To subscribe to our Newsletters www.palos.ca/register

PALOS

CONTENTS

Notice of Summer Break and answering some questions 1
Follow us on LinkedIn 4
Palos Funds vs. Benchmarks (Total Returns) 5
Disclaimer & Contacts 6

Weekly Commentary

Issue **No. 29** | **JULY 18, 2022**

By Charles Marleau CIM® and William Mitchell CIM®

Notice of Summer Break and answering some questions

Before we wrap up our writing for the first half and take our summer break, we felt it would be valuable for us to share some of our thoughts on what's transpired over the first half of 2022. This includes sharing our thoughts on some of the questions we receive from investors. We hope our insights on how we are navigating the current market conditions will be helpful in alleviating some of the concerns that all investors face from time to time.

Why are markets so volatile?

In response to the economic fallout from the onset of the pandemic, central bankers across the globe instituted extremely accommodative monetary policies designed to stimulate the economy during unprecedented uncertainty. To do this, historically low interest rates were used as a tool to expand the amount of money in the economy. Easy monetary policies achieved the desired objective of stimulating economies during the period when pandemic shutdowns threatened to derail the global economy.

Why are central banks reversing course?

The easy money worked its way through the system as intended and this helped soften the impact of the pandemic. One of the unintended side effects was strong consumer demand fueled by excess cash while at the same time, supply chains were disrupted. The result: demand outstripped supply and this led to a forty-year high in the rate of inflation. To reign in the rapid rise in prices, central banks are attempting to reverse course by raising interest rates.

Why are central banks raising rates?

This is the most efficient tool that central bankers use to reduce demand in a 'hot' economy. The intention is to weaken the economy in order to achieve an equilibrium and reduce the rate of inflation. This process will take time to achieve its goals, and, in the meantime, policy makers are aware that overly aggressive interest rate policy has the potential to overshoot and create a recession. The challenge for central bankers is to find the sweet spot. Whether they are successful or not remains to be seen.

By Charles Marleau CIM® and William Mitchell CIM®

Is it different this time?

In our view, the current economic state of affairs differs from previous economic slowdowns or recessions, if in fact we are headed for one. The principal difference is that central bankers are intentionally trying to slow down the economy. Most recessions in recent memory were caused by missteps (the housing crisis), over exuberance (the dot.com bubble) or uncertainty (Covid pandemic). This time around, the economy is too strong. Housing prices are supported by high demand, job vacancies are abundant, and commodities (energy, food, raw inputs) are in shortening supply. Inflation is getting out of hand. The intention is to slow down an economy that is running way too hot.

Markets are cyclical

Seasoned investors understand that markets do not go up in a straight line. Prices tend to fluctuate over time, and this is the natural progression of free trading markets. The ups and downs should not be feared as fluctuations in prices are perfectly normal given the sensitivity of financial assets to the economic cycle. In fact, markets that are in correction mode and where prices are moving lower, offer precisely the conditions we embrace for putting new money to work. The best time to buy anything is when it's on sale and this philosophy is best demonstrated through the words of iconic investor Warren Buffet who famously said, "whether we're talking about socks or stocks, I like buying quality merchandise when its marked down."

This is not the time to sell.

The first half of 2022 has been the worst first-half performance for stocks since the 1970's, and marks one of the few instances in history when both equities and bonds fell in value. Normally, bonds act as a "safe haven" asset class and move contrary to stocks but so far in 2022 this has not been the case. There is no disputing that global financial markets have been in correction mode since the first week of January. This makes all investors uneasy, even the seasoned pros. However, if there is one piece of advice that we cannot emphasize enough, it is that this is not the time to be a seller.

Discipline is Paramount

The key to successful investing has always been through a commitment to remain disciplined regardless of short-term volatility, and by sticking to a long-term plan. In fact, volatility and uncertainty are the two most important catalysts that lead to the creation of outsized opportunities in the "markets". Successful investors understand that having the discipline and conviction to capitalize on investment opportunities while others are capitulating, mostly due to fear, is without a doubt the best pathway to achieving outsized returns.

Experience matters

Chasing stock prices when markets are irrationally exuberant or selling investments when prices are weak are the two biggest mistakes that novice investors make. Both of these actions will usually result in regret, remorse and portfolio underperformance over the long term. We (Charles and Bill) have been plying our trade in financial markets for over sixty years collectively and we've seen every "bull" and "bear" phase since

By Charles Marleau CIM® and William Mitchell CIM®

the late 1980's. There is one piece of advice that we believe to be the most important. Weak markets should always be used as opportunities to invest and not as a reason to sell.

Be wary of who you listen to

When markets are weak many self-proclaimed "experts" will come out of the woodwork and flood the media with opinions, advice and dire warnings about the future of the economy. We learned long ago that those who profess to being "experts" are very seldom so, and that self-serving interests are the usual drivers behind their viewpoints, advice or expertise. Be wary of the TV gurus!

There is light at the end of the tunnel.

We are currently in the midst of extreme pessimism. In fact, widely followed investor sentiment indicators are at all-time lows. This is not sustainable. Although recently released inflation numbers for May have indicating a continuation of the current inflationary cycle, there are reasons to believe inflation has peaked. Commodities like copper, steel, lumber and industrial metals have fallen significantly since peaking in the spring. Similar trends are apparent in agricultural commodities and energy (oil and natural gas). Rising mortgage rates has led to increased inventory and wary new buyers in the real estate sector. The bottom line is this: prices across the board have likely peaked. If the leading indicators are accurate (we believe they are), the "new information" that will be used by "data-dependent" policy makers would be bearish for central bank aggressiveness and bullish for financial assets.

The bottom will occur without pomp, pageantry or an "all clear" signal

In our experience, markets will always hit bottom and begin the march higher while the headlines remain pessimistic. Markets are forward looking mechanisms and tend to reverse course well ahead of the data. Further, any positive news on the Ukraine/Russia war, the energy crisis in Europe, China lockdowns, rampant inflation and persistent supply chain bottlenecks should be a catalyst for a rally. Markets tend to bottom out and start moving higher before the "headlines" turn positive. Our conviction is high that we are getting closer to a "reversal of fortunes" and that conditions are currently favorable for a once-in-a-decade opportunity. Opportunities are visible everywhere and valuations are starting to look very appealing. Our belief is that patient investors who stick to a disciplined, long-term plan will be well rewarded.

Note: This is the last edition of the Palos Weekly prior to our summer break. Weekly performance updates will continue to be furnished during this time. The regular newsletter will return on Monday September 12. We extend our wishes for a wonderful summer and we look forward to resuming our weekly letter after Labour Day.

Best regards,

Charles Marleau CIM®

William Mitchell CIM®

By Charles Marleau CIM® and William Mitchell CIM®

Follow us on LinkedIn:

Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$7.92	-15.81%
Palos Equity Income Fund - RRSP	PAL101	$6.14	-14.60%
Palos Merchant Fund L.P. (Dec 31, 2021) [2]	PAL500	$1.16	24.67%
Palos WP Growth Fund - RRSP	PAL213	$12.02	-36.38%
Palos-Mitchell Alpha Fund [3]	PAL300	$7.78	-24.35%
S&P TSX Composite (Total Return with dividends reinvested)			-11.98%
S&P 500 (Total Return with dividends reinvested)			-18.28%
S&P TSX Venture (Total Return with dividends reinvested)			-37.74%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			2.92%
Canadian Government 10-Year			3.07%
Crude Oil Spot			US $97.59
Gold Spot			US $1,703.60
US Gov't10-Year/Moody BAA Corp. Spread			231 bps
USD/CAD Exchange Rate Spot			US $0.7678

[1] *Period ending July 15th, 2022. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

Weekly Commentary

Issue No. 29 | JULY 18, 2022

Disclaimer:

PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188
F. +1 (514) 397-0199

1 St. Clair Avenue East Suite 504
Toronto, Ontario M4T 2V7

T. +1 (647) 276-0110
F. +1 (647) 343-7772

www.palos.ca