in our previous quarterly letter, the driver of the reversal in fortune of many asset classes has been the rise in interest rates triggered by the Federal Reserve's and its world-wide counterparts' desire to moderate inflation that is hotter than is healthy for the economy. This quarter witnessed the anxiety surrounding those rate increases manifest itself in the most negative implication: the risk that the central bankers tighten so much that the global economy falls into recession. As a result, many investors have repriced stocks for the worst potential outcome – just as they had priced many stocks for perfection in the autumn of 2021.

We are not in the business of macroeconomic prognostications, but the companies we follow and know well are not girding for pending economic doom. Many of these companies are raising their dividends and buying back stock (not common when there is financial risk in the future). Many companies have modest and manageable debt levels, having been able to refinance when interest rates were at historic lows. Refinancing has helped the consumer as well. Recent low mortgage rates allowed individuals to shore up their personal balance sheets over the last few years. While the consumer appears to be spending less and recent headlines about layoffs are concerning, the U.S. is at historic lows for unemployment and job openings remain high. None of this is to say that the slowing economy won't fall into recession. However, we feel confident that an extreme economic outcome is highly unlikely, with the understanding that unforeseen global events can always occur.

While the selloff in the markets during the second quarter was more rapid than typical, history teaches us that equity markets rarely finish the year at their lows. In fact, the S&P 500 Index overcame a 34% decline during the October 1987 Black Monday selloff to end the year with a positive 2% return. Of course, there is no guarantee that we will be in positive territory by December 31st. But if we look back at the last 50 years of market corrections, the average time for the index to recover their loss was about 11 months*.

Extreme market volatility produces a wide range of emotional responses, both positive and negative (remember volatility works both ways: up and down). The stress and anxiety that market corrections (downward volatility) create is the unfortunate part of being a long-term investor. Yet, it is usually during these periods that it is often the best time to invest.

As we are now experiencing, there will be times when our investments in individual companies are influenced by the market at large. These market selloffs allow us to position your accounts for the inevitable time when emotions calm and more rational analysis drive the price of stocks. A correction provides opportunities to purchase the shares of companies that were, until recently, overpriced or add to positions where we see improving business prospects.

As John C. Bogle, the founder of Vanguard Mutual Funds, reminds us, “the stock market is a giant distraction from the business of investing.” At Cannell & Co. we are investors. We treat our client’s money as we do our own – investing right alongside you. We look past the distraction of the stock market and focus on understanding individual companies – our business of investing.

Market drawdowns are never an enjoyable experience. Patience is the best strategy as investors are often rewarded handsomely in the 12 months following the bottoming of market. We saw a stark example of this when the markets recovered from the February-March 2020 market collapse with a stunning 75% recovery.

Thank you for your continued trust. We are available should you want to review your current circumstances. Please do not hesitate to reach out.

Sincerely,

The Partners of CANNELL & CO.

*Source: Bloomberg