ADKINS SEALE CAPITAL MANAGEMENT, LLC

Investment Commentary
July 5, 2016

Dear Clients:

"Alice laughed. 'There's no use trying, One can't believe impossible things.' 'I daresay you haven't had much practice,' said the Queen. 'When I was younger, I always did it for half an hour a day. Why sometimes I've believed as many as six impossible things before breakfast." From Alice In Wonderland by Lewis Carroll.

Today's events and circumstances are presenting investors with a host of heretofore thought to be impossible situations. As this piece goes to press, the current yield to maturity for a 10 year Swiss government bond is **minus -0.68%**; a buyer of such bonds pays $107 today for the right to receive $100 in 2026. With the advent of negative bond yields, some commentators are selling the merits of holding physical currency as a viable part of bond/cash holdings. The US is in the midst of a presidential election year where the two major candidates both have unfavorable public perceptions by more than 50% of the polled respondents. We can only hope this particular poll response will prove an inaccurate characterization of the winner's governing result. This high unfavorable feeling led to a strong showing by a self-described socialist promising to solve all economic ills through a material expansion of governmental participation in the daily lives of Americans and substantial restrictions on free market capitalism that has produced one of the world's highest per capita living standard.

We are unsure how all of these forces come together without a fair amount of volatile pushback and friction, but we believe investors should be prepared for the unexpected while maintaining an unemotional view of investment markets and political rhetoric. Making distinctions between the likely and the unlikely is an essential part of the investing process while remaining mindful that almost any investment outcome is possible and only a few truly impossible.

Investment Market Returns as of June 30, 2016

US stock market returns continued on a positive trend, with the S&P500 Index generating total returns of 2.46% and 3.84%, respectively, for the second quarter and year to date. The sectors performing the best in 2016 were energy, utilities, healthcare, and consumer staples; these patterns represented a reversal from 2015 and a reflection of ultra-low interest rates and curiously conflicting signals on the near-term odds for recession or recovery. Mid to Small capitalization US stocks performed in line with their large capitalization brethren.

The stock index for non-US developed countries finished the quarter and year to date periods with negative returns of -1.48% and -4.42%, respectively, as concerns for future economic growth and geo-political risks more than offset a slight average currency advantage. For emerging markets stocks, the story was more favorable, reflecting the benefits of rising commodity prices and a more pronounced appreciation of those currencies versus the US dollar.

Fixed income market returns achieved "near-impossible" status since January 1. The Barclays Capital US Aggregate Bond Index generated total returns of 2.21% and 5.31%, respectively. Given the current quarterly yield is less than 0.50%, such returns were driven largely by the tail wind of falling annual yields. Holders of foreign bond issuers included in the Barclays Capital Global Majors ex-US Bond Index realized total returns of 5.43% and 15.04%, respectively, as yields on ten year bonds in Switzerland, Japan, and Germany dropped below zero. One might describe this tail wind as near "hurricane force." The broader Barclays Capital Global Aggregate Bond Index generated total returns of 2.5% and 8.5%, respectively, which were closer to the US bond average but still measurably better. To put it mildly, low duration bond portfolios have not fared well so far in 2016 and the preceding five years.

Our Alternative Investment asset class experienced generally favorable total returns driven largely by rising commodity prices, particularly for gold and oil, strong demand for interest-sensitive REIT stocks, and in-line returns from our hedge fund selections. These assets have performed as designed so far this year, but one cannot help but notice the contradictory signals from these assets compared to those of stocks and bonds.

Our Look Forward

Current market prices for stocks and bonds are being heavily influenced by historically low (even "impossible" negative) interest rates across global developed country markets. Tried and true valuation methods focus on calculating the present value of future cash flows discounted at an appropriate interest rate (aka cost of capital) to determine fair value. Values determined in this fashion are very sensitive to the level of interest rates. To wit, at a zero interest rate, $100 received ten years in the future is worth $100 today. But at a 5% interest rate, that present value falls to $61.39, and at a 10% rate (the long term norm for stocks), that present value is worth only $38.55. Periodic dividend and interest payments would help cushion the price declines driven by higher interest rates, but the investor pain resulting from a rapid rise in interest rates would be significant.

The current price of the S&P500 Index suggests an annual net earnings yield (inclusive of dividends) of about 4% compared to historical averages of 6.5%+/-. Since 1870, there have been many more monthly observations of earnings yields at or **above** 6.5% than below 4%. This suggests investors should not be surprised by the reversion to the higher earnings yield and resultant decline in stock prices by an order of magnitude of 30-35%. Similarly, the 10 year US Treasury note is currently yielding around 1.4%, compared to an average of 4.6% for the period 1870 to present. The price decline for a 10 year zero coupon UST bond resulting from an increase in yield by 3.2% would be minus -27%. For those investors in foreign bonds with negative interest yields, the price decline would be nearer minus -40%. These price changes are not our forecast for the next year or two, as restoring valuation metrics to historical norms can be accomplished with a combination of improved earnings, gradual rises in interest rates, and time.

We are uncertain of future prices of stocks and bonds. Anything is possible, including currently elevated prices persisting for a longer time. What is certain is that substantially lower prices from today's level are not impossible, no matter how hard we imagine or wish it so. A balanced approach using high quality securities seems the best approach for managing through these unusual times and seemingly extreme valuation metrics.

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 meet 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