ADKINS SEALE CAPITAL MANAGEMENT, LLC

Investment Commentary
As of June 30, 2013

Dear Clients:

This is our inaugural letter to you since the formation of Adkins Seale Capital Management LLC on April 19, 2013. Each quarter, we will be providing you with our big-picture thoughts on the investment environment through this letter; we will expand on these topics and those of your specific interest during our one-on-one review sessions.

Investment Market Returns as of June 30, 2013

Market returns through June 30, 2013 were characterized by continued strong gains for US equities, more muted gains for non-US developed country stocks, and rather sharp declines in prices for emerging markets stocks and both US and foreign longer-duration bonds. On a year-to-date basis, the total return of the S&P 500 Index and the Russell 2000 Index were 13.8% and 15.9%, respectively, continuing the high returns generated in all of 2012. By contrast, returns on non-US equity indices were less robust, with the MSCI-EAFE Index return up only 4.1% and the MSCI-Emerging Markets Index down by (9.6)%. A significant portion of the higher returns on US stocks resulted from a rising price to earnings ratio (PE). The current PE for the S&P 500 Index based on trailing 12 month earnings is about 19.4x compared to a very long term average of 15.5x. Higher than normal US stock valuations are also indicated by Robert Shiller's CAPE ratio which is now about 24.5x versus an average of 16.5x over the last 142+ years. The boost to PE multiples has come from both below average bond yields and an expectation for materially higher "forward" earnings.

The impact of very low bond yields, as well as the near-zero return for cash, has been in place for most of the last three years. The US Treasury 10 year bond yield has been below 2% for essentially all of 2012 and the first four months of 2013. By comparison, the very long term average for this key indicator is 4.6%. This period of very low interest rates may have ended around the end of April 2013. Since that point, the yield on the 10yr UST has risen to over 2.5% currently. As a consequence of the reversal in bond yields, returns on fixed income investments were negative for the second quarter and year to date. Total return on investment grade US taxable bonds was negative (2.4) % since January 1, 2013 as price declines overwhelmed interest payments. Similar negative returns were experienced on US tax-exempt and foreign bonds.

Our View Looking Forward

The "fairly valued" case for US and foreign stocks rests on two primary arguments: bond yields remain very low and unattractive versus the "expected" return from corporate dividends and sustained growth in corporate earnings.

We believe bond yields are comprised fundamentally of three components: an inflation factor, a duration risk factor, and a credit risk factor. Based on data from Ibbotson SBBI 2013, since 1925 inflation in the US has averaged 3.0%, while the duration risk premium and credit risk premium for intermediate term notes have averaged about 2.4% and 0.4%, respectively. Our view is that fixed income markets will be on path to return to long term averages. If this path is completed over the next twelve months, returns from intermediate duration bonds will be significantly negative, possibly as much as (7) %. A more prolonged path to long run averages would result in smaller, but still uncomfortable, negative returns. In either event, our assessment of the risk/reward tradeoff for bonds leads us to maintain lower than normal durations with a tilt to higher credit quality.

The outlook for equity returns is dependent both on the pace of the increase in bond yields and the realization of expected forward corporate earnings, with the earnings factor being the most significant. Using data compiled by Standard and Poor's Corporation, forward net earnings per share for the companies in the S&P 500 Index, expressed as a percentage of the current index value, for 2013 and 2014 are 6.1% and 7.0%, respectively. These "earnings yields" are generally consistent with long term averages and considerably higher the 5% earnings yield based on actual trailing earnings. The talking heads on Wall Street would have investors believe these forecasts are "in the bag." We have two major concerns with the achievability of these forecasts.

First, the year over year growth rates in forward net earnings for 2013 and 2014 are 19% and 14%, respectively. By contrast, annualized growth rates for sales for the constituent companies for the two years ended March 31, 2013 have averaged less than 3%, with little expectation for much near term improvement. Sustaining high rates of earnings growth in the absence of robust sales growth seems questionable. We believe expense reductions and EPS enhancement through share repurchases can only go so far.

Second, the forecasts for 2013 and 2014 are based largely on "operating" earnings; operating earnings are supposedly an indicator of the companies' forward earning power. Unfortunately, history tells us that actual net earnings are consistently below operating earnings due to such "non-recurring" factors as plant closings, workforce reductions, and write-downs of prior period acquisitions. In fact, the average percentage reduction from operating earnings to net earnings is about 11%, while the forecast for future net income includes a reduction of only about 3%. Count us skeptical on the quality of "operating earnings" as a reliable indicator of future earnings capacity for US companies taken as a whole.

Our view of the most likely outcome for US equities is for low to mid-single digit returns over the next 3-5 years being driven by the earnings yield and sustainable growth. If bond yields return to long term averages more rapidly than currently anticipated by the market and/or earnings disappoint, then equity returns will be lower. If bond yields remain low and earnings meet or exceed expectations, equity returns will be higher. We expect returns on international equities to follow US equities with a slight premium due in large part to better growth prospects in Asia and other emerging markets and an expectation for a stable to declining USD exchange posture. Alternatively, a rising USD in response to global instability would dampen returns from international equities. We believe current equity prices suggest a lower than normal allocation to this asset class, particularly for investors with shorter time horizons.

In Closing
The three months since we formed our firm has been a period of elevated multi-tasking. It has been fun, rewarding, and only occasionally frustrating. Thanks to you our clients for making this transition a great success. 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.

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

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