**ADKINS SEALE CAPITAL MANAGEMENT, LLC**

Investment Commentary
January 9, 2014

**Dear Clients:**

The year 2013 ended with a surprisingly calm atmosphere across most capital markets, particularly those in the US. Perhaps investors were comforted by the very modest budget accord at the federal level and the uncontested succession at the helm of the Federal Reserve Board, but almost certainly the surprising strength of the US economy and the concomitant rise in profits were the substantive supports for the markets. Adverse consequences from the flawed implementation of the Patient Protection and Affordable Care Act, worsening strife in the Middle East, continued uncertainty over the unwinding of the Fed's unprecedented money creation, and the ongoing "unfair" subsidy transfer from savers and holders of money market instruments to the US government and borrowers in general were seemingly brushed aside as inconsequential. We have a newfound admiration for the resilience of the US economy, but remain concerned that the monetary oil in the fuel mix may turn out to be toxic.

**Investment Market Returns as of December 31, 2013**

Equity returns in the US and in the developed international markets were stronger than long term trends for the second year in a row. The total return for the S&P 500 Index was 10.5% for the quarter and 32.4% for the year ended December 31, 2013. This result built upon a 16% total return for 2012 and far exceeded the average annual return of 9.8% per year since 1925. Returns for mid and small cap US stock were even stronger. The total return for the MSCI-EAFE Index of stocks in developed markets outside the US was 5.7% and 22.8% for the fourth quarter and full year 2013, respectively. Only the total return for stocks in emerging markets under-performed significantly with a modest 1.8% for the fourth quarter and a -2.6% negative return for the full year. Currency effects from a stronger US dollar negatively impacted international equity results.

In looking back over the prior four years, we find that corporate earnings each year have averaged about 7% of the prior year end index value for the S&P 500 Index. Year over year earnings growth is expected to be about 12% for 2013 following a flat 2012 but in line with the strong recovery in earnings since 2008. Given all the headwinds facing our economy, this has been somewhat of a surprise as the growth in sales over the last few years has been in the low to mid single digits and very likely will be flat for 2013 versus 2012. The power of strong cost management and a small lift from share buy backs have boosted equity returns above normal levels for the last two years.

Fixed income returns were the mirror image of the stock market. The Barclays Capital (BarCap) US Aggregate Bond Index was essentially flat for the fourth quarter as price declines offset the quarterly yield of about 0.60%. For the full year 2013, this index lost 2.0% as price declines more than offset the coupon return of 2.25%+/-. The BarCap US Municipal bond index generated similarly weak returns, while the BarCap index for non-US bonds was much weaker, with negative returns of -1.7% and -5.6% for the quarter and full year, respectively. Credit concerns in certain countries and a strong US dollar contributed to the weak performance of the broad foreign bond market. Inflation as measured by the CPI remains muted as indicated by a 1.5% rise for the full year.

**2014 Outlook**

We are believers in mean reversion when it comes to returns on stocks and bonds. In the case of stocks, above normal returns are followed by below normal returns and vice versa. Since equity returns were above normal in both 2012 and 2013 (about 3 times above normal in 2013), we expect stocks to generate returns less than 10% in 2014 with a reasonable probability for a sizable correction of down 10-15%. Based on data compiled by Howard Silverblatt, S&P Senior Index Analyst, the current forecast for index-equivalent earnings from the constituent companies in the S&P 500 Index ranges from a high of 121.49 from sell side analysts to a low of 106 from top down economists. The lower number represents a 17.4 multiple of the 2013 year end index value and a 9.6% increase over 2013 estimated earnings; we find both numbers aggressive compared to historical averages. We believe the top down economists are more realistic in forecasting earnings, so we would apply an average 16.5 multiple to 106 to get our estimate of the 2014 year end S&P 500 Index value of around 1760.

By contrast, most of Wall Street is calling for continued strong returns from stocks in 2014. Barron's December 16, 2013 issue listed the 2014 forecasts from ten large investment companies that call for the S&P 500 Index to end 2014 as high as 2100 and as low as 1900 compared to the 1848 value at year end 2013. Six of the firms called for an index value at or above 2000, while three firms were more modest in their expectation for a 1900 ending index. All ten firms had index earnings between 116 and 120. Other signs of excessive optimism among investors can be found in the ratio of bullish to bearish advisory sentiment and in the increased level of share re-purchases by companies and insider sales.

Our expectation for international stocks is less clear as generally lower earnings multiples versus US stocks have been offset by adverse currency impact. Given the recent under-performance of international stocks, we think it a reasonable expectation for out-performance over the next couple of years, albeit with higher volatility.

The outlook for fixed income seems more certain as easy money policies and an improving economy would normally push inflation expectations and bond yields higher and bond prices lower. This trend began in 2013 and will probably continue. However, we are keeping an eye on the US TIPS market as a primary indicator of future inflation. Recent prices for US TIPS suggest a forward CPI of about 2.2% per year, somewhat below the long term average of 3% but ahead of the 1.5% reported for 2013. Our concern is that the CPI was actually negative for the last calendar quarter and the January 2014 inflation factor for US TIPS bonds is generating declines in the par value of these bonds. Such deflation is precisely what worries the Federal Reserve Bank the most and is the reason for its pursuit of easy money through quantitative easing.

**Our View Looking Forward**

We are encouraged by the robustness of the US corporate earnings and are optimistic longer term about both US and foreign stocks. However, in the US, we are wary of the broad enthusiasm for taking on more investment risk to escape low returns from fixed income assets. Such actions will likely create undesirable outcomes. We expect to remain under-weighted to equities and longer-duration fixed income. We will use cash and fixed income assets to take advantage of equity opportunities should a sizable correction occur.

**In Closing**

We look forward to visiting with each of you about your investment results and expectations for the future and to make sure your portfolios are aligned with your specific circumstances. We greatly appreciate the opportunity to serve as your investment adviser and pledge our best efforts to meeting your expectations.

P. Michael Adkins, CFA
mikeadkins@ascm-llc.com

J. Richard Seale, CFA
dickseale@ascm-llc.com

333 Texas Street, Suite 2235 Shreveport, LA 71101
318-703-3641 800-304-6588