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Weekly Commentary

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Navigating a Bear Market

In the simplest of terms, a bear market occurs when securities decline in price over a sustained period. By definition, a bear market is typically in place when prices fall by 20% or more from recent highs made during a bull market that precedes the bear. Bull and bear markets occur in all asset classes including stocks, bonds, commodities, real estate and alternatives (e.g. art and collectibles).

To date in 2022, the major equity indices in North America are in bear market territory with the S&P500 Index (-24.8%), the NASDAQ Composite (-34.0%) and Canada's S&P/TSX Composite Index (-21.0%) meeting the criteria for a bear market. The bond markets, which under normal times would perform counter to the prevailing trend in stocks, are in the midst of their worst performance in over four decades. This leaves us with little doubt that we are in a bear market across multiple asset classes.

While the timing and reasons for a bear market are rarely evident at the outset, they are usually accompanied by shifts in investor sentiment (from positive to negative), a reduction in economic activity, or a geopolitical and/or financial crisis. The factors contributing to the current bear market are evident: central banks aggressively raising interest rates to tame inflation, the conflict in Ukraine, persistent Covid shutdowns in China, and an energy crisis in Europe. The current state of affairs has impacted financial assets around the globe and increased price volatility in markets.

Bear markets are a normal occurrence for financial markets. Asset prices have always fluctuated over time and it's important to remind ourselves that the market value of any portfolio does not rise in a straight line. This is a simple fact when it comes to investing. Since the beginning of this century alone we have witnessed numerous Bear markets including the bursting of the "tech bubble" (2000-01), the 9/11 attacks (2001), the subprime mortgage and credit crisis (2007-08), a European debt crisis (2011-12), the China growth and currency collapse (2015), the late December sell-off (2018) and the Covid pandemic (2020-21). Despite these ominous events, and without exception, markets have continued to make new highs over time; a reminder of how important it is to maintain a long-term perspective.

Furthermore, it is crucially important to remain invested. Bear markets, which are usually accompanied by incessantly negative and unwarranted media attention, can entice some investors to over-react and realize

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losses by selling. In our experience, and in our advice to clients, we are very clear in our conviction that this is absolutely the wrong thing to do. Unanticipated market rallies can occur over short periods of time. The evidence is clear: missing out on these rallies can seriously impact an investor's ability to realize their long-term investment objectives.

To illustrate the above, a report from BMO Global Asset Management determined that an investor making a $100,000 investment in the S&P/TSX Composite Total Return Index in 2000 would have increased the value of their portfolio to $444,555 by 2021, a return of 344.4%. By contrast, if the investor missed out on the 5 "best days" the return would have been reduced to 186.5% ($286,489 value). If the investor missed out on the 10 "best days, returns fell to 115.2% ($215,244 value).

In our experience, maintaining patience, remaining disciplined and avoiding the mistakes that many investors make are the keys to successful investing. From 1960 to 2021, the average length of a bull market was 41 months with an average return of 74%. The average length of a bear market was 10 months with an average decline of 23% (source: BMO Mutual Funds). This implies that 80% of the time we're in a bull (41 of 51 months) versus 20% of the time in a bear market (10 of 51 months). In addition, returns that accompany a bull market tend to exceed the magnitude of declines in a bear market. The evidence is clear. Remaining invested as opposed to trying to "time the markets" has proven itself to be the best long-term strategy for success. Bear markets do not last forever, and markets often reverse from bear to Bull very quickly.

While "timing the markets" is very difficult to do, we remind you that at Palos we are active managers as opposed to those who decide to passively endure investment cycles. We continue to tactically manage risk, rebalance asset and sector exposure in portfolios, and seize on the tremendous opportunities that arise when asset prices become attractive while nervous investors "throw in the towel". Current investor sentiment indicators, leading inflation indicators and extremely oversold markets are suggesting to us that we are much closer to a market bottom than a market top. This creates opportunistic risk-reward conditions. While volatility may persist for some time as markets adjust, we believe patience and discipline should be well rewarded in due time.

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Chart 1: Palos Domestic Funds versus Benchmarks (Total Returns) [1]	FundServ	NAVPS	YTD Returns
Palos Income Fund L.P.	PAL100	$7.95	-14.66%
Palos Equity Income Fund - RRSP	PAL101	$6.23	-14.16%
Palos Merchant Fund L.P. (Dec 31, 2021) [2]	PAL500	$1.16	24.67%
Palos WP Growth Fund - RRSP	PAL213	$12.39	-37.66%
Palos-Mitchell Alpha Fund [3]	PAL300	$8.35	-23.97%
S&P TSX Composite (Total Return with dividends reinvested)			-11.54%
S&P 500 (Total Return with dividends reinvested)			-23.88%
S&P TSX Venture (Total Return with dividends reinvested)			-38.07%
Chart 2: Market Data [1]			**Value**
US Government 10-Year			4.02%
Canadian Government 10-Year			3.49%
Crude Oil Spot			US $85.61
Gold Spot			US $1,641.70
US Gov't10-Year/Moody BAA Corp. Spread			231 bps
USD/CAD Exchange Rate Spot			US $0.7202

[1] *Period ending October 14th, 2022. Data extracted from Bloomberg*
[2] *Fund is priced annually*
[3] *Fund is priced weekly on Tuesdays*

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