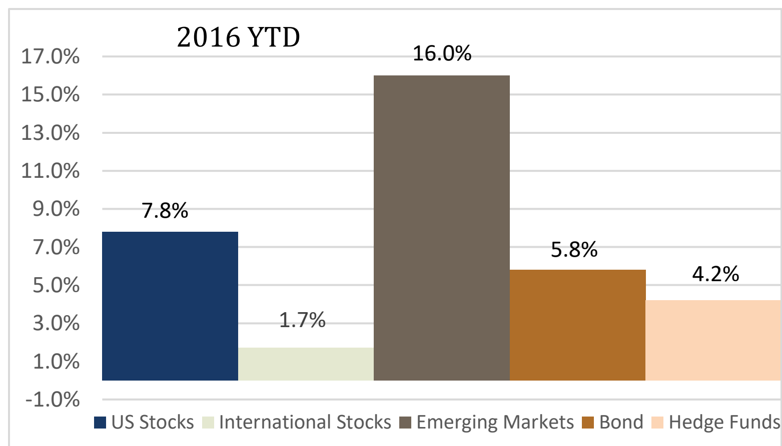
The Long and Short of it...

"The spectacle of modern investment markets has sometimes moved me towards the conclusion that to make the purchase of an investment permanent and indissoluble, like marriage, except by reason of death or other grave cause, might be a useful remedy for our contemporary evils. For this would force the investor to direct his mind to the long-term prospects and to those only." ***–John Maynard Keynes***

As John Maynard Keynes so eloquently put in his book "The General Theory of Employment, Interest and Money" nearly 80 years ago, investing is about the long term. If we just thought of investing like so many other long term focuses in our lives, we would all no doubt be better at it. Our job as wealth managers, not investment managers, is to make sure that our clients continue to take a longer term view and keep the "contemporary evils" from getting in the way of sound advice. Despite our long term focus, as investment managers in addition to wealth managers, we must also keep an eye on the near term to either protect against a downturn or seize opportunities in the ever-changing market environment. While long term we see troubling issues facing global markets and economies, there may be some near term opportunities which we will address:

Climbing the "Wall of Worry"

Despite a busy quarter of news headlines, the stock market, as measured by the S&P 500, has gone nowhere since the middle of July. The post-Brexit rally helped the market reach all-time highs in August, but much of the gains have been given back. Persistent uncertainty and the "wall of worry" that comes with it has continued to impede the market's forward movement.



While writing this newsletter has always been a labor of love, it has become one of frustration as there is little new information to report. The same issues continue to face the market and global economy: full stock market valuations, negative sovereign interest rates, maturing credit markets, US elections, divergent central bank policies, growing populism around the world, and declining corporate profits. Until we get some semblance of clarity, these issues will continue to keep that "wall of worry" high and difficult to climb over.

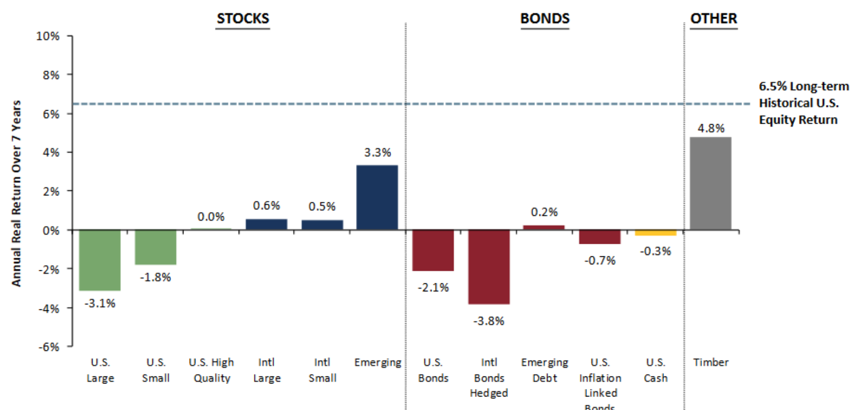
In spite of all this, fundamentals and history are pointing to positive returns for stocks in the near term:

- We've already had "the correction" that everyone was waiting for with a +11% intra-year decline experienced earlier this year.
- Historically, the 4th quarter is positive for stocks.
- There is typically a post-election bump during a presidential cycle as a winner is finally determined, ending uncertainty.
- A lot of cash continues to sit on the sidelines while a majority of money managers underperform their benchmarks. This often leads to performance chasing and an environment that's rife with risk taking.

While the chance for a market downturn over the next few years is elevated, we think it's unlikely in the near term.

GMO 7 Year Forecasts

We have always been big fans of the institutional research and money management firm GMO. In particular, we are close followers of their monthly produced 7 year asset class forecasts. While we by no means think that one can consistently predict future market returns, we do think it's crucial to establish a framework, based on superior research, to help us allocate assets. If not, it begs the question: how do you invest? As we formulate long-term investment decisions, we utilize the work that Jeremy Grantham and his team at GMO have spent decades building as the basis of our own decision making process.



When we look at the current 7 year forecasts, there is very little to get excited about. All signs point to low returns and high volatility. Therefore, we believe that it is vital to structure portfolios with diverse sources of return. In particular we are overweight in:

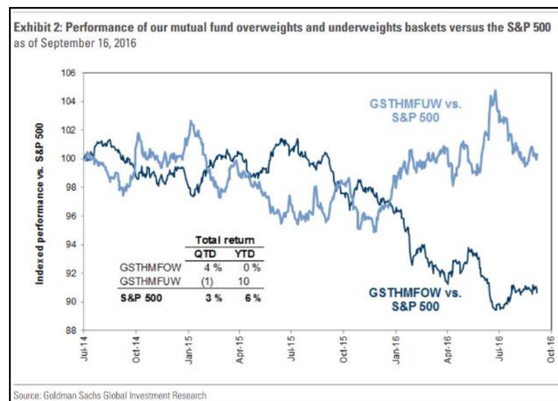
- **High quality US stocks** that have shown the ability to return value to shareholders in this anemic growth environment, whether that's through growing dividends or invested capital.

1401 EAST CARY STREET, SUITE 401 RICHMOND, VIRGINIA 23219 | www.canalcapitalmanagement.com | T +1 804.325.1450 | F +1 866.381.5362

- **International stocks**, in particular **emerging markets**. Most of the fastest growing companies in the world have been outside the US. In 2001, the US accounted for 33% of global GDP, but by 2014, the US represented just 22%.
- **Private Real Estate** due to its ability to provide portfolio diversification and above average and growing income in a low and rising interest rate environment.

Another Tough Year for Mutual Funds

Mutual Fund managers have experienced another challenging year. Professional money managers in general, including the star Hedge Fund managers, have struggled the past couple of years as the market has become saturated with information and smart investors. Their ability to come up with new ideas has become incredibly difficult. The chart to the left details this inability to correctly pick the right stocks by showing how their underweighted stocks have out performed their over-weighted stocks (Source: Goldman Sachs). This failure to add value has created a mass exodus of capital from professional, active money managers into more passive strategies.



In addition to a year of underperformance, many mutual fund owners will be surprised at the end of the year when they are saddled with potentially large capital gain distributions. Because mutual fund managers become forced sellers, they have to trade no matter the tax consequences when an investor wants to redeem shares. So, in a year where money is flowing out of mutual funds and stocks are sold at record prices, those gains become realized and passed onto investors, even those who remain invested in the mutual fund, whether they like it or not.

Conclusion

The market environment continues to be a challenging one. Low interest rates over a long time period have created a high risk of causing unintended consequences that could affect economies and markets in ways that are currently unforeseeable. We think investors that are heavy in risky assets (stocks) right now, are doing so blindfolded. Any success from this point on would be attributable to luck, and relying on luck as an investment strategy is dangerous in the long run.

Our strategy has never been one of chasing returns and hot markets; it has always been that of helping our clients to consistently achieve their return objectives. We intentionally allocate portfolios by combining

thoughtful investment research with a disciplined and repeatable process. This gives us the conviction to execute our investment decisions with a high level of confidence.

While diversification and prudent portfolio construction has been missing from typical investors' portfolios over the past few years, we believe that our continued commitment to a diversified, disciplined and repeatable process will deliver sustainable and positive performance over the long term for our clients. Charlie Munger, the billionaire partner of Warren Buffet, made an important observation a long time ago in a letter to Wesco Shareholders:

"Wesco continues to try more to profit from always remembering the obvious than from grasping the esoteric. …It is remarkable how much long-term advantage people like us have gotten by trying to be consistently not stupid, instead of trying to be very intelligent. There must be some wisdom in the folk saying, 'it's the strong swimmers who drown.'"

We at Canal Capital Management have taken that advice to heart – you don't win by trying to be the smartest guy in the room, you win by not being stupid and taking unnecessary risks.

As always, please don't hesitate to contact us with any questions or to discuss changes in your overall risk tolerance.

Canal Update

We would like to welcome Procter Fishburne, CFP®, MBA who joined our term this past August. Prior to joining Canal, he was the head of the Planning Group at Wealthcare Capital Management working with advisors' client's financial plans. Prior to entering wealth management, he worked as a Sr. Financial Analyst at Wachovia Securities now known as Wells Fargo Advisors. He is a Certified Financial Planner™ and is currently enrolled in the Graduate Certificate in Real Estate and Urban Land Development at Virginia Commonwealth University and upon completion of that program will pursue a Master of Science in Business with concentration in Real Estate Valuation.

DISCLOSURE: Past performance is no guarantee of future results. Investments are subject to risk, including the loss of principal. Because investment return and principal value fluctuate, shares may be worth more or less than original value. These investments may not be suitable for all investors, and there is no guarantee that any investment objective will be obtained.

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.

1401 EAST CARY STREET, SUITE 401 RICHMOND, VIRGINIA 23219 | www.canalcapitalmanagement.com | T +1 804.325.1450 | F +1 866.381.5362