ADKINS SEALE CAPITAL MANAGEMENT, LLC

Investment Commentary
April 4, 2017

Dear Clients:

"Beware the Ides of March" is a slogan supposedly made popular from the assassination of Julius Caesar in 44 BC on March 15. From the oldest Roman calendar, the month of March was the first month of the year, so Romans traditionally celebrated the time as a period of new beginnings. Today, society has followed that tradition somewhat with all sorts of hoopla associated with the first quarter of a new calendar year. Newly-elected US Presidents and members of Congress are sworn into office in January following the previous year's election results. In years such as 2017, the first quarter is full of much sound and fury as the new voices in government try to make good on a load of campaign promises - some of which are **undeliverable**. Well-intended "New Year's resolutions" make an annual appearance across our land and sometimes have a lasting effect throughout the year. Carnival is a major first quarter celebration in most of the Christian world followed by the more sober period known as Lent. Perhaps the Lenten season provides some support needed to complete those less enjoyable tasks associated with filing annual income tax returns and yearend financial statements.

To us, this year may mark the beginning of something really "huge." The United Kingdom is just beginning to digest its exit from the European Union. The US is in the early stages of adapting to the unconventional actions of a new President in concert with a paralyzing partisan atmosphere in Congress. The US Federal Reserve Bank may be in the early stages of unwinding perhaps the most unconventional monetary policy maneuver in history. Continued threats of large military conflicts in Eastern Europe, the Middle East, and the Pacific region remain a daily concern. To date, global investment markets have shrugged off these prospective threats as "normal and customary." Our hope is that the path will lead to more "normal" interest rates that adequately compensate investors/savers for the risk of inflation and uncertainty. Of course, such a path may well lead to lower prices for both stocks and bonds in the near turn but in exchange for more understandable returns over the longer term. We say "beware the Ides of March, buckle your seat belts, and keep your insurance policies intact."

Investment Market Returns as of March 31, 2017

Stock market returns across the globe were generally positive as investors priced in favorable expectations for future earnings and continued low interest rates. As a consequence, first quarter total return with dividends for the S&P500 and the MSCI-EAFE indices were 6.1% and 7.2%, respectively. The dividend yield component for the quarter was about 0.50% and 0.60%, respectively, as rising price multiples provided the bulk of the return. The total return on stocks in emerging markets was even stronger, up 11.4% including a dividend component of 0.45%. Over the twelve months ended March 31, 2017, these broad market indices returned 17.2%, 11.7%, and 17.2%, respectively, primarily on the expectation for higher future earnings. Cash dividends provided less than a fifth of the total return. Returns on foreign stocks benefited from a 3% depreciation in the US dollar during the most recent quarter but were negatively impacted by a strong US dollar over the twelve months. .

Returns on fixed income assets for the recent quarter were aided by a flattening US yield curve and the price effect of a weaker US dollar on foreign bonds. The total return on the Bloomberg Barclays US Aggregate Bond Index was 0.8%, including a 0.6% yield, while the Bloomberg Barclays Global Majors exUS Bond Index returned 2.4%, with a quarterly yield of only 0.2%. Not much angst about future events among bond investors was demonstrated by these results. For the trailing twelve months, the total returns for these indices were 0.4% and -4.2%, respectively, as rising interest rates and a strong US dollar in the fourth quarter 2016 generated price reductions in excess of the yield component.

Alternative asset returns were subdued for both the quarter and trailing twelve months. Trend following strategies were particularly upended by the significant political upheavals in the US and UK. US REIT asset returns were hurt by concerns about future interest rates and over supply of certain real estate sectors. Commodities performed well for the twelve month period as both gold and industrial commodities rallied through the April to September period. That trend reversed strongly in the 2016 fourth quarter but recovered slightly for the current quarter.

Our Look Forward

Current prices for stocks and bonds suggest modest (aka lower than historical norms) future returns. The current forecast for trailing twelve month net income from the S&P500 Index constituents suggests an earnings yield of slightly more than 4% (a P/E ratio of 25+/-). This number plus future growth in earnings will determine future annual returns, assuming the market does not re-price the earnings yield back to a historical norm of 6% or a P/E of 16.5. Future GDP growth expectations seem to fall in the range of 2% - 4%, depending on the level of annual inflation which is currently around 2%. Investors should keep the range of possible outcomes for US stock prices in focus. We see this range in the S&P500 Index from its current level of around 2350 to as low as 1650 if a long term earnings yield average is applied to current earnings to as high as 3000 if the current earnings yield is maintained and the current forecast for 2017 earnings is realized. The bottom-up current forecast for 2017 earnings shows a 25% increase from 2016, followed by a 9% increase in 2018 from 2017. The specific uncertainties confronting global markets and economies may generate significant headwinds to achieving the optimistic earnings forecast.

The return outlook for international stocks appears somewhat more favorable than that of the US based largely on a higher current earnings yield. This advantage is reflected in the recent returns from these stocks after having lagged the US for most of the years following 2008. We expect these stocks to provide better returns than those based in the US over the next few years but with more volatility and greater unique event risks. Allocations to international stocks including emerging markets should consider these characteristics.

Fixed income returns remain underwhelming and ripe for a reversion to the mean. The current option-adjusted yield to maturity for US Aggregate Bond Index is around 2.4% which suggests a real return of only about 0.4%. Looking back over the past nearly 150 years, the average yield has been closer to 5%, while the real yield has been nearer 2%. The US Federal Reserve Bank has begun the process of raising the overnight funds rate from the near zero level maintained since 2008. Investors should keep a keen eye on this process as rising overnight rates generally affect longer-dated bonds and eventually the earnings yield on stocks. Interestingly, the yield curve has been flattening recently as higher short term rates have been accompanied by stable to falling longer dated yields.

Flattening yield curves have been associated historically with slowing economic activity including preceding recessionary periods. The current optimism for strong business earnings growth conjoined with a benign (aka low) interest rate structure could prove unsustainable. From our perspective, there remains enough uncertainty and mixed signals from the market to justify keeping a tilt to a lower risk allocation strategy.

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.

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