STOKES CAPITAL ADVISORS, LLC

Market Commentary
June 30, 2018

Quarterly Market Review

U.S. equities reversed course during the quarter and posted modest gains across the equity spectrum with the S&P 500 returning to positive territory for the year. Year to date the S&P 500 Index has recorded a 2.6% gain, however investors remained cautious during the quarter as concerns over a looming trade war with China and Europe dampened returns for global equities.

Small-cap equities benefited the most during the quarter posting a 7.8% gain as investors favored companies that may have less exposure to the trade and/or tariff debates.

Foreign equities did not fare as well during the quarter with major foreign indices all in retreat. Particularly hard hit was China which is now in bear market territory, defined as a 20% decline or more. Emerging markets, the best performing asset class in 2017, are now the worst performing year to date which are being weighed down by a deceleration in earnings growth, a strengthening U.S. dollar and a simultaneous tightening of liquidity conditions.

Master Limited Partnership investors finally received some much-needed relief during the quarter as investor sentiment turned positive and improving fundamentals coupled with compelling valuations helped bring the embattled sector to almost breakeven levels for the year.

Turning to the credit markets, bonds recorded mixed results for the quarter but remain in negative territory for the year. Rising short term interest rates and an increase in U.S. Treasury debt issuance continue to put downward pressure on bond returns for 2018. Particularly hard hit were investment grade corporate bonds, down -3.3% year to date, as spreads widen from historical lows and investors continue to reprice risk in the credit markets.

Global Economic Outlook

United States: Economic growth appears on track to record stellar performance in Q2, fueled by strong business investment, tax cuts and an ever-tightening labor market boosting consumer spending. In May, the unemployment rate hit a new low, and growth in retail sales accelerated as consumer confidence remained near a historic high. Furthermore, housing starts picked up in the same month, helped by rising wages and lower taxes boosting household incomes. Survey data for May indicates the private sector has so far been unfazed by current tensions with trade partners, although President Trump's rapidly escalating rhetoric vis-à-vis China in past weeks could prove damaging to business confidence. The month ahead might represent a critical junction, as new restrictions on investments between Chinese and American firms are set to be unveiled on 30 June, while reciprocal tariffs with China and retaliatory measures from Canada will take effect in early July.

Eurozone: Comprehensive data confirmed that the Eurozone economy lost steam in Q1, growing at the weakest pace since Q2 2016. The external sector was primarily behind the slowdown, with a strong euro and slowing global recovery fueling a decline in overseas sales. Data for Q2 suggests that momentum has regained some lost ground, although growth is likely still below last year's highs. The outlook for the Eurozone has turned gloomier in recent weeks. On 22 June, U.S. President Donald Trump threatened to slap a 20% tariff on all European Union manufactured automobiles if retaliatory tariffs on U.S. goods enacted by the EU were not lifted. While the U.S.'s initial tariffs on steel and aluminum are expected to have a relatively small economic effect, the automobile industry is a much larger sector and tariffs could dampen manufacturing activity.

Japan: Although the economy appears to be recovering from the soft patch in Q1, recent data suggests that the rebound will be weaker than expected. Despite remaining firmly entrenched in positive territory, the Q2 average for the manufacturing PMI was lower than in Q1, likely due to rising global trade uncertainty. Moreover, consumer confidence remains constrained by disappointing income growth. Export growth remained relatively robust in the first two months of Q2. However, rising trade protectionism in the United States, which enacted tariffs on aluminum and steel imports from Japan, and evidence that the global tech cycle likely peaked in Q1 pose downside risks to Japan's external sector.

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China: Economic growth moderated sharply in May, mostly due to tighter financial conditions as authorities continue to crack down on shadow banking and support financial deleveraging. Infrastructure investment, which is highly sensitive to new credit, led the fall in fixed asset investment growth. While manufacturing output slowed in May, activities related to the new economy—mostly high-tech—continued to post solid growth. After showing resilience for most of this year, consumption has now become a concern as retail sales growth fell to a multi-year low in May. While a decline in car sales represents the bulk of the deceleration, a further deterioration in retail sales could seriously hit growth in H2. The escalation in the trade war between China and the U.S. continued in June, with both countries targeting USD 50 billion in import tariffs. While the impact is expected to be rather limited, it represents another step towards a full-blown trade conflict.

Investment Strategy & Outlook

As we pause mid-year to reflect on market performance and provide an outlook for the second half, one key observation notably missing is the "synchronized global recovery" theme. Indeed, the first half of 2018 has been anything but synchronized with economic growth, capital markets and Central Bank policy all moving in different directions. In addition, conflicting views regarding the outlook for the aged global recovery have surfaced in currency, credit and global equity markets.

The U.S. Treasury yield curve continues to flatten, and corporate yield spreads are widening. Historically these patterns have presaged a contraction in economic growth and/or recession. In addition, global equity markets are diverging with U.S. markets taking the lead while European and Asian markets are in decline and China enters bear market territory.

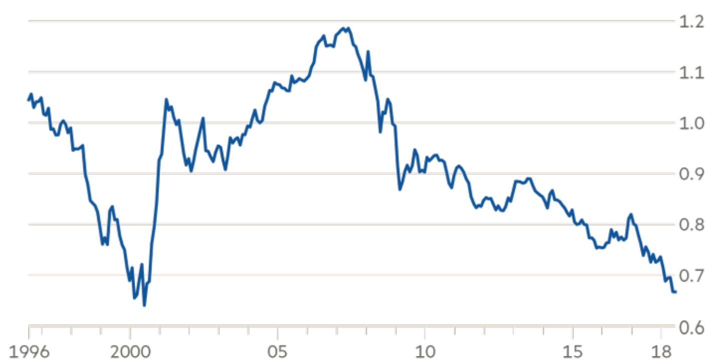
There are stark contrasts in global Central Bank policies with the Fed raising short-term interest rates while Europe and Japan remain on hold. Currency markets have reversed last year's trend with the U.S. dollar appreciating against most foreign currencies.

We believe the global recovery, now nine years old is entering a late cycle phase and the removal of Central Bank policy accommodation, while expected will likely create a headwind for financial assets. While we do not anticipate a recession in the next 24 months, security selection will be more important and valuation more in focus.

One area of extreme divergence has been the performance of growth stocks versus value stocks, such polarization is typical for a late stage bull market and brings back haunting memories of the late 1990's "dotcom" bubble. Specifically, the performance for a select few growth stocks, popularly known as "FANG" (FB, AMZN, NFLX, GOOGL) has reached extreme levels. The group has gained over 287% in the last 12 months and trades at 66 times next year's earnings! Indeed, value stocks are being shunned in favor of this elite group of stocks that appear to be immune to economic headwinds and competitive pressures. This narrowing of focus is never healthy and almost always ends badly.

Value relative to growth: the US

MSCI US value/MSCI US growth



Source: Arcus Investment
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The temptation to chase returns should be resisted at-all-times. While there are no short cuts to building wealth, there are numerous ways to quickly destroy it. Invest with a clearly defined goal, employ a simple and effective discipline and harness the power of compounding.....A portfolio of dividend growth stocks is a perfect solution!

Performance Scorecard

Benchmark Description	Q2	YTD
Barclays Aggregate Bond Total Return Index	-0.2%	-1.6%
S&P 500 Total Return Index	3.4%	2.6%
NASDAQ Dividend Achievers Select Index TR	1.1%	0.6%
Russell 2000 Index	7.8%	7.7%
Alerian MLP Total Return Index	11.8%	-0.6%
U.K. FTSE 100 Index (Price Only)	8.2%	-0.7%
German DAX Index (Price Only)	1.7%	-4.7%
China SCI 300 Index (Price Only)	-9.8%	-12.9%
Japan Nikkei 225 Index (Price Only)	4.0%	-2.1%
MSCI Emerging Markets USD Total Return	-7.9%	-6.5%

Performance Scorecard data as of 06/30/2018. Global economic outlook provided by Focus Economics. Stokes Capital Advisors, LLC is a Registered Investment Adviser. This market commentary is solely for informational purposes. Advisory services are only offered to clients or prospective clients where Stokes Capital Advisors, LLC and its representatives are properly licensed or exempt from licensure. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Stokes Capital Advisors, LLC unless a client service agreement is in place.