STOKES CAPITAL ADVISORS, LLC

Market Commentary
September 30, 2017

Quarterly Market Review

The rally in U.S. equities continued during third quarter with the S&P 500, Dow Jones Industrial Average and NASDAQ all posting record highs while shrugging off increasing geopolitical tensions with North Korea, two devastating hurricanes and a more “hawkish” Federal Reserve announcing plans to reduce it’s $4 trillion balance sheet as part of its path toward policy normalization.

Underpinning the now eight year old bull market for equities are several factors, including solid earnings growth, steady global economic growth, low inflation and low interest rates/bond yields. Indeed, a synchronized global expansion has provided a steady backdrop with sentiment heavily tilted toward risk assets.

Foreign equities added to their gains during the quarter as well and continue to benefit from a declining U.S. dollar, improving economic data and attractive valuations relative to U.S. equities. However, during the quarter, equities in the U.K. and Japan lagged the U.S. and much of the world as the U.K. faces late cycle pressures and Japan’s fiscal reform and indebtedness create a cloud of uncertainty.

Turning to bonds, fixed-income securities recorded muted returns for the quarter as investors evaluated the “hawkish” comments from the Federal Reserve and the poor risk/reward characteristcs bonds historically exhibit in a rate rising environment. However, this did not deter investors need/desire for income with investment grade corporate bonds and high yield debt outperforming the broader bond market for the quarter.

Oil enjoyed a dramatic reversal during the quarter with Brent Crude recording a 20% gain closing at $57 and West Texas Intermediate or WTI gaining 12% to close at $52 per barrell, roughly the price recorded at the beginning of the year. Increased global demand, storage draw downs and a decline in global supply all provided support for the “black gold”. Gold headed sharply higher during the quarter but finished realtively flat. The precious metal has managed to log a 12% gain for the year.

Lastly, once again volatility was absent from our quarterly observations with the CBOE VIX recording all time lows. The last time the S&P 500 Index recorded a 2% daily delcine was September 9th, 2016. In addition, trading volumes have been below average for much of the summer.

Global Economic Outlook

United States: The economy is already grappling with the adverse effects of Hurricanes Harvey and Irma, which analysts expect to exert around half a point of drag on Q3 growth. Leading data has begun to show the extent of Harvey’s impact, with both industrial output and retail sales recording bleak performances in August. However, economic growth is expected to recover next quarter due to rebuilding activity and new purchases made to replace lost goods, with $15.3 billion in hurricane relief already approved by the Senate. In the fiscal policy arena, Congress reached a deal in early September to increase the debt ceiling and extend government funding for three months. With these short-term hurdles cleared, analysts now expect the Congress and administration to focus on tax reform, which could provide a boost to growth next year.

Eurozone: Comprehensive GDP data confirmed that the Eurozone’s recovery continued in the second quarter of 2017, supported by both robust domestic demand and the external sector. Positive tailwinds from a stronger labor market, upbeat sentiment and a healthier global backdrop led to buoyant growth in the quarter. Incoming data for Q3 points to a continuation of firm activity. Industrial production rebounded in July, economic sentiment rose to an over 10-year high in August and the composite PMI increased in September. However, the euro has appreciated notably this year and recent figures suggest that its strength could be taking a bite out of overseas sales: The trade surplus narrowed more than had been expected in July.

Japan: Following a slowdown in private non-residential investment, growth in the second quarter was revised down to 2.5% in seasonally-adjusted annualized terms, significantly below the 4.0% figure reported in a preliminary estimate. Despite this revision, the print marked the fastest expansion since Q1 2015 and puts the economy on a steady track to recovery. The latest data suggests that healthy growth is being sustained in the third quarter. Machinery orders rebounded in July, and exports had the fastest pace of expansion in almost four years in August. Strong economic momentum and a splintered opposition compelled Prime Minister Shinzo Abe to hold snap elections on 22 October in a bid to consolidate his grip on power. Unlike in previous elections, the prime minister is not expected to postpone an unpopular 10% sales tax hike projected in 2019 to lower astronomical public debt, despite the adverse effects it could have on private consumption and economic growth.

China: Recent data points to easing momentum in China's economy, following buoyant growth in the first half of the year. While the incoming data suggests that growth has peaked and entered a downward trajectory in H2, the downturn is likely to be modest overall as government spending should prevent a sharp slowdown. Meanwhile, all eyes are on the government's 19th National Congress of the Communist Party on 18 October. Five of the seven members of the standing committee are due to retire, and their replacements will help shape the future of China's policy. President Xi Jinping will also lay out the party's priorities for the next five years.

Investment Strategy

The synchronized global expansion and extreme central bank policy accommodation has provided a very fertile ground for investors. Indeed, record low borrowing costs, low inflation and steady global growth have re-inflated financial assets to record highs amid record low levels of volatility. However, firming inflation and improved global growth have given the Federal Reserve confidence to continue gradually hiking short-term interest rates. Meanwhile, a disconnect has emerged with the market's rate-hike expectations remaining well below the Fed's projections, which has the potential to boost market volatility.

In addition, geopolitical risks have increased and Washington continues to grapple with fiscal reform: Both will likely be key market drivers over the near term. Other potential market drivers could be a recession scare or an inflation scare that sends interest rate expectations significantly higher. Both seem unlikely in the near term, although we believe fixed income markets seem to be underestimating the potential for U.S. inflation pressures and Fed rate hikes in 2018. Offsets to these risks could be better than expected earnings growth, delays in central bank tightening and improvements in global economic conditions.

Essentially, investors face a conundrum: The world is experiencing a record synchronous growth phase, but an increasing number of assets are becoming overvalued just as fundamental risks lurk in the background. Indeed, navigating this environment is no easy challenge. First, investors should avoid the most overvalued assets, where irrational behavior is evident. Long duration, sovereign debt is at the top of the list. Second, you should consider what's unloved and still relatively inexpensive, our favorite continues to be MLP's. Valuations are attractive on almost every metric, fundamentals are improving and they are by far the most "unloved" sector in the market.

Finally, the start of 4th quarter marks the 10-year anniversary of the last bull market top for the S&P 500 Index which was October 9, 2007. Since that time investors have travelled across a wide range of peaks and valleys the likes of which have not been witnessed since the Great Depression. If you had the fortitude and discipline to stay the course over the decade you would have doubled your money, recording a 100% gain. In addition, over the 10-year period, dividends accounted for over 40% of this return. Proof once again that dividends are an important component to stock returns and investors should not attempt to time the market.

Performance Scorecard

Benchmark Description	Q3	YTD
Barclays Aggregate Bond Total Return Index	0.7%	3.1%
S&P 500 Total Return Index	4.5%	14.2%
NASDAQ Dividend Achievers Select Index TR	2.8%	13.1%
Russell 2000 Index	5.7%	10.9%
Alerian MLP Total Return Index	-3.1%	-5.7%
MSCI ACWI Ex USA Index (USD)	6.1%	20.1%
U.K. FTSE 100 Index (Price Only)	0.8%	3.2%
China SCI 300 Index (Price Only)	4.6%	15.9%
Japan Nikkei 225 Index (Price Only)	1.6%	6.5%

Performance Scorecard data as of 09/30/2017. 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.