STOKES CAPITAL ADVISORS, LLC

Market Commentary
September 30, 2018

Quarterly Market Review

U.S. equities recorded the best quarterly result in over five years with the S&P 500 Index rising 7.7% for Q3 lifting markets to fresh record highs as strong quarterly earnings and improving economic conditions offset the headwinds of trade tensions, rising interest rates and geopolitical uncertainty.

Small-cap equities added to their strong year to date performance during the quarter but finished below their record high in September. Small-cap earnings are less exposed to negative currency translation and the potential headwinds from the ongoing tariff discussions.

Foreign equities recorded declines across most regions during the quarter as trade war tensions heat up and economic growth in most developed economies lag the U.S. expansion. Indeed, there are stark contrasts in capital market returns between U.S. and developed foreign markets. Since January 2016, U.S. equites have gained more than 50% while the U.K. and Germany are up 20% and 14% respectively. Emerging markets, which are more sensitive to moves in currencies and short-term interest rates, have lagged the U.S. markets by 15% in the last 12 months.

Brent crude oil is up 23% year to date crossing $80, a level not seen since November 2014. Relatively stable inventory levels and healthy demand is expected to keep prices in $72 to $76 range through the end of 2019 according to EAI.

Master Limited Partnerships gained 6.6% for the quarter bringing the asset class to positive returns for the year. While structural changes, capital allocation decisions and regulatory uncertainty has checked investor optimism recently, fundamentals are improving and the long-term outlook for the group remains positive.

Turning to the credit markets, bonds continued their decline during the quarter with high yield bonds providing the only respite. The Federal Reserve has now raised rates eight times since the normalization process began in February 2016 bringing the 2year Treasury to 2.8%, a level not seen in over a decade. As we enter Q4, bond yields continue to move higher as strong employment data clear the path for future Fed rate increases.

Global Economic Outlook

United States: The economy continues to fire on all cylinders in the third quarter, after growth hit a near four-year high in Q2. Industrial production and ISM survey data for July and August show the manufacturing sector kept running at full capacity. Job creation also remained robust in the same two months, while wage growth accelerated and consumer confidence hit an 18-year high in August, boding well for private consumption despite softening August retail sales. Although headwinds are rapidly mounting with the recent announcement of tariffs on USD 200 billion of Chinese goods, growth in Q3 might benefit from front-loading effects in September and from a replenishment of inventories depleted in Q2.

The near-term outlook remains bright thanks to buoyant activity, tax-cut effects and large federal spending increases expected throughout H2 2018. Looking further ahead, however, growth is likely to dampen in 2019 and beyond as tax-cut effects fade while inflation and interest rates continue rising. The now full-fledged trade war between China and the U.S. is the main downside risk, which could strike a heavy blow to both consumer spending, as well as to business investment and economic momentum amid heightened uncertainty. Economists see GDP expanding 2.8% in 2018 and 2.5% in 2019.

Eurozone: Comprehensive data showed slower, but stable, growth in the Eurozone throughout the first half of the year, with second-quarter growth confirmed at a seasonally-adjusted 0.4% quarter-on-quarter. As feared, external-sector dynamics dragged on growth as exports continued to underwhelm amid this year's slump in global trade. Meanwhile, lower composite PMI readings and waning industrial metrics point to slack in the economy that could be exacerbated by the pullback in global demand and uncertainty over the Eurozone's trade relationship with the United States. In late September, the prospect of a chaotic, no-deal Brexit grew following an informal summit in Austria, in which a number of the UK's proposals were dismissed by the bloc's leaders as unworkable.

A lower cruising speed is expected next year as moderate wage growth and slower employment gains run up against higher inflation. That said, the outlook for investment looks bright amid the prospect of still-accommodative interest rates. Meanwhile, geopolitical uncertainties are expected to keep weighing on external trade and the firming of the euro is seen hitting exports. Economists project growth of 2.1% in 2018 and 1.8% in 2019.

Japan: Economic growth will remain broadly stable next year mostly propelled by solid domestic demand. An ever-tighter labor market is expected to fuel wage growth, while industrial upgrades and the 2020 Tokyo Olympics will bolster investment. Risks mostly stem from rising trade protectionism, slow global economic growth and drag from a planned sales tax hike in October 2019. Economists see the economy growing 1.0% in 2018 and 1.1% in 2019.

China: The Chinese economy held up well in August despite escalating trade tensions with the United States and a cooling domestic economy. Ongoing trade disputes with the United States worsened on 17 September following U.S. President Donald Trump's decision to impose a 10% tariff on USD 200 billion of Chinese imports, effective 24 September, which will be increased to 25% on 1 January 2019. Moreover, Trump warned that his administration will impose tariffs on USD 267 billion of additional imports if China takes retaliatory action. Against this backdrop, China will likely reject new trade talks by the U.S. administration. In addition, while China will ultimately run out of U.S. imports to target, the Chinese authorities are also expected to retaliate with other measures on top of the tariffs. This could take the shape of additional trade barriers against the U.S. through the imposition of export restrictions.

Despite mounting economic headwinds, the Chinese economy is expected to comfortably meet this year's growth target of 6.5%. A full-blown trade war with the United States, a sudden slowdown in the property market and potential corporate defaults are the main downside risks to China's economic outlook. Stronger-than-expected policy support, however, could push GDP higher in the coming quarters. Economists see the economy growing 6.6% in 2018 and 6.3% in 2019.

Investment Strategy & Outlook

September 15th, 2018 marked the 10 year anniversary of the collapse of Lehman Brothers and the darkest days of the 2008 financial crisis. The events that unfolded post Lehman prompted an unprecedented rescue of the banking system by global central banks. These actions created a decade long run of negative real interest rates punishing savers and forcing investors to take on risk in the quest for positive real returns.

Clearly, stock holders were the big winners of such historic policy actions leading to a bull market that is now the longest on record at 3,495 days and surpassing the 1990-2000 record run. Since the 2008 recession low, the S&P500 Index is up 420%, Corporate profits have climbed 137%, household balance sheets have doubled, initial jobless claims reach 50 year lows, inflation appears contained and economic growth is picking up. However, there are unintended consequences from the central bank experiment also known as "Quantitative Easing": The rise of populism and wealth inequality, massive central government deficits and swelling sovereign indebtedness to mention a few.

There are investment implications as we transition from extreme policy accommodation. Asset bubbles are starting to appear, valuations look stretched and are in greater focus, global capital markets diverge, and a de-synchronization of central bank policy create episodes of market volatility. In my opinion, this will create investment opportunities for active managers.

So now a decade later, the Fed begins the transition from extreme policy accommodation to searching for a neutral policy where the Central Bank is neither accommodative nor restrictive. Historically, a very difficult task. In my opinion, a policy error is one of the greatest risks to the global recovery and may signal an end to the record run in equities. Bringing the lens closer in, rising bond yields with tightening labor markets and a pickup in inflation are likely catalysts for near term market volatility.

Performance Scorecard

Benchmark Description	Q3	YTD	1 Yr.
Barclays Aggregate Bond Index	0.0%	-1.6%	-1.2%
S&P 500 Index	7.7%	10.6%	17.9%
NASDAQ Dividend Achievers Index	9.5%	10.2%	19.1%
Russell 2000 Index	3.6%	11.5%	15.2%
Alerian MLP Index	6.6%	5.9%	4.9%
U.K. FTSE 100 Index	-1.9%	-2.6%	3.1%
German DAX Index	-1.0%	-8.3%	-6.2%
China SCI 300 Index	-4.6%	-17.5%	-11.6%
Japan Nikkei 225 Index	6.2%	6.9%	19.7%
MSCI Emerging Markets USD	-0.9%	-7.4%	-0.4%