# ADKINS SEALE CAPITAL MANAGEMENT, LLC

Investment Commentary
April 5, 2016

**Dear Clients:**

The first quarter of 2016 was another but completely different version of the "Worst of Time and Best of Times" thriller courtesy of global investment markets. During this brief period, investors saw returns on global equities decline between 9 and 12 percent from January 1 through February 10 only to rebound up by 10n to 16 percent from February 11 through March 31. According to the main stream investment press, this bi-polar behavior was driven by a rapid change in psychology from concern for the coincident consequences of higher interest rates and lower corporate earnings (the first six weeks of the quarter) to a grand relief rally brought on by significant declines in yields on high quality, longer-dated bonds and a dovish retreat by the US Federal Reserve Bank from its planned, albeit extended, return to interest rate normalcy (the last six weeks of the quarter). As annual yields approach zero for many long-dated, developed-market government bonds, stock traders must have concluded that 4% earnings yields (including 2% annual dividends) on common stocks is a relative bargain. We remain skeptical of this trade based on our skepticism of the efficacy of central bankers' adroitness in creating ever-increasing amounts of electronic liquidity to finance an ever-increasing debt load on global economies without suffering unpleasant unintended consequences.

On a positive note, the power of portfolio diversification was on display this quarter. Portfolio returns benefited from favorable active management in US mid to small company stocks and non-US dollar stocks, and non-correlated investments, particularly gold. The SPDR Gold ETF increased 12.8% during the mini-bear market episode early in the quarter and finished the quarter up nearly 16%. We believe Harry Markowitz's Nobel Prize in Economics for his work on multiple asset class portfolio diversification was well-deserved and are glad to see the evidence starting to show up in actual results. Investment markets remain exposed to a number of disruptive forces across the globe, not the least of which is the current US presidential election cycle where calls for destructive trade isolationism, higher taxes on wealth creation, and greater regulatory oversight would damp expected future economic growth and concomitant investment returns. Winston Churchill is believed to have once said, "The Americans can always be trusted to do the right thing, once all other possibilities have been exhausted." We trust this truism remains in place but will keep certain hedges in place during this trial and error episode.

**Investment Market Returns as of March 31, 2016**

Total investment returns in the US stock market finished slightly positive for the quarter and slightly negative for the twelve months ended March 31, 2016. The total return from the S&P 500 Index was +1.35% in the first quarter and +1.78% for the trailing twelve months. Returns for smaller US companies were decidedly weaker as evidenced by negative returns from the Russell 2000 Index of -1.52% and -9.76%, respectively, for the two periods. Concerns about future earnings and rising interest rates have restrained stock prices with the more pronounced impact being on smaller and more leveraged enterprises.

Returns for foreign stocks were a mixed bag with a negative -3.01% result for the MSCI-EAFE Index (developed country stocks) during the quarter and a negative -8.27% result for the trailing twelve month ended March 31, 2016. In contrast, the total return from emerging market stocks was a positive +5.71% for the quarter, partially offsetting the nearly -16.8% negative result from April 1, 2015 through December 31, 2015. The returns from foreign stocks were cushioned by a declining US dollar versus the global currency basket; for the quarter and full twelve month periods, a falling US dollar added around 3% to foreign stock returns.

The US investment grade fixed income market has been relatively stable but totally uninspiring over the last twelve months. Annual yields on the broad indices for both taxable and tax exempt bonds remain around 2% with average durations of about 6x. A host of credit downgrades in the US energy sector sent high yield spreads upward during 2015 but that downer was reversed in the current quarter as rebounding oil prices provided a welcome bid to this sector and a positive +3.35% total return from high yield bonds.

The sleepy behavior of US bond markets was over shadowed by the dramatic movement in markets for foreign bonds, particularly those issued by the governments of the major developed countries. The Barclays Global Majors exUS Bond Index returned +9.1% for the recent quarter completely reversing the negative -0.6% result during the nine months through year end 2015. This reversal was due to a drop in longer-dated bond yields to near zero and a rise in the currencies of the major Asian and European countries. Our clients have virtually no exposure to such bonds as indicated by the modest returns in the foreign bond segment. We favor 3%+coupons, short durations, and currencies with stronger future growth opportunities.

Investment results for the Alternatives segment in the first quarter were consistent with the desired "hedge" orientation. With the exception of gold, these assets generated modest single digit plus or minus returns on a different path from the more traditional stock and bond segments.

**Our Look Forward**

The current relationship between stock prices and underlying earnings suggest low single digit returns from stocks over the next few years. This expectation assumes interest rates stay lower than historical averages and that corporate earnings remain reasonably stable with modest upside growth. The significant risks to this expectation are some combination of lower corporate earnings and higher interest rates. We believe such risks have a higher probability of occurrence than the probability of significantly higher than expected earnings and a continuation of bond yields at or below the rate of annual price inflation. Given these beliefs, we expect to keep our clients' portfolios under-weighted to stocks and bond duration and over-weighted slightly to hedge strategies and cash. We expect to maintain a meaningful exposure to non-US stocks and bonds, consistent with our belief in the value of global diversification.

**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.

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