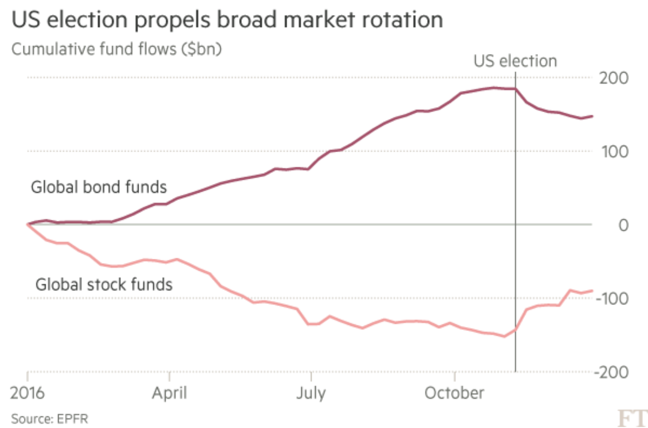
STOKES CAPITAL ADVISORS, LLC

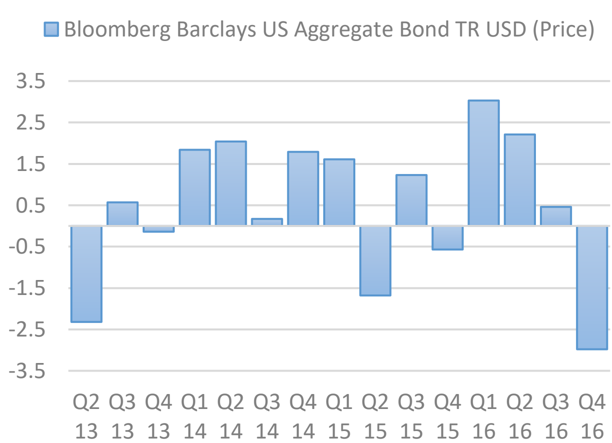
Market Commentary
December 31, 2016

Quarterly Market Review

Global equity markets finished the year on a positive note with investors abruptly reversing course and rotating out of bonds and into equities as Donald Trump was elected the 45th President of the United States. It was a bullish trifecta of an unexpected regime change in Washington advocating pro-growth policies and structural reform, a reversal of more than $150 billion that has flowed from equities to bonds and bullish end-of-year seasonal trading. Put it all together and you a “melt-up” in equities.



Bonds on the other hand witnessed a trifecta in the other direction with rising interest rates, mounting inflationary pressures and a tightening labor market pushed yields higher and bond prices lower for a -3.0% “melt-down” in the Barclays Aggregate Bond Index; The sharpest quarterly decline since the famed “taper tantrum” of Q2 2013.



Turning to global markets, European equities rallied off their lows from 3rd quarter as concerns over “Brexit” and the fate of the European Union took a temporary backseat to the European Central Bank’s ultra-accommodative monetary policy and attractive relative valuations found in select European equities. Asian markets finished the year with only modest gains with the MSCI AC ASIA Pacific Index recording a 2.3% gain.

Global Economic Outlook

United States: The signs of strength in the U.S. economy, as Donald Trump prepares to assume office, provide a strong contrast to the difficult context inherited by his predecessor, Barack Obama, who took office at the depths of the financial crisis. Trump has vowed to further boost U.S. growth to about 3.5% a year on average. However, Focus Economics analysts expect the boost that Trump can add to U.S. growth in 2017 and 2018 to be modest. They see GDP growth at 2.2% in 2017–up 0.1 percentage points from last month’s estimate and inching up further to 2.3% in 2018.

Eurozone: The common-currency region’s growth outlook improved by 0.1 percentage points this month and the Focus Economics panel sees GDP expanding 1.5% in 2017. A solid domestic economy should support the economy’s momentum, however, political risks are elevated in the face of a jam-packed election schedule next year. In 2018, the panel sees growth remaining stable at 1.5%.

Japan: An accommodative monetary policy and a weaker yen are expected to boost growth next year. That said, ambitious economic and social reforms are needed to ensure a healthier and more sustainable growth trajectory. The main downside risk to growth next year will be increased protectionism under Trump’s administration. Analysts see the economy growing 0.9% next year, which is up 0.1 percentage points from last month's projection. For 2018, they see growth at 0.8%.

China: The economy will moderate next year on the back of a cooling property market and a slow but steady domestic economic rebalancing, though the impact of these factors will be cushioned by policy support and stronger global growth. Focus Economics panelists forecast that the economy will grow 6.4% in 2017, which is unchanged from last month's estimate. In 2018, the panel expects GDP to slow to 6.1%.

Investment Strategy

For 2017, politics will likely be a major market driver and as with all political events, investors should avoid trying to predict their outcomes – A lesson learned from Brexit and the U.S. Presidential election. Instead, focus should remain on fundamentals and valuations which are at the core of any prudent investment management discipline.

We continue to favor U.S. equities given the fundamental and political backdrop. In addition, while improving US nominal economic growth and rising inflation warrant higher interest rates and removal of some policy accommodation from the Federal Reserve in 2017, we do not see these events necessarily as contractionary or headwinds for equities or for the overall economy. Indeed, keeping interest rates at the zero bound for almost a decade (a bold new experiment) has created distortions in financial asset prices and could prove to be deflationary and growth restrictive over the long run. Finally, the possibility of fiscal policy reform, less regulation, lower corporate tax rates and a pickup in inflation should provide a tailwind for equities.

Looking across the equity spectrum, small cap equities may continue their dominance as large cap multinational companies will likely face a headwind of currency translation brought on by a strengthening U.S. dollar. In addition, fiscal reform from Washington, while positive for many, will likely have a greater impact at the margin on smaller companies which received little or no assistance from the prior administration. Lastly, small cap equities have lagged large cap equities over the last three years by a significant margin and valuations remain attractive on a relative and forward looking basis.

From a sector perspective, financials and energy stocks have enjoyed an impressive run since the election as investors waged bets that the new administration will be more business friendly and unlock capital investment that has been stagnate for most of the decade. In addition, rising interest rates and a steepening yield curve should bode well for banks. For energy related names, OPEC's decision to cut production will likely place a floor on the price of oil in the mid to low $50's if not boost prices higher given steady global demand.

Health care stocks on the other hand were the dogs of the market last year with the sector recording a -4.4% decline. Concerns over regulation and price inequities have been launched from both sides of the political spectrum. In addition, the repeal and replacement of the Affordable Care Act casts a cloud of uncertainty over the sector as well. However, valuations for the sector remain attractive and many companies exhibit strong balance sheets, rising free cash flow and improving margins. Security selection will be critical.

Master Limited Partnerships or MLP's were our top pick for 2016. While the sector struggled during the first quarter, improving fundamentals, rising oil prices, attractive valuations and investor appetite for income created tailwinds for the mid-stream sector. For 2017, we believe these tailwinds remain in place. In addition, the new administration appears to be pro-energy which could increase project approvals and loosen regulations.

For bonds the outlook remains negative as a repricing of risk is underway. Investors should expect continued downward pressure on bond prices across the maturity spectrum as absolute returns remain challenged. In terms of strategy, we favor credit over sovereign debt as spreads continue to narrow in an improving growth environment and favor maturities inside 10 years.

Performance Scorecard

Benchmark Description	Q4	YTD
Barclays Aggregate Bond Index TR	-3.0%	2.6%
S&P 500 Total Return Index	3.8%	12.0%
NASDAQ Dividend Achievers Select Index TR	2.1%	11.9%
S&P Small Cap 600 Index	7.3%	19.9%
Alerian MLP Total Return Index	2.0%	18.3%
MSCI ACWI Ex USA Index (USD)	-1.3%	4.5%
U.K. FTSE 100 Index (Price Only)	3.5%	14.4%
China SCI 300 Index (Price Only)	1.8%	-11.3%
Japan Nikkei 225 Index (Price Only)	16.2%	0.4%

Performance Scorecard data as of 12/31/2016. 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.