**ADKINS SEALE CAPITAL MANAGEMENT, LLC**

Investment Commentary
October 4, 2017

**Dear Clients**:

“In theory, there is no difference between theory and practice. In practice, there is.” Yogi Berra.

As is the case with most of Mr. Berra’s quotes, the wisdoms of his thoughts were sometimes obfuscated by incongruent sentence structure. In the investment management world, the “Efficient Markets Hypothesis” represents classical theory that marketable securities prices are set by “players” who have full access to all factors needed to determine fair valuation. Stock prices reflect accurately expected future discount rates (aka interest rates) adjusted for market uncertainty and expected future earnings including cash dividend distributions. Likewise, bond prices are an accurate depiction of the future short term yields linked over time with adjustments for duration and credit premiums. This specific theory is the foundation for Index-based investing, about which so much has been written of late in the popular press. ”Modern Portfolio Theory” (MPT) provides the mathematical formulations for optimizing investment returns for a given level of return volatility through asset class diversification. Put simply, MPT suggests, by combining a group of assets with different return and volatility characteristics and trend correlations of less than +1, diversification generates better return outcomes. This theory is the foundation for global diversification of stocks, bonds, and alternatives.

We in the investment advisory world often find ourselves confronted with deciding whether the application of accepted investment theory is the “best practices” course of action in specific circumstances. The popular financial press abounds with the “news” that passive index investing is the only logical choice for all except the most sophisticated investors. We have no quarrel with such sentiments for equity investing over the long term, for unlike the cone of uncertainties for hurricanes which broaden as the time spectrum lengthens, the range of possible outcomes for long term equity investors narrows significantly over a longer time horizon. Today, the popular equity indices are priced for a combination of low bond yields, average historical growth rates for most companies, and rapid growth by a few select companies such as Amazon and Facebook. If these assumptions hold for the long term, financial asset annual returns will be constrained to low single digits.

In practice, our firm utilizes the two theories highlighted above act as guideposts for constructing our clients’ investment portfolios. Unless limited by specific client mandate, most managed portfolios are diversified across global stocks, global bonds, alternative investments, and cash. The equity components (stocks) will be constructed with both active and index (passive) strategies, while fixed income (bonds) and alternatives will be largely active strategies. Our approach reflects our experience that, in the near term, markets can be quite inefficient and subject to rapid changes in sentiment or valuation metrics, principally earnings forecasts and interest rates. Today’s historically high earnings multiples and low bond yields lead us to under-weight traditional passive equity strategies for the time being. In addition, we question whether the potential risks resulting from geo-political conflicts, the unwinding of the unprecedented monetary expansion, the onset of higher inflation, or the actions of a polarized political atmosphere in the US are properly reflected in current prices for marketable securities.

**Investment Market Returns as of September 30, 2017**

Market returns through September 30, continued the bullish run following the 2016 election. The broad US equity market registered total returns of 4.5% for the recent quarter and 18.6% for the trailing twelve months. Equity returns from non-US markets, including the benefit of a falling US dollar, exceeded that of the US markets. Comparable total returns from non-US developed countries were 5.4% and 19.1%, respectively for the two periods, while such returns from non-US emerging countries were 7.9% and 22.5%, respectively. Market returns both in the US and aboard continue to reflect the impact of higher earnings multiples being driven by the prospect for improved future earnings. US equity returns have been above long term averages in five of the last six years; this situation calls to mind the adage that above average returns are followed by below average returns and vice versa.

Returns on fixed income assets (bonds) continued to benefit from falling yields across the globe. Since yearend 2016, yields on US investment grade bonds have fallen steadily, essentially offsetting the negative bond returns experienced in the fourth quarter of 2016. Returns on non-US bonds were even stronger in 2017, but trailing twelve month returns remained negative given the sharp price declines in late 2016. Investors need to remain vigilant about the risk of higher interest rates as current coupons remain low at around 0.50% per quarter while at the same time issuers are actively marketing very long duration securities to a yield-starved public. Buyer beware.

Returns on Alternative strategies continued to lag the broad equity markets as insurance against price declines in stocks and bonds was not needed over the quarter and trailing twelve months. Insurance is always a waste of money until the claim is filed.

**Hedged-Equity Strategies**

Diversification has been the only answer to reducing risk when building an investment portfolio, but the benefits of diversification are limited when addressing market risk; does 2008 ring a bell? Market risk is the possibility for an investor to experience losses due to factors that affect the overall performance of the financial markets. With US equities now entering the second longest bull market in history and yields expected to rise, traditional stock and bond portfolios require some additional alternative strategies to mitigate the potential simultaneous decline in stock and bond prices. We believe hedged equity can serve as added protection against market risk. Like any good investment, the strategy needs to have a disciplined process that delivers protection when markets experience large declines. The appropriateness of this alternative investment depends on the client’s unique objectives and risk tolerance. During 2017, we have begun deploying client assets into a broader lineup of “hedged equity” securities in response to our concerns about excessive valuations. We expect such assets to give our clients upside exposure of 75-80% but only 50-60% of the downside. As is the case with all expectations, actual returns may vary from expectations. Clients can monitor the benefit or cost of these assets on pages with Class/Segment/Individual Holdings returns in their quarterly performance report.

**Note on Proxy Voting**

On advice of counsel, our firm does not vote proxies for clients. In general, we recommend our clients vote as recommended by management/board of directors (trustees). Our recommendation is based on the belief that securities held in client accounts are led by competent and honorable individuals. If our firm determines this circumstance no longer applies to a specific security, that security is simply sold from the portfolio and replaced with an issue that meets our standards. In a few circumstances, we may recommend “Withheld” votes for specific directors/trustees who do not hold a meaningful amount of shares in the security subject to the vote. We are available to advise clients with specific questions about voting matters.

**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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