STOKES CAPITAL ADVISORS, LLC

Market Commentary
March 31, 2018

Quarterly Market Review

Global equity markets got off to a record setting start in January but finished the quarter lower as concerns over a possible trade war with China, rising interest rates and regulatory concerns in large technology companies gave investors reason to pause. The S&P 500 Index slipped fractionally (-0.76%) for the quarter but took investors on a volatile ride falling over 11% from the record high put in on January 26th but managed to find support around the 200-day moving average on February 9th.

Last year we noted the absence of volatility in markets and described the market environment as abnormal with an expectation that volatility would return. However, the violent daily moves observed in February were not “normal” either. While the exact cause was unknown, the unwinding of an obscure and popular institutional leveraged investment strategy tied to the VIX contributed to the sell off and not a deterioration in market fundamentals.

Foreign equities finished the quarter mostly lower as well with European markets struggling to remain in positive territory and now lag U.S. equities by more than 10% on trailing 12 month basis. Emerging markets, the only bright spot for foreign equites during the quarter, managed to post fractional gains for the quarter and remain the best performing asset class on a trailing 12 month basis.

Another notable observation was the continued torment for Master Limited Partnerships or MLPs which stumbled during the quarter when the FERC ruled that certain MLPs could not recover income taxes within tarrifs under a cost of service framework, arguing that it constitutes double recovery of taxes. However, within hours of the FERC announcement, managements of MLPs confirmed that the ruling would have no material impact on earnings or distributions.

On a positive note for MLPs during the quarter was the continued improvement in commodity prices and company fundamentals. Brent crude managed a 5% gain for the quarter and is up over 34% trailing 1 year as global demand remains steady and supply constraints from several key OPEC members provide tailwinds. In addition, year over year earnings for MLPs are expected to increase more than 30% according to FactSet Research making the sector one of the most attractive areas to invest.

Turning to the credit markets, bonds recorded negative returns for the quarter and remain only fractionally positive for the last 12 months as the Federal Reserve continues down the path toward policy normalization. The selloff in bonds was broad based with most sectors and maturities in delcine. Investors holding long dated U.S. Treasury bonds and investment grade corporate bonds suffered the most recording a -3.3% and -2.2% decline respectively for the quarter.

Global Economic Outlook

United States: The economy likely lost some steam in the first quarter of the year, partially reflecting residual seasonality but mostly the result of a moderation in consumer spending following robust growth in the previous quarter. Nonetheless, the underlying economic picture remains encouraging, with solid employment gains and accelerating wage growth buttressing private outlays and sentiment. Similarly, data for February showed healthy business sentiment and factory output underpinning an economy at full throttle. Trade measures enacted by President Trump’s administration could, however, counterbalance growth-inducing fiscal impulses. In recent weeks, the executive forged ahead with tariffs on steel and aluminum imports, which caused National Economic Council director and free-trade advocate Gary Cohn to resign. Trade tensions with China also flared up after the administration proposed tariffs on up to USD 60 billion worth of Chinese imports by invoking Section 301, which followed an investigation into intellectual property theft by China.

Eurozone: Detailed data confirmed that the Eurozone economy continued to grow robustly in the fourth quarter of 2017, capping off the best year of growth in over a decade. The solid reading was driven by a rebound in fixed investment, supported by optimistic business sentiment, and buoyant export growth despite a strong euro. Recent data for Q1 has been strong, albeit pointing to a

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moderation from prior levels. Economic sentiment edged down in February, while the composite PMI fell in March. However, the unemployment rate remained at a multi-year low in January. Meanwhile, the relationship with the United States, a major trading partner, has come into focus in recent weeks, after U.S. President Trump announced tariffs on steel and aluminum. On 23 March, the U.S. government announced that exports from the EU would be temporarily exempted until 1 May, and discussions on the topic are ongoing. A breakout of a tit-for-tat tariff battle could dent confidence and economic activity on both sides of the Atlantic.

Japan: Economic growth momentum from 2017 appears to have partially carried over into Q1 of this year. In January, seasonally-adjusted unemployment fell to an over two-decade low, boding well for private consumption. Moreover, survey data suggested that, in March, the manufacturing sector expanded for the nineteenth consecutive month. Looking back, the economy performed better in Q4 than previously estimated, according to government data, largely due to an upward revision in private non-residential investment growth. Meanwhile, on 8 March, the government signed up to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which will provide a lucrative opportunity for exporters upon coming into force.

China: The economy started 2018 on strong footing. Contrasting earlier expectations, data for January–February showed that the ongoing campaign to crack down on pollution did not hit industrial production growth, as solid global demand is fueling manufacturing activity. Despite tighter financial conditions, infrastructure outlays remained robust in January–February, propelling overall growth in urban fixed-asset investment. Retail sales were also strong in the first two months of the year, suggesting healthy private consumption. On 11 March, the National People's Congress (NPC) paved the way for President Xi Jinping to stay at the country's helm indefinitely with the abolition of the constitutional two-term limit. In the same venue, the NPC left economic targets mostly unchanged, while rolling out further economic reforms. While China responded with cautious criticism to U.S. President Donald Trump's decision to impose tariffs on steel and aluminum imports, authorities did not rule out retaliatory measures against the U.S., and the prospect of a trade war looms.

Investment Strategy & Outlook

The current expansion is now nine years old, one of the longest on record. A key driver to the longevity has been the ultra-accommodative policies of global central banks, which have inflated financial assets and created distortions in global currencies and sovereign debt.

As we begin 2018, Central Banks continue their transition from ultra-accommodative policies to normalization with the Federal Reserve venturing down the path first. I believe this transition will be a bumpy journey and a key driver to both, investment returns and market volatility going forward.

Clearly investors have benefited from Central Bank intervention, however a by-product of this "grand policy experiment" is the unprecedented amount of sovereign debt, ballooning fiscal deficits and stagnate global economic growth. We now find ourselves at a crossroads as the global economy enters the late stages of an historic expansion and Central Banks step back. Inevitably, higher growth rates will be required for the global economy to escape the current debt constrained orbit.

Finally, a rising interest rate environment can magnify less healthy businesses/securities and sharpens valuation metrics for all assets. As such, portfolio positioning and security selection will become increasingly important as this expansion ages. Long term bonds and non-dividend paying equities could suffer in the coming years while dividend growth stocks with low levels of debt and short-term investment grade bonds may produce better results.

Performance Scorecard

Benchmark Description	Q1	1 Year
Barclays Aggregate Bond Total Return Index	-1.5%	1.2%
S&P 500 Total Return Index	-0.8%	14.0%
NASDAQ Dividend Achievers Select Index TR	-0.5%	14.6%
Russell 2000 Index	-0.1%	11.8%
Alerian MLP Total Return Index	-11.1%	-20.1%
U.K. FTSE 100 Index (Price Only)	-7.2%	0.2%
German DAX Index (Price Only)	-6.4%	-1.8%
China SCI 300 Index (Price Only)	-3.4%	12.7%
Japan Nikkei 225 Index (Price Only)	-4.9%	15.6%
MSCI Emerging Markets USD (Price Only)	0.8%	22.4%