STOKES CAPITAL ADVISORS, LLC

Market Commentary
June 30, 2016

Quarterly Review

The surprise decision from a referendum in the U.K. to exit the European Union, or "Brexit" triggered a global selloff among risk assets during the quarter while safe haven assets benefited from renewed uncertainty surrounding the global economy and the risk of recession in the U.K. Indeed, the initial market reaction sent global equity markets sharply lower however investors changed course during the final days of the quarter as questions surfaced about the impact "Brexit" would have on the Eurozone and the global economy. In addition, expectations for more stimulus from Central Banks in Europe and a likely pause from future Federal Reserve interest rate hikes quelled investor fears.

Global bond yields declined to record lows in Europe as a flight to quality theme permeated credit and currency markets alike. Safe haven currencies such as the U.S. Dollar, Japanese Yen and Swiss Franc all appreciated while the Euro and British Pound Sterling declined to lows not seen in decades. In the wake of all the chaos, investors grappled with negative sovereign bond yields with 10 year German Bunds dropping to -.14%, Japanese 10 Year fell to -.23% and the Swiss 10 year bonds touching -.60% levels. By comparison, the 10 Year U.S. Treasury yield finished the quarter at 1.49%.

Why would any savvy investor, hedge fund, central bank, pension fund or otherwise, invest in a bond that pays you nothing or worse you receive less than what you invested you may ask? Many institutional investors have strict investment policies or limitations and can only invest in these securities. Some investors are currency speculators, attempting to purchase in one currency and convert to another in hopes the translation will result in a positive return. Others are simply fearful and are willing to accept a negative return for safety. Then there are those that are concerned about the threat of global deflation. This investor believes that disinflationary forces will override Central Bank re-inflation policies/programs and thereby yield a positive real return in the future. At this point the outcome for these bond investors is difficult to predict and the so-called risk free return may indeed be an unprecedented negative value for the foreseeable future.

So what is the bond market telling us about the outlook for the global economy? For sure, negative bond yields do not project a pickup in inflation or economic growth and central bank tightening seems doubtful in the near future. So while equity markets have rallied in recent months, bond yields have stagnated or dipped to historically low levels; Is this a disconnect that is sending conflicting forecasts about the global economy or is this the new normal we have inherited as the global capital markets continue to deleverage and recover from the Great Recession while the Central Banks remain the "only game in town"?

Global Outlook

Without question Brexit has created a cloud over the outlook for the U.K., the second largest economy in the EU. In addition, Britain under new leadership, must now carefully renegotiate terms with EU leaders while navigating a possible referendum in Scotland and other EU member nations. A daunting task for any administration. As such, the European Central Bank will remain accommodative for the foreseeable future with real economic growth rates in the 1.0 – 1.5% range for the EU.

The current expansion in the U.S. is over seven years old and the economy continues to grow but at a sluggish 2.0 – 2.5% annual growth rate. Inflation remains below the Federal Reserve target of 2.0% and job growth stagnate. Improvements in household incomes, consumer spending and housing have been recent bright spots for the U.S. economy of late. However, the outlook remains uncertain and susceptible to shocks such as Brexit. As a result, the Federal Reserve may hold off on raising short term rates for the remainder of 2016 and look for possible rate cuts should conditions erode.

The strong dollar remains a significant headwind for emerging markets and could pressure China's central bank to devalue the renminbi. For now, capital outflows have abated and China appears to be managing the challenges of rebalancing its economy toward domestic demand and consumption. Economists forecast that the economy will expand 6.5% for 2016 and 6.3% for 2017.

The United Kingdom's vote for Brexit strengthened Japanese yen to levels not seen since early 2014, which adds pressure to Japan's fragile economic recovery and paves the way for further policy stimulus. While a strong yen and weak global demand are weighing on growth this year, Prime Minister Abe's decision to postpone the sales tax increase will slightly boost the Japanese economy next year. Nevertheless, the absence of deep structural reforms will continue constraining Japan's potential growth. Analysts see the economy growing 0.6% for 2016 and 0.8% GDP growth for 2017.

Investment Strategy

Our asset allocation continues to favor equities over bonds with portfolios at the midpoint of their respective investment policy ranges. Our strategic equity allocation is overweight large cap dividend growth stocks and underweight foreign equities. Small cap equities were reduced to a neutral weight during the quarter given stretched valuations and the aging U.S. economic cycle.

Energy Master Limited Partnerships remain our favorite sector theme for the remainder of 2016. While MLP's enjoyed a strong rally during the quarter, valuations are only halfway back to where they were two years ago. In addition, the low yield environment and investor desire for income makes the MLP asset class attractive on an absolute and relative basis.

Bond portfolios are overweight investment grade corporate bonds with an average maturity of five to seven years. We see this segment of the yield curve providing the most attractive risk/reward. While the recent rally in U.S. Treasury securities raises valuation concerns, when compared to other aforementioned sovereign debt yields, U.S. Treasury securities remain attractive on a relative basis.

Performance Scorecard

Benchmark Description	Q2	YTD
Barclays Aggregate Bond Index	2.2%	5.3%
S&P 500 Index	1.9%	2.7%
NASDAQ Dividend Achievers Select Index	3.1%	8.3%
S&P Small Cap 600 Index	0.7%	6.3%
Alerian MLP Index	17.4%	9.8%
MSCI ACWI Ex USA Index (Net)	-0.7%	-0.9%

Performance data as of June 30, 2016.