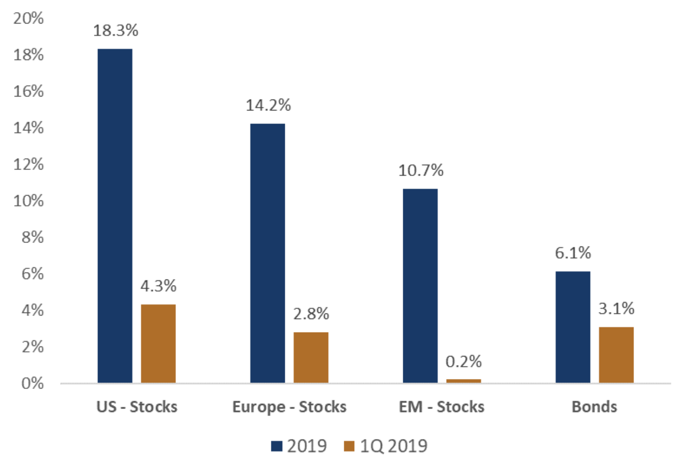
Resiliency

"The main purpose of the stock market is to make fools of as many men as possible."
– Bernard Baruch

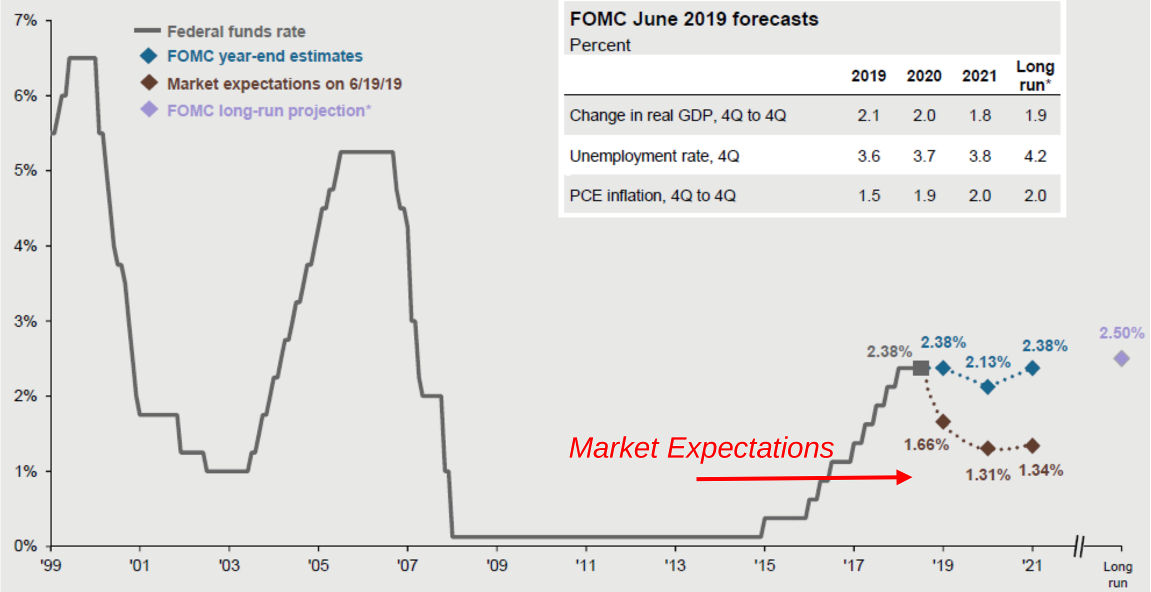
On Christmas Eve, it looked like the bull market was over, with the market down nearly 20% in less than a quarter. Now, 6 months later, we are back at all-time highs and the market has rallied over 26%. While the average investor is left scratching his or her head, the rally is the result one main catalyst, the Federal Reserve's desire to keep interest rates low. This is not a new phenomenon, as the low interest rates have been a driver to much of the market's success over the past decade.



Interest Rates

On November 8th the 10-year treasury yield peaked at 3.24%. The Federal Reserve was planning to continue raising rates throughout 2019 because the economy was doing well. As a reminder, the Fed has a dual mandate to maximize employment and to keep prices stable (inflation), while moderating long term interest rates. The Fed ultimately wants a solid economy and higher interest rates, which will also encourage a somewhat higher level of inflation. Although not advertised, the Fed also wants higher interest rates to

Federal funds rate expectations
FOMC and market expectations for the federal funds rate



FOMC June 2019 forecasts
Percent

	2019	2020	2021	Long run*
Change in real GDP, 4Q to 4Q	2.1	2.0	1.8	1.9
Unemployment rate, 4Q	3.6	3.7	3.8	4.2
PCE inflation, 4Q to 4Q	1.5	1.9	2.0	2.0

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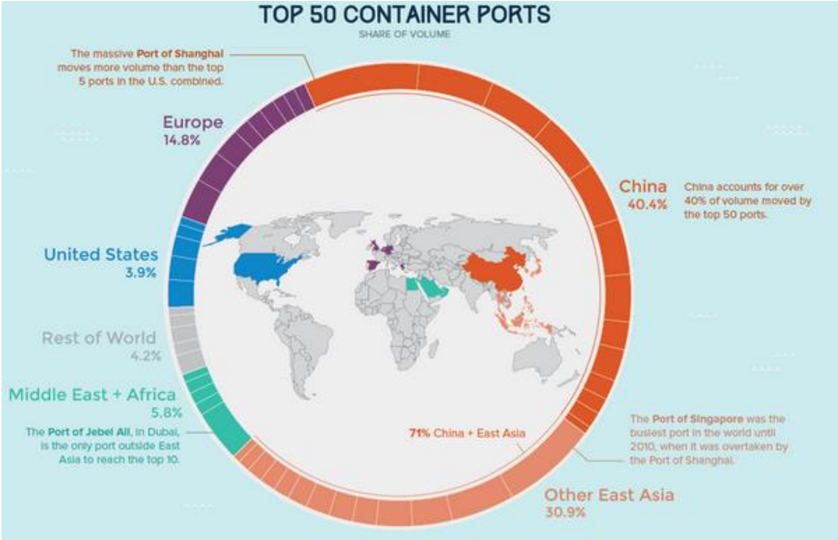
provide stimulus in the next crisis or recession. However, the markets nor consumers want higher interest rates as it increases borrowing costs of all types and slows overall growth and consumption. Early in 2019, the Fed completely reversed course and instead of raising rates, they signaled the potential to decrease interest rates over the course of the year. The chart above shows the Fed's forecasts and more interestingly the market expectations, which are even lower than the Fed's. All of this translates into a huge rally for the stock market and once again many prognosticators claiming the Fed is driving the market.

Where do we go from Here?

The market has come a long way in a short amount of time. Typically, when there is a 20% drop, there is a rally and then a test of the low, before prices ultimately move higher. It is rare to have such a large rally without a significant pullback. In May, the market dropped approximately 7%, but that can't really be called a true test of the bottom. Below are the potential drivers of the market for the balance of the year:

- **The Fed** – As discussed above, the Fed is signaling the potential to lower rates and will do so aggressively if needed. This is a major positive and gives a floor to asset prices of all types.
- **Tariffs** – We have discussed the tariffs several times. While we agree with the theory, tariffs put a lot of pressure on both the US and the global economy. As we move into the next earning season, we will see a number of companies with lower sales and earnings guidance as a result of the tariffs. Below is a great chart, showing the importance of China as they account for 40% of the volume of global shipping. We believe that there is also a floor in asset prices as they relate to tariffs. If things get too bad, President Trump will give in and cut a deal, even it is not optimal, to save his economic record.
- **2020 Election** – Although we have numerous research reports demonstrating the President (Republican or Democrat) doesn't control financial market outcomes, this time feels different. What we can expect is more volatility, as we go into an election year.
- **The Trend** – The trend of the last 10 years is still in place. Typically, the 18-24 month period before an election is characterized by a melt up phase. There is a chance that the combination of low interest rates and a tariff solution may push us into a very good return environment.



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New Office

Please note that we changed office locations at the end of June. We are very excited to have a great new office building, with lots of history, better technology and parking for clients. The new address is 9 South 5th Street, Richmond, VA 23219. Although, we are just 9 blocks from our old office, it is much easier to get in and out of downtown from the new location. We are actively looking for tenants for approximately 3,300 square feet in our basement. If you or anyone you know has interest, please let us know.

As we continue to better serve our clients, if you would like to change how you are receiving these statements, mailed vs. emailed, let us know by either emailing or calling us, 804-325-1450.

Thanks for reading and as always, please don't hesitate to contact us with any changes to your personal situation, investment goals or risk tolerance.

Sincerely,

Canal Capital Management