STEWARDSHIP PARTNERS MARKET COMMENTARY

QUARTERLY COMMENTARY | VOLUME 16 ISSUE 3 | OCTOBER 2016

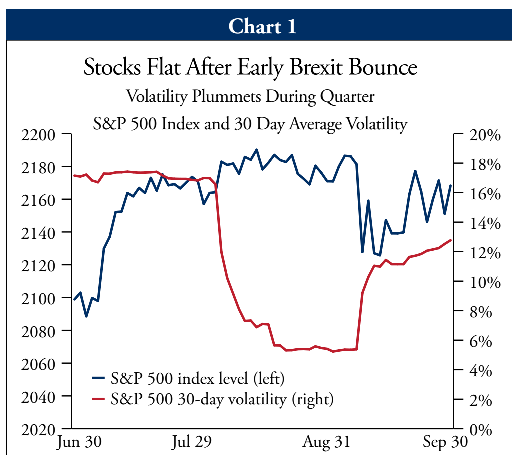
Authored by Howard J. "Rusty" Leonard, CFA
CEO and Chief Investment Officer, Stewardship Partners Investment Counsel, Inc.

Riskiest Assets Perform Best in Third Quarter of 2016 - Sign of a Top?

"The tree grew large and strong and its top touched the sky; it was visible to the ends of the earth." Daniel 4:11

In this age of massive central bank intervention in financial markets, negative interest rates and other market distortions created by various forms of aggressive, short-term trading, it has become normal for every quarter's performance results to contain many oddities. 2016's third quarter performance results were no exception. Despite growing risks from another potential European banking crisis, highlighted by growing concerns over both Deutsche Bank and the Italian banks, the global markets managed to turn in positive returns during the quarter (Table 1). In the US, however, all of those gains came in the first two weeks of the quarter as the markets quickly recovered from the Brexit sell-off at the end of the second quarter. After that initial move higher US equities proceeded to move sidewards throughout August with almost no volatility (Chart 1). Indeed, measures of share price volatility plumbed record lows in the middle of the quarter. Volatility picked up in September due to rising concerns about the weakening European banks as well as the possibility the Fed might raise interest rates. After a small sell-off, one which seemed too small considering the risks, the market rebounded, moving back towards the highs reached earlier in the quarter. Despite growing concerns about the market's advance, risky stocks were among the best performers during the third quarter. Banking, Brazilian, Greek and Russian shares rose the most. High yield bonds, the riskiest fixed income category, also performed well. Given the potential threats to economic growth and financial stability, speculators pursuing riskier assets seemed unwise. This type of speculative behavior is common at the end of a bull market. With this bull market already being the second longest ever, the odds are rising we are already near the end of this long, central-bank-assisted upturn. Rising concerns central banks may run into practical limits to their financial market interventions could also contribute to increasing investor fear about the potential end of the current bull run. More importantly, it could lead to a potentially violent negative reaction in stock and bond prices should this nascent worry gain credibility in the minds of investors.

Chart 1



Source: Bloomberg

Table 1

3Q16 Total Returns

US Indices	3Q16	YTD	5y ann
S&P 500	3.9%	7.8%	16.4%
S&P 500 Value	2.9%	9.4%	15.9%
S&P 500 Growth	4.8%	6.4%	16.8%
NASDAQ	10.0%	7.1%	18.5%
S&P 400 (Mid Cap)	4.1%	12.4%	16.5%
S&P 600 (Small Cap)	7.2%	13.9%	17.9%
Treasury Bonds	-0.3%	5.1%	2.2%
High Grade Corp. Bonds	1.4%	9.2%	5.1%
High Yield Corp. Bonds	5.6%	15.1%	8.3%
Gold	-0.5%	24.0%	-4.1%
Global & International Indices			
MSCI World	4.9%	5.6%	11.6%
MSCI EAFE	6.4%	1.7%	7.4%
MSCI Euro	7.3%	-0.6%	7.3%
MSCI Far East	8.6%	3.8%	7.7%
MSCI Japan	8.6%	2.5%	7.4%
MSCI Emerging Markets	9.0%	16.0%	3.0%
US Economic Sectors			
Energy	2.3%	18.7%	6.0%
Materials	3.7%	11.4%	12.7%
Industrials	4.1%	10.9%	17.5%
Consumer Discretionary	2.9%	3.6%	20.1%
Consumer Staples	-2.6%	7.6%	15.4%
Health Care	0.9%	1.4%	20.0%
Financials	4.6%	1.4%	17.4%
Information Technology	12.9%	12.5%	18.1%
Telecom	-5.6%	17.9%	12.3%
Utilities	-5.9%	16.1%	12.1%

Source: Bloomberg

For many years now, the policies of the world's central banks have been the key factor directing the financial markets. The Fed ceased its QE program some time ago but extremely aggressive market interventions by the Euopean Central Bank (ECB) and the Bank of Japan (BOJ) and other central banks have more than compensated for the recent lack of Fed finacial market interventions. Corporate earnings have been weak for some time all across the globe, but demand for financial assets from central bankers and the low, or even negative, interest rates their actions created influenced equities to advance to new highs. Essentially, central bank actions, compounded by major investors following their lead, have stripped the financial markets of their normal ability to periodically correct excesses, thereby creating new, longer term, risks. Central bankers hoped to eliminate risk for investors thereby creating an economic environment where economic growth could thrive. Unfortunately, risk cannot really be eliminated, just moved around. If that is true, the risk the central banks absorbed with their interventions will some day need to be transferred back to the financial markets. As we have noted in the past, it is easy for the central banks to send the markets soaring higher, but much harder for them to "stick the landing" when the asset buying ceases.

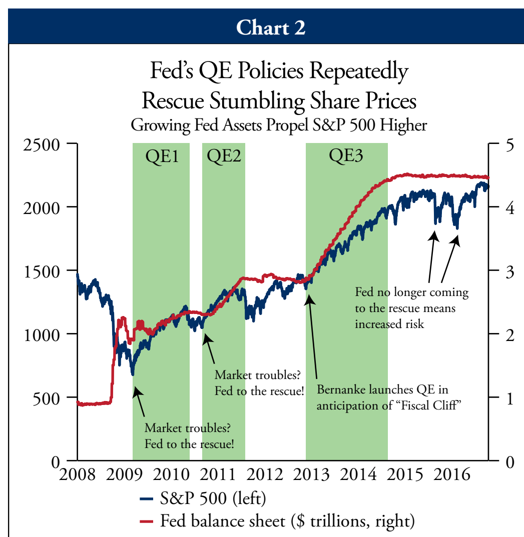
Stewardship Partners was blessed to perform so well in the first half of 2016 we decided to significantly de-risk our portfolios during the second quarter. At the end of July, we further de-risked and went into a full defensive mode. Our objective was to limit volatility and to preserve the very strong returns already gained, which we largely achieved. We don't believe risk from central banks unwinding their market accomodations is imminent, but we are concerned the markets have already started to begin worrying about this issue. Given our enviable performance so far in 2016, we remain content to be defensively positioned. We have greatly reduced the risk of our portfolios to a market fall and are positioned in several stocks we believe have unusually good short term growth prospects (although success cannot be guaranteed).

Central Banks Coming to End of Ability to Intervene in Markets?

"Pride goes before destruction, a haughty spirit before a fall." Proverbs 16:18

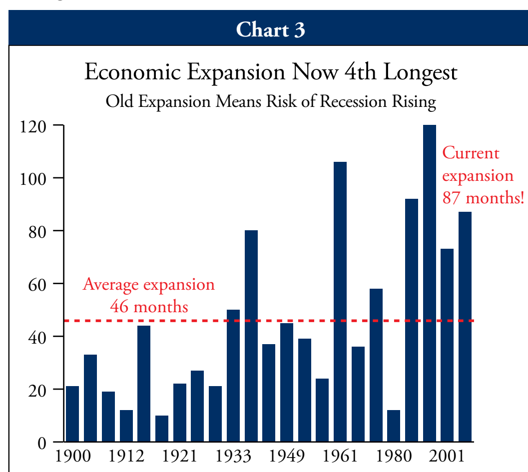
The 2008 "Great Recession" was a very serious event for the financial markets which could easily have led to years of economic malaise. Thankfully, the Federal Reserve was quick to recognize the dire implications for the global economy and responded with appropriately aggressive monetary accommodation. Other central banks eventually recognized the need to respond in like manner. As a result, the "Great Recession" never turned into the second "Great Depression". Since 2008, global economic growth has been tepid at best, but at least it has been positive. At the same time, deflation has been a constant threat and the initial accommodative policy responses had to be extended again and again (see QE1, QE2 and QE3 in Chart 2) in order to keep financial markets from falling. By late 2014 in the US, however, the financial system and the economy had recovered sufficiently that the Fed was finally able to at least halt its QE efforts.

Chart 2



Source: Bloomberg

Chart 3



Source: NBER

Reflecting the impact of the Fed's QE policies on the markets, the S&P 500 has failed to make any significant progress since the Fed balance sheet stopped growing. To be sure, the Fed's QE policies did help avoid a potentially devastating deflationary economic spiral and created one of the longest, if not weakest, economic recoveries in history (Chart 3). Even so, these same policies unnaturally propped up bond and equity prices. While this was certainly not a bad outcome in some respects, as higher financial asset prices further encouraged economic growth, it clearly hindered the normal role of the financial markets in resolving previous economic imbalances. Worse, it also created plenty of new economic and market imbalances which will need to be dealt with in the future. Furthermore, it also contributed greatly to income and wealth inequality which has, and continues to have, negative social and political reverberations. The aggressive actions of the world's central banks initially avoided truly ugly economic outcomes by shifting risk from the markets to the central banks. While the US economy has recovered sufficiently that the Fed has been able to begin normalizing policy, it still has a long way to go, particularly with regard to returning interest rates to a typical level. Foreign economies are not so far advanced in their economic healing and still require extensive monetary support from their central banks. Central bankers will need quite a deft touch to properly calibrate their exit from the policies they embraced over the last eight years in order to avoid roiling the global financial markets. It is hard to imagine there will not be some serious bumps in that road to monetary policy normalcy.

It seems to Stewardship Partners the financial markets are just beginning the process of assessing the ability of the world's central banks to "stick the landing". Given the central banks have been unwilling or unable to articulate a coherent plan of slowly stepping out of the highly distorting role they have played in the financial markets for the better part of a decade now, investors have every reason to be anxious. The world's largest hedge fund, Bridgewater, has calculated that if the ECB, for example, simply continued down its current policy path, it would run out of available assets to purchase in just eight months (Table 2). With Europe's economy hardly out of the economic woods yet, the financial markets are bound to react negatively if this were to come to pass so quickly. The ECB has some options to extend its QE as noted in the table and we suspect they will embrace one or more of these options over time, thereby avoiding disrupting the financial markets in the short term. To say we are highly confident this will happen, however, is an overstatement. Getting anything done in Europe, where there are so many competing interests affecting policymaking, is difficult. Therefore, there is a risk the European markets will get more volatile in the months ahead as these interests vie to influence the future direction of the ECB's QE efforts. In Japan, because the Bank of Japan's QE program already is hyper-aggressive in terms of scope, there are 28 months remaining before the buying would come to a sudden stop.

Table 2

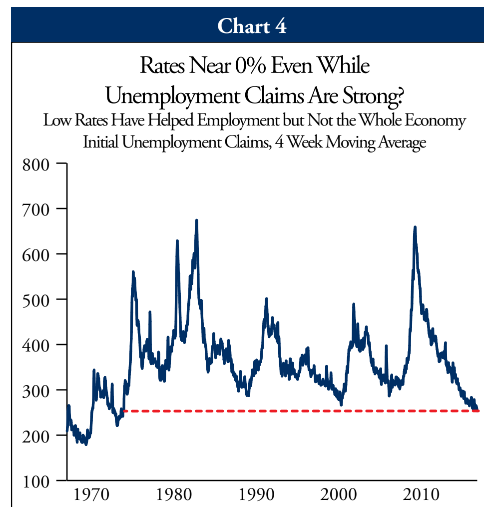
Impending Limits On Continued ECB QE
Currently Buying €80 Billion Bonds per Month

Levers to Extend QE:	Add'l Months of QE	Est Months of QE Left
Current program (none)	-	About 8
Broke capital key, buying 1/3 of all eligible bonds	+8	16
Also bought more corporate bonds (€25bln/month)	+6	22
Also bought bonds with yields below the deposit rate	+6	28
Also raised the cap of gov't bonds to 50%	+15	44
Also purchased any corporate bond and reached their buying limits across bonds	+14	57
Also bought 20% of the equity market	+11	68

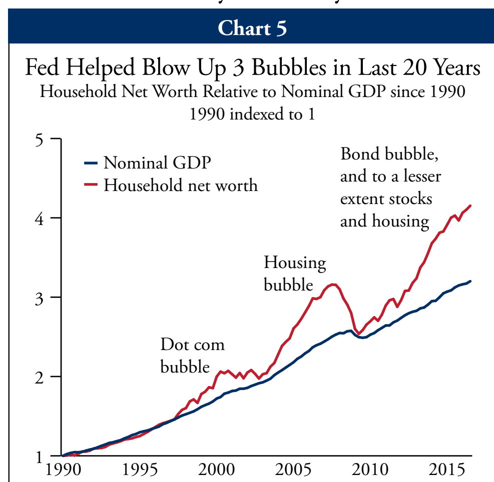
Source: Bridgewater

There is also some concern central bankers have become addicted to their ability to "play God" in the financial markets. QE1 started innocuously enough as it seemed like a sensible and creative policy maneuver given the implications of Lehman's demise and the crash of 2008. While the Fed has

weaned itself off QE programs, Chairwoman Yellen has openly speculated recently about the future need to change the laws so the Fed could buy corporate bonds and stocks, as well as government bonds, much like the ECB and the Bank of Japan are already doing. For now, however, the biggest debate at the Fed is whether or not to raise interest rates again. With economic growth still quite low, some Fed governors, as well as the markets themselves, believe the Fed should leave interest rates at their currently historically low levels. Others, however, are concerned the Fed is already well behind the curve and continued low interest rates could soon unleash a significant inflation threat. One of the more remarkable economic juxtapositions currently is ultra-low interest rates versus the strength in the employment market. As seen in Chart 4, weekly unemployment claims have strengthened to the point where they are now at levels last seen in the early 1970's when the US economy was much, much smaller than it is now. On the other hand, this remarkable distortion in economic indicators also reflects that, despite a strong employment market, overall economic conditions remain weak enough to have not yet set off inflationary alarm bells. The Fed itself is confused by these developments and an indecisive Fed does not inspire investor confidence.



Source: FRED



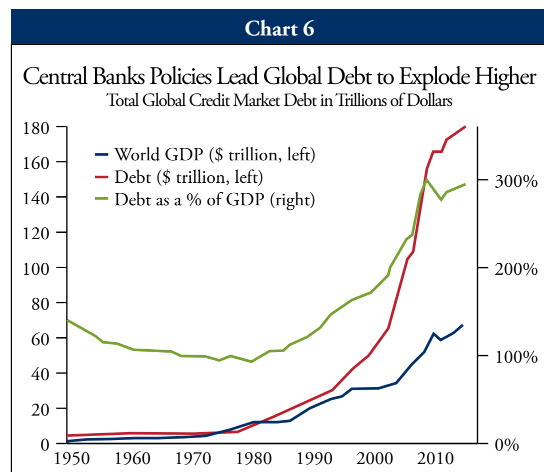
Source: Bloomberg

In Stewardship Partners' view investors should be wary of future central bank policy changes. In the last 20 years financial market bubbles have been heavily impacted by Fed policy mistakes. Prior to that time, the net worth of US households tracked pretty closely with nominal GDP in the US. Then, the Fed became complicit in creating economic bubbles as seen in Chart 5. Greenspan's Fed said they were not able to identify a stock market bubble and kept policy too loose for too long thereby greatly contributing to the dot-com bubble. Bernanke also kept Fed policy too loose for too long leading to the housing bubble. Yellen's Fed has clung to its extraordinarily accommodative policy for a considerable period and has been joined with significant gusto by the ECB, Bank of Japan and Bank of China, thereby creating another bubble in bonds and to a much lesser extent in stocks and housing. As the bond bubble in particular deflates, there will be many important implications for investors.

Central Bank Induced Global Debt Explosion Poses Rising Danger

"Let no debt remain outstanding, except the continuing debt to love one another ..." Romans 13:8

Given it is election season in the US, there has been the usual increased focus in political advertisements and commentary on the growing US national debt. Republican candidates typically use the nearly $20 trillion gross national debt and the near doubling of that amount on President Obama's watch as a blunt instrument against their opponents as often as they can. Naturally, given the sheer size of the debt, voters and investors alike can get alarmed by the potential for disaster. Clearly, the US would be better off if it had no debt at all, but these claims of impending doom surrounding the national debt, whether made by politicians or television gold salespeople, are misplaced. First, a sizable portion of that nearly $20 trillion in debt is owed by the government to itself. After cancelling that amount out, the net debt is a very manageable 70-75% of US GDP. Moreover, this percentage is not expected to rise very much in the next several years. From the standpoint of the financial markets, the situation with the US national debt, absent the possibility of a new and deep recession, is not considered a serious threat to overall economic prosperity or stock and bond prices anytime soon. It may not be until the middle of the next decade when the national debt will become a meaningful investment issue for investors given current trends. On the other hand, investors should be much more alarmed by the extremely rapid rise in the combined debt of individuals, corporations and countries when viewed in a global context. Chart 6 highlights the recent exceptionally fast growth in the total amount of debt around the globe. This extended global debt situation could easily cause turmoil for the financial markets should future economic developments unfold in a more negative fashion then currently assumed.



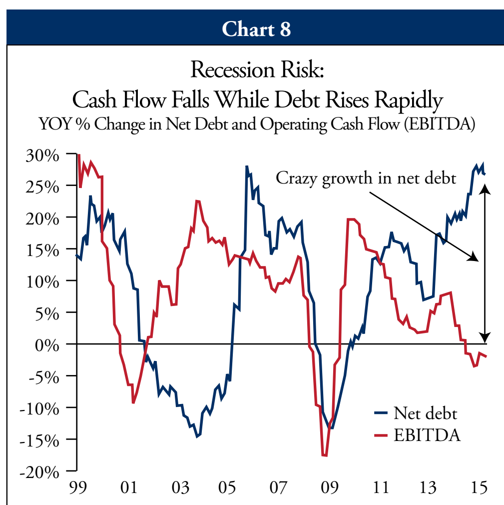
Source: US Federal Reserve, BIS, Economist, World Bank

As we noted earlier, the current US economic recovery, while shallow, has still been one of the longest on record, thereby increasing the risk of economic imbalances which could lead to a recession before too much longer. Furthermore, the distortions caused by unusually low interest rates and highly accommodative central bank policies have created new economic

and financial market dislocations. While much of the increased debt around the world has come from outside the US, the US non-financial sector has also seen its debt rise to the record high as a percent of GDP last seen during the aftermath of the 2008 crisis (Chart 7). While this certainly is no guarantee of an imminent recession, like so many other indicators, it is telling us we are much closer to a potential recession than we have been in the past. Accordingly, it is just common sense to start getting more conservative in our investment approach as the risks of an unfortunate turn lower in economic growth are now higher.

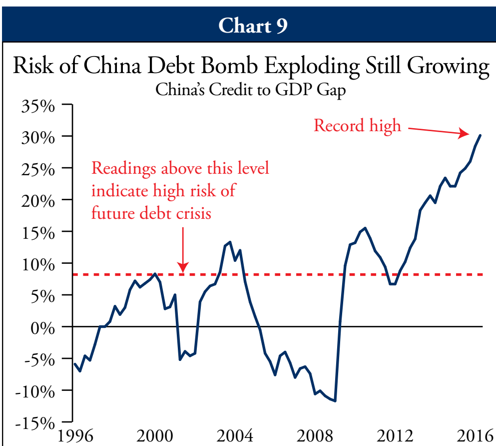
Source: FRB, BEA, Haver Analytics, Deutsche Bank

Another sign telling investors to stay alert for signs of a weakening economy is not only the rapid increase in US corporate debt but also the coincident decline in corporate cash flow (as measured by EBITDA - earnings before interest, taxes, depreciation and amortization costs as shown in Chart 8). Corporate net debt, or debt less cash, has been growing recently at roughly 25% annualized while cash flow has been in decline. Slow growth in capital expenditures and low productivity growth indicate this rapid debt build-up was not primarily utilized for building new factories or enhancing current facilities with modern equipment. Instead the trend for corporate management to enhance earnings in a slow growth economy by borrowing ultra-low cost debt and using the proceeds to repurchase shares, thereby increasing earnings per share, has contributed to the debt expansion. At this point, however, even share buybacks have begun to slow as profitability has begun to wane. Corporate managers are likely becoming more worried about the big jump in debt on their balance sheets. As management becomes more focused on getting their debt under control, they become less aggressive in expanding their businesses, which, in turn, can leader to slower economic growth. Moreover, the aggregate corporate statistics on debt and cash flow overstate the situation as just top 1% of the most cash rich US companies hold 50% of all the corporate cash. The remaining 99% of the companies have $6.6 trillion of debt but only $900 billion in cash. Most companies are going to be in a pinch if the economy turns lower and the very fact these companies are in this stretched financial condition will contribute to a potential recession.

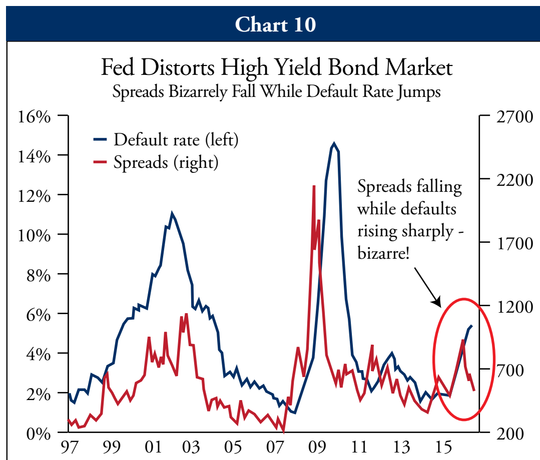


Source: SG Cross Asset Research/Equity Quant, Factset

A debt-driven recession can be slow to develop if companies are simply adjusting their balance sheets over time and not going bankrupt. On the other hand, if defaults are an issue, the process can become painful for investors much more quickly as banks begin to suffer losses and threats to the entire financial system arise. While this seems highly unlikely in the US, overseas it is not a far-fetched idea. For years, Japan has seen its debts soar relative to its GDP and the strength of its banking sector is hard to nail down. While also a long shot, we would never be surprised if a Japanese led debt crisis arose faster than any investor thought possible. The biggest threat, however, remains China. Its debt growth throughout all sectors of its economy has been enormous, which is always the best sign of a possible debt crisis. The IMF calculates a measure it calls the Credit to GDP Gap. We will not try to explain the details of this measure in this limited space, but academic studies suggest it has done a good job of predicting past credit crises. As seen in Chart 9, China's Credit to GDP Gap has been rising incessantly in recent years and now stands at a record high of 30, well above the level of 8 research indicates often leads to a meaningful risk of a credit crisis. China's ability to delay any such crisis has proven to be substantial in the past and it is clearly possible government officials will see to it that no crisis erupts anytime soon. Nevertheless, a Chinese debt crisis currently remains one of the most serious risks to investors and global economic growth, as S&P reiterated in a recent report.



Source: Bloomberg



Source: Citi Research, Yield Book, Moody's

As we noted in our last Quarterly Commentary, a European banking crisis is the other serious risk to global prosperity. Since that time, Deutsche Bank's struggles have grown and Italy's banking system has made no meaningful progress. Back in the US, the default rate on high yield bonds has continued to climb while the yield spread on such bonds has perversely improved (Chart 10). This is one of the many distortions caused by the Fed's low interest rate policies as yield hungry investors have become speculators by buying risky bonds, pushing yields lower even as risks rise.

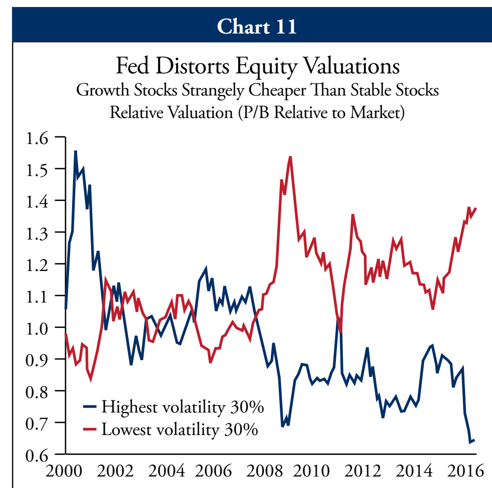
STEWARDSHIP PARTNERS MARKET COMMENTARY

Recession Risk Growing with Earnings and Margins Under Pressure

"We were under great pressure, far beyond our ability to endure ..." 2 Corinthians 1:8

High yield debt prices are not the only asset class which has been distorted by the Fed's ultra-low interest rates policy. Higher yielding equities also were bid up to unusually high levels during the first half of 2016 as investors searching for yield desperately hunted for bond substitutes. In a real historical oddity, defensive equities led the market's move to new all-time highs earlier this year. Normally, of course, it is more speculative stocks leading the charge to new market highs as investors celebrate over-enthusiastically. In this case, however, the most volatile stocks languished and the valuation of high yielding, low volatility shares rose to almost double that of the most volatile stocks (Chart 11). During the third quarter, however, this unusual situation did begin to correct as the NASDAQ performed best of the major market indices while the higher yielding, lower volatility shares failed to extend their lead over the market during the year-to-date period. Part of the reason for this was the growing risk the Fed would begin to raise rates. While the Fed once again passed on the opportunity to increase rates in September, three governors disagreed with the majority opinion and even several of those who voted in favor of not raising rates indicated a rate hike was likely late in 2016. Market volatility certainly picked up a little as the September Fed meeting picked up as any increase in interest rates signals investors the Fed is trying to take the punch bowl away from the low rate financial market party. Since investors rode the Fed's coattails all during its "extraordinarily accommodation" phase, having to work harder at achieving favorable investment results in the future is not a particularly attractive alternative.

Chart 11



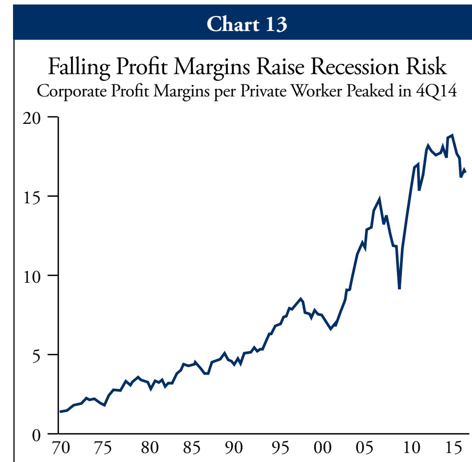
Source: FactSet, UBS

Chart 12

Source: MSCI World, UBS Quant

After years of "buying the dip" because the Fed's policies would always push share prices higher, the prospect of having to analyze company's earnings outlooks and valuations to determine the best possible investments must come as a shock to some. Furthermore, the situation is not made any less worrisome by recent ugly trends in earnings (Chart 12). After an initial nice recovery from the collapse in 2008, earnings growth across the globe over the last five years has been tepid at best and negative over the last 2-3 years. Since share prices have continued to rise while earnings have fallen, valuations are now also above average. In view of still low earnings, higher than typical valuations and the prospect of a less friendly Fed, investors have good reason to approach both the bond and stock markets with a degree of caution. Indeed, the bond market remains in a Fed induced bubble in our view, with foreign bonds in an even greater bubble due to central banks forcing negative yields in their markets.

Chart 13



Source: BEA, BLS, Haver Analytics, Deutsche Bank

Table 3

Could a Recession be Close at Hand?
Margins Typically Peak 2 Years Before a Recession

Business cycle	Peak in margins	Distance to recession (quarters)
1949 to 1953	Q4 1950	11
1954 to 1957	Q4 1955	8
1958 to 1960	Q2 1959	5
1961 to 1969	Q1 1966	16
1970 to 1973	Q1 1973	4
1975 to 1980	Q4 1978	6
1983 to 1990	Q4 1988	8
1991 to 2001	Q3 1997	15
2002 to 2007	Q3 2006	6
2009 to present	Q4 2014	?
Average		**9**
Median		**8**

Source: BEA, NBER, Haver Analytics, Deutsche Bank

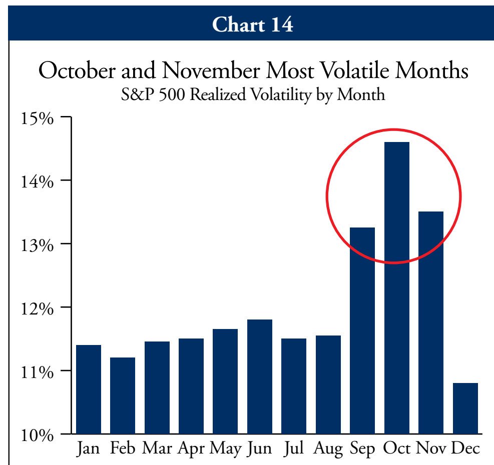
One of the reasons profits in the US have been depressed lately is profit margins peaked in late 2014 and sales growth has been difficult to achieve. Much of the problems on both fronts can be traced to the Saudi-induced crash in the oil market. Even so, profit margins faltered (Chart 13) and lower margins have historically been a good indicator of an impending recession. Naturally, as companies begin to see their costs rise relative to sales, management looks for ways to restore previous the level of profitability. More often than not, this leads to cost-cutting and layoffs. Layoffs, in turn spur consumers to pay down debt, increase savings and reduce spending, all of which puts the economy at the risk of recession. Thus far we have not seen any indication of layoffs as the employment market has remained robust. Also, as Table 3 reveals, recessions do not immediately develop after profit margins peak. On average it has normally taken 8-9 quarters before a recession ensues. In two cases a recession took roughly four years to develop following a peak in profit margins. Since we are now seven quarters removed from the most recent profit margin peak, it would be wise for investors to be playing close attention to economic trends. With oil prices now recovering, however, it is possible margins will also recover, thereby helping to hold off any potential recession before it starts.

In View of Growing Risks We Remain Cautiously Positioned

"One who is wise is cautious … but a fool is reckless and careless." Proverbs 14:16

Central bank interventions have driven the stock and bond markets higher for almost eight years but could the end of these distortions of market pricing be on the horizon? This cartoon from Hedgeye is emblematic of the growing understanding that the Fed's support for the market cannot go on forever. As we have seen, there are practical limitations to QE programs and the markets are becoming increasingly aware of these. As a result, the practice of "buying any dip" in share prices, knowing QE buying would send prices higher again, may be coming to an end sooner than many realize. How the eventual Yellen/S&P 500 "separation and divorce" takes place will be very important for the future trend in equity prices. As Axel Weber, formerly of the ECB and now Chairman of the Union Bank of Switzerland, recently said, "I don't think a single trader can tell you what the appropriate price of an asset he buys is, if you take out all this central bank intervention". He added these market-distorting policies are causing investors to make bad choices regarding where they are investing their money. We believe he was primarily referring to the mad rush of yield-hungry investors into risky fixed income investments. Equity valuations are above average but are not in a bubble like bonds. Nevertheless, when the "divorce" of Yellen and stocks is near, share prices could easily stumble.

Chart 14



Source: JP Morgan QDS

While it is difficult to pin down the exact timing of when the market may begin to worry about the end of central bank QE policies, we do know the timing of two key political events which may increase volatility in the short term. The first is the US election. At the time of this writing, Clinton looks to be comfortably ahead, which for reasons that are debatable, is soothing to Wall Street. In this race, however, nothing can be taken for granted. Should there be an October surprise that derails Clinton's campaign or should there be any other development which would lead the Republican candidate to appear to have a chance, then we should expect the market to get more volatile. Moreover, a little under a month after the US election, Italy goes to the polls to vote on whether they should leave the European Union. Early polls give a slight advantage to the "Stay" vote, but that was true in England as well before the surprise Brexit vote. In any event, October and November are normally more volatile than the other months of the year, even when there are no elections scheduled (Chart 14). Accordingly, we believe the cautious approach to constructing our portfolios Stewardship Partners has utilized since the second quarter remains appropriate.

Table 4

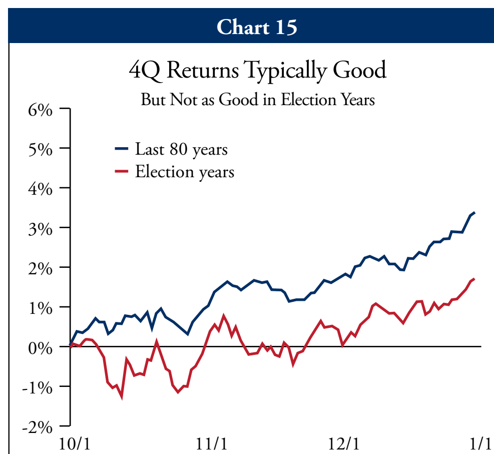
Stocks Advance Even When Interest Rates Are Higher
S&P 500 Performance at Different Levels of Interest Rates – 1926 - 2016

10 Year Treasury Starting Yield	5 Year Average Annual Returns	10 Year Average Annual Returns	15 Year Average Annual Returns
3% & Under	13.05%	13.81%	13.64%
3% to 4%	6.60%	6.12%	6.27%
4% to 5%	4.82%	5.84%	5.90%
5% to 6%	6.13%	4.57%	6.57%
6% to 7%	7.26%	6.96%	8.41%
7% to 8%	12.14%	12.70%	12.14%
8% to 9%	13.79%	16.45%	12.57%
9% to 10%	14.28%	17.18%	13.64%
10% & Up	18.17%	15.80%	17.01%

Source: awealthofcommonsense.com

Another development which could roil the markets in the fourth quarter is the likelihood of an increase in interest rates by the Federal Reserve. While any increase would be tiny, the message the markets may hear is the fun of the last eight years of extraordinary monetary accommodation is ending. After the initial shock wears off, however, investors may take some solace in the facts displayed in Table 4. On average, long term equity returns are lower as interest rates increase to between 3% and 7%, but investors still make money. In this case, however, we have never experienced what happens after a long period of the world's central banks intervening directly in the markets. It is worth considering that the results may be different this time.

Chart 15



Despite all the potential risks, the odds favor a good performance by share prices in the fourth quarter. The fourth quarter has always been the best quarter for investors and there are clearly strong, positive seasonal tendencies which we would be foolish to ignore. It is worth noting, however, that in election years, the favorable bias is not as strong and really does not kick in until December (Chart 15). Accordingly, we are reluctant to even tactically remove our defensive portfolio positioning until at least we have some clarity on the election in the US, the referendum in Italy and some additional insight that a banking crisis in Europe will be avoided. The rising risk of direct military action between Russia and the US in Syria is also disconcerting. Additionally, we believe we own several stocks that could provide excellent fourth quarter returns for our clients even while we are in a protective mode. Therefore, we are hopeful we will be able to extend our already good 2016 performance in the fourth quarter, even while taking almost no risk of a market fall.

We at Stewardship Partners continue to be grateful for the opportunity to serve your investment needs. Please do not hesitate to contact us if you have any questions or if we can be of assistance.

Biblically Responsible Investing (BRI) – Investing as Jesus Would

"Blessed are they that maintain justice, who constantly do what is right." Psalm 106:3

Stewardship Partners, founded in 2000, is a leader in the field of investing with a Christian perspective, a form of Socially Responsible Investing (SRI) known as Biblically Responsible Investing (BRI). Rusty Leonard, CFA, Stewardship Partners' founder and CEO, practiced this investment philosophy while managing over $3 billion of assets as a portfolio manager during his decade of service with the Templeton organization. He also had the privilege of working directly with world-renowned global mutual fund manager, Sir John Templeton. **By employing a BRI approach to investing, Stewardship Partners seeks to achieve long-term capital gains through ownership in securities of companies that are a blessing to mankind. Conversely, we seek to avoid profiting from owning companies engaged in sinful activities which bring physical and spiritual loss to our fellow man. Our heart's desire is to do no harm to our fellow man in the process of being the best possible guardians of the wealth the Lord has given us stewardship over.** Simply put, a "what would Jesus do" approach to portfolio management is what we seek for our clients.

Below are just some of the issues of concern to Stewardship Partners and the specific sinful activities that fall into each category:

1. **We desire *justice and mercy for the defenseless* so we seek to avoid companies involved in:**
   - Abortion
   - Life destroying or distorting scientific research
   - Human rights issues such as religious persecution, terrorism and political oppression

2. **We desire *justice and mercy for the poor* so we seek to avoid companies involved in:**
   - Greed-based marketing techniques
   - Discrimination and unjust labor practices
   - Any abuses of the poor, children and/or the elderly

3. **We have *compassion for those addicted and/or engaged in sinful lifestyles* so we seek to avoid companies involved in:**
   - Alcohol, Gambling and Tobacco
   - Pornography
   - Homosexuality (those companies deemed to be the most active supporters)

4. **We desire to *protect marriage and the family* so we seek to avoid companies involved in:**
   - Entertainment that seeks to destroy biblically-based attitudes
   - Efforts to promote lifestyles the Bible indicates are sinful

Additionally, we favor companies that clearly embrace:
- Honesty, Compassion, Diligence, Prudence and Creativity
- Support for quality products at fair prices and constructive stakeholder relations
- Support for a sustainable and healthy environment
- Support for charitable giving
- Support for the Jewish people and the state of Israel

We obtain information on both the objectionable practices and the exemplary attributes of corporations from our affiliate **The Biblically Responsible Investing Institute** (www.BRIInstitute.com). We believe BRII gives Stewardship Partners the most comprehensive database of BRI information that currently exists and utilize much of it to realize our goal of investing in a manner that most honors our Lord. Equipped with this information, we are then prepared to make as strong an effort as possible to build investment portfolios which best reflect our clients' biblically-based Christian worldview.

Like all people, all companies are sinners. Therefore, we attempt to use the BRI information at our disposal to eliminate the worst offenders from our portfolios. At times, this is easy. For example, a company involved in making drugs used in the abortion process will always be excluded from our portfolios. In many cases, however, we need to utilize judgment, such as when a company has operations in a country that is a known violator of human rights. The type and size of that exposure, among other considerations, are taken into account before eliminating the company from our portfolios. When judgments must be made we are guided by the principal of trying to do what we believe Jesus would do if He were making the decision.

For a more in depth study of the topic of Biblically Responsible Investing (BRI), please see our paper entitled "The Scriptural Basis for Biblically Responsible Investing".

BRI in Action – Comparing Good and Bad Corporate Behavior

"Love must be sincere. Hate what is evil; cling to what is good." Romans 12:9

Below you will find an example of both a company exhibiting exemplary attributes, ExxonMobil, and one we avoid, Wells Fargo. ExxonMobil is a holding in some of our Stewardship Partners portfolios while we actively avoid ownership in Wells Fargo in order not to be co-owners in enterprises engaged in or supportive of activities which are harmful to our fellow man and our Lord's creation. **We believe, in the long run, both countries and companies that best align their activities with biblical principles will achieve the greatest success.**

The Good – ExxonMobil – Outstanding Corporate Citizen

"Instruct them to do good, to be rich in good works, to be generous." 1 Timothy 6:18a

ExxonMobil, the world's largest, non-government controlled oil and gas company, was founded 125 years ago when oil was first discovered in Titusville, PA. Not long afterward, John D. Rockefeller acquired control of this operation. Rockefeller's oil interests quickly grew very large and he was forced by the Supreme Court of the US to break his company into 34 separate firms. Standard Oil Company of New Jersey was the forerunner to Exxon and Standard Oil Company of New York eventually became known as Mobil. The two companies were reunited in 1999 when the two giant companies merged to form a truly enormous company. Today ExxonMobil is the world's eighth largest firm as measured by annual revenue and is the second most profitable company as well. Additionally, it has often been the world's most valuable company as measured by market capitalization. In terms of oil reserves and production, however, the company's footprint is not quite so gigantic as it holds less than 1% of the globe's oil and gas reserves and accounts for around 3% of all oil and gas produced each year. In terms of oil refining, however, with 37 refineries in 21 countries, ExxonMobil is the largest single oil refiner in the world. Given the wide scope of the company's operations in a controversial business, ExxonMobil has certainly seen its share of public controversies over the years, most notably with the Exxon Valdez oil spill in Alaska in 1989. While no company, like no person, is perfect, ExxonMobil's overall track record of good corporate citizenship is often overshadowed by the one-sided, negative press treatment energy companies have come to expect. The company's Guiding Principles give a glimpse into a more accurate depiction of the ExxonMobil. The preamble to these principles states the following: "Exxon Mobil Corporation is committed to being the world's premier petroleum and petrochemical company. To that end, we must continuously achieve superior financial and operating results while simultaneously adhering to high ethical standards." The company then defines its Guiding Principles by addressing four areas, Shareholders, Employees, Customers and Communities. Included among these principles are a commitment to their workforce, which they recognize a critical component to their competitive edge, and a promise to maintain the highest ethical standards while operating in as safe and environmentally-friendly way as possible.

Large corporations can easily hire the top consultants available to put together policies which sound great to outside observers, but ExxonMobil has shown a willingness to not succumb to outside pressure to conform to societal trends which can lead to destructive corporate policies. For example, the company has very few violations in the Biblically Responsible Investing Institute's (BRII) database in the area of homosexuality. This is quite unusual for a large oil company frequently in the public's eye and under substantial pressure to adopt politically correct postures on contentious issues. By taking stands such as it has, ExxonMobil has shown its board and management have courage in their convictions which is quite admirable. The company also has in place a comprehensive Standards of Business Practice document which reinforces their desire to be a good corporate citizen in all of the countries in which they operate. Included under the "Ethics" section is the following: "Even where the law is permissive, the Corporation chooses the course of highest integrity. Local customs, traditions, and mores differ from place to place, and this must be recognized. But honesty is not subject to criticism in any culture. Shades of dishonesty simply invite demoralizing and reprehensible judgments. A well-founded reputation for scrupulous dealing is itself a priceless corporate asset. The Corporation cares how results are obtained, not just that they are obtained." It also says this: "The Corporation expects candor from employees at all levels and adherence to its policies and internal controls. One harm which results when employees conceal information from higher management or the auditors is that other employees think they are being given a signal that the Corporation's policies and internal controls can be ignored when they are inconvenient. That can result in corruption and demoralization of an organization. The Corporation's system of management will not work without honesty, including honest bookkeeping, honest budget proposals, and honest economic evaluation of projects." This type of candor is no doubt one of the many reasons ExxonMobil has been so successful in generating

superlative results in all aspects of its business over many years.

Like all well-managed companies, ExxonMobil recognizes its nearly 74,000 employees across the globe are its most valuable asset. Moreover, the company views the extraordinary diversity of its global employee base as a strength which it seeks to amplify. As an extremely large and profitable company, ExxonMobil has the capacity to be on the leading edge in corporate activity to support its staff. Accordingly, not only does the company offer an extensive package of benefits to its workers, but it also does much more. For example, the company recognizes the great importance of safety in what is, by nature, a dangerous field. Therefore, it has been on the leading edge of researching and implementing methods to ensure employee alertness is as high as possible since studies have shown fatigue increases the odds of accidents. Moreover, given the health hazards of working in remote areas, where many of its employees are situated, ExxonMobil has instigated comprehensive efforts to protect its staff from infectious diseases. While malaria, tuberculosis and HIV are common threats, the company has also had to contend with the risk to its staff from Ebola. Due to the company's preparedness, none of its employees were impacted by the Ebola outbreak that killed over 11,000 people in Western Africa in 2014-15. The company also donated $670,000 to local communities impacted by the outbreak. Other ExxonMobil employees face significant security threats and the company spends considerable amounts of time and money training employees to keep them out of harm's way. The company's all-encompassing efforts to keep its employees safe have been rewarded with a significantly lower rate than the industry. Additionally, the rate has trended lower in recent years as well. Back in the much safer confines of the US, company employees at ExxonMobil's headquarters campus benefit from many programs meant to enhance their lives. Flexible work hours are an option, adaptable workplace arrangements can be made and other methods of accommodating employee's specific needs are available. A wide variety of health care, retirement and savings plans are part of the benefit packages ExxonMobil employees enjoy as well as extensive efforts to contribute to employee wellness. It is worth noting that the company has a variety of special employee groups, including one for veterans, but has none for homosexuals as it clearly has decided to not use shareholder funds to promote homosexuality.

ExxonMobil has also demonstrated its desire to be a blessing to the communities where it works. Since it is engaged in so many far off corners of the earth, the needs of the communities it interacts with are quite varied. Often times, the company is working with indigenous people and it strives to work with these communities on the people's own terms. Given the vast size and nature of the projects the company is involved in, some disruption of local communities is often inevitable. Therefore, the company goes to great lengths to minimize its impact and restore that which is disrupted. Moreover, the company has shown itself to be generous, spending $268 million in charitable efforts in 2015, This spending was focused on the company's signature charitable endeavors in combatting malaria, improving education and promoting economic opportunities for women. Over the last 15 years, ExxonMobil has been the single largest private funder of anti-malaria programs, dispensing more than 14 million bed nets, 3.8 million doses of antimalarial treatments and training more than 520,000 health workers. These effort have benefitted an estimated 125 million people!

ExxonMobil's good works, while numerous, are of course, no guarantee of long-term investment success. As Biblically Responsible Investors, however, the company's commitment to being an exemplary corporate citizen as well as its outstanding treatment of its employees and commendable charitable efforts, allows us to know we are shareholders in a company seeking to be a blessing to all. While no company, like no person, is perfect, this is clearly a company which seeks to benefit those it comes into contact with and one we can be proud to own!

The Bad – Wells Fargo – Mistreating Clients, Abortion and Homosexuality

"Things that cause people to sin are bound to come, but woe to that person through who they come." Luke 17:1

Unlike ExxonMobil, which has clearly sought to minimize the use of shareholder funds in the support of homosexuality, Wells Fargo has made extensive efforts in this area and is designated as one of the Most Active corporate sponsors of homosexual behavior by the Biblically Responsible Investing Institute. ExxonMobil treats homosexuals just as it treats all other employees, with respect but no special recognition or support of this lifestyle which the Bible clearly indicates as sinful. Additionally, Wells Fargo has in the past been a significant corporate sponsor of Planned Parenthood. More recently, however, its support for abortion has waned, for which we are thankful. While Wells Fargo has made progress in that regard, unfortunately, it has recently been implicated in widespread criminal activity over a long period of time. Apparently, due to excessive incentives given to employees to sign customers up to receive new Wells Fargo credit cards, those employees resorted to opening up such accounts without the permission of the bank's clients. Reports indicate the bank fired 5,300 employees for this criminal activity in recent years but it has only just come to light with the general public. Well Fargo's CEO recently testified before Congress about this situation and admitted that crimes were committed. It has also come to light that the company fired whistle blowers trying to report the practice of opening false accounts and that Wells Fargo had repossessed soldier's cars in violation of the law. On top of this, management paid itself enormous bonuses despite these illegal and unethical business practices. Clearly, Wells Fargo has a big clean-up job ahead of it and will be spending a lot of money on lawyers.

Excluding Wells Fargo from our list of potential investments is not a difficult decision. As BRI investors seeking to please and honor our Lord, we naturally look elsewhere to achieve investment success as we do not want to be associated with a company using shareholder resources in a manner the Bible defines as sinful and which can have a negative impact on individuals and society in general.

Our Ultimate Goal – Funding the Lord's Work

"Therefore go and make disciples of all nations." Matthew 28:19a

It is our hope that Stewardship Partners' ability to create an abundance for you will help you to share with those who are in need and assist in fulfilling the Great Commission. Our non-profit ministry affiliate, Wall Watchers, provides a free service to help you educate yourself about the many wonderful Christian giving opportunities available to wise donors. We invite you to join the thousands of visitors to our ministry's website at www.MinistryWatch.com, as best we can tell, the Internet's top site for donors to Christian ministries to gather critical information about the ministries they are considering supporting. The site contains a variety of helpful information about hundreds of the largest US-based Christian ministries including ministries statements of faith, the history of the ministry, program accomplishments, ministry financial statements and financial efficiency ratings. Please feel free to utilize this free resource as you seek to be a wise and effective donor to Christian ministries. We would be pleased to help you bless God's people who are in need, and clients of Stewardship Partners have access to further resources from MinistryWatch.com. It is our sincere desire to see Christians leading the way in giving generously, wisely and effectively so that the Lord's work on earth can be completed and many can be both blessed and saved.

Featured Ministry – Youth for Christ

"He said to them, 'Go into all the world and preach the gospel to all creation.'" Mark 16:15

Youth for Christ (YFC) reaches young people everywhere, working together with the local church and other like-minded partners to raise up lifelong followers of Jesus who lead by their godliness in lifestyle, devotion to the Word of God and prayer, passion for sharing the love of Christ, and commitment to social involvement. Founded in 1944 as World War II was coming to an end, Billy Graham was the ministry's first full time staff member. Originally focused on youth rallies, the ministry has changed its approach on various occasions over the ensuing decades. In the late 1950's and 1960's the ministry's focus shifted to bible clubs for youth. Also in the early 1960's the ministry began to develop an international focus and partnered with Young Life to bring ministry to children of military personnel on military bases. Since the 90's, YFC's continues to develop effective relational ministry with different types of unchurched youth. Parent Life mentors and equips young mothers and fathers with parenting skills as well as the love of Jesus Christ. City Life reaches out to the millions of young people in our major urban communities, partnering with the church and other organizations. YFC Core helps school-based adults lead teams of Christian students to reach out to their lost friends. DeafTeen Quest ministers to the unique needs of hearing-impaired teens. And the theme of the YFC Camp program is "Where Everything Changes", intentionally targeting lost teens through the proclamation and the demonstration of the gospel message in an outdoor experience.

Over its long history, YFC has referenced its motto of "Anchored to the Rock, geared to the times" to reflect its desire to remain faithful to the Word while adapting to the ever-changing needs of youth and culture around the world. With inner cities growing in turmoil, its City Life outreach is perhaps one of its most important ministries at the moment. The City Life core ministry model has its roots in a rich history of YFC desiring to reach high-risk youth. Lifeline ministries launched this passion through camps and trips, but the model evolved to a year round ministry called Youth Guidance. Youth Guidance focused primarily on youth in the penal systems. Ultimately, YFC staff saw the need to develop a ministry model that worked with young people in urban communities before they might become incarcerated. City Life was then begun in order to provide the hope of Christ to urban youth.

Youth for Christ's efforts to bring the message of gospel to the youth of the world have been tested over decades. Moreover, it has managed the financial affairs of its ministry well, achieving a three star rating from MinistryWatch.com for financial efficiency. Taking together its good stewardship of donor resources and its effective ministry, Youth for Christ is worthy of your consideration for financial support.

The Christian Ministry Marketplace – Helping Donors Give Wisely

"A generous man will prosper, he who refreshes others will himself be refreshed." Proverbs 11:25

Much like the stock market provides for a sensible and efficient allocation of capital in our economy, the rise of a Christian Ministry Marketplace is providing donors with a myriad of helpful resources to maximize the impact and joy of giving to the work of the Lord.

As donors begin to take their giving as seriously as their investing, they will find the assistance offered by the groups listed below to be invaluable. By utilizing these resources, donors are not only likely to make better personal giving decisions, but are also contributing to the growth in the marketplace itself. By so doing, they are helping to lay a foundation for wiser giving for all who follow in their footsteps. Accordingly, we encourage donors to investigate how these groups might help you to give more wisely, achieve a greater impact and create increased joy for both yourself and receivers of your gifts.

The Christian Ministry Marketplace
Resources for Christian Donors

WHY to give to Christian ministries?

Teaching on Stewardship:

- Crown (crown.org)
- Eternal Perspectives (epm.org)
- Generous Giving (generousgiving.org)
- Global Generosity Movement (generositymovement.org)
- The Steward's Way (thestewardsway.org)
- The Gathering (thegathering.org)
- MaximumGenerosity.org (maximumgenerosity.org)
- Stewardship Ministries (stewardshipministries.org)

HOW to give with a discerning mind?

Professional Advisors:

- Kingdom Advisors (kingdomadvisors.org)
- National Association of Christian Financial Consultants (nacfc.org)
- WaterStone (waterstone.org)
- National Christian Foundation (nationalchristian.com)

Donor Advisors:

- Excellence in Giving (excellenceingiving.com)
- Calvin Edwards & Company (calvinedwardscompany.com)
- E Six-Thirteen (esixthirteen.com)

WHERE to invest in kingdom ministries?

Ministry Research:

- ECFA (ecfa.org)
- MinistryWatch.com (ministrywatch.com)
- Acton Institute (acton.org/public-policy/effective-compassion)
- Intelligent Philanthropy (intelligentphilanthropy.com)

Ministry Mutual Funds:

- National Christian Foundation (nationalchristian.com)
- Strategic Resource Group (srginc.org)
- Sovereign's Wealth Fund (kingdomimpactfund.com)

Featured Ministry Marketplace Participant – ECFA

"You will be made rich in every way so that you can be generous on every occasion." 2 Corinthians 9:11

The ECFA, founded in 1979 by a group of 150 Christian ministries, is an accreditation agency dedicated to helping Christian ministries earn the public's trust through adherence to its Seven Standards of Responsible Stewardship. ECFA, under the leadership of President Dan Busby, now has roughly 1,800 member ministries with combined revenue measured in the billions. Donors to ECFA member ministries, which can be recognized by the ECFA seal on ministry literature or by checking on the ECFA.org website, can have confidence these ministries have voluntarily submitted themselves to the most comprehensive rules and regulations of any peer accountability group in the non-profit arena. We would encourage interested donors to visit the ECFA website at www.ecfa.org. Due to the good work of the ECFA, the Christian Ministry Marketplace is more advanced than the non-profit marketplace in general, thereby affording donors to ECFA members greater confidence that their gift is being utilized wisely. Donors do need to understand, however, that the ECFA exists primarily to protect the interests of ministries and it is the ministries which provide the fee income to the ECFA to enable its operations. As a result, the ECFA is reticent to highlight bad behavior of member ministries out of concern this might be detrimental to giving to those ministries that are deserving of donor's gifts.

ECFA's Standards of Responsible Stewardship focus on board governance, financial transparency, integrity in fund-raising, and proper use of charity resources. ECFA provides several services to the donor public. Disclosure requirements enable donors to request and receive audited financial statements for all ECFA members. ECFA's website contains a membership directory with selected financial information of all its members, guidelines for wise giving and wide variety of information helpful to Christian donors and the ministries they give to. The ECFA also responds to complaints against its members. All such complaints are investigated thoroughly in order to determine if there has been non-compliance with the ECFA's standards.

Knowing Jesus Christ as Your Lord and Savior

While most of those reading this will have already established a personal relationship with Jesus as their Lord and Savior, it is very likely that many have not. If you are someone who has not yet turned your life over to your Creator, we would have failed you miserably if we presented only information relating to your investments yet did not share with you the most important information of all: truths which have eternal significance for your soul and that will have an overwhelmingly positive impact on your life on this earth.

The gospel message is a simple one, far less complicated than the global impact of rising oil prices or the effect of a revaluation of the Chinese currency. For most people, the first part of it is easy to relate to – you are a sinner. If you are anything like the rest of us (and you are) more often than you probably would like to admit, you either do, say or think something that is clearly wrong and which you are ashamed of. "But what's the big deal", you might say. "If everyone has this problem with sin, can't we all just accept the fact and try our best to get along?"

Well, on this earth, that is exactly what we try to do. We forgive one another's faults and press on with life. From an eternal perspective, however, there remains a problem. Our Creator, who loves us with a love that can only be described as extravagant, has prepared an eternal home for us that He very much desires to share with us. Unfortunately, in our sinful state, we are unable to enter into heaven, which is by its very nature perfect. Desperate not to be separated from us for an eternity, our God devised the only possible solution – a divine exchange. He sent His very own son, who was perfect and thus without sin, as a sacrifice to pay the penalty for our sins. In this exchange, Jesus bore, through His death, all of our sins, so that we in turn could receive all the glory that was due to Him. He was made sinful while we were made perfect and, in our now perfect state, we are able to enter into the eternal home our Lord has prepared for us.

What then gives each of us access to participate in this divine exchange? By responding to this incredible demonstration of extravagant love by our God through an amazing act of your own. As you let the realization of just what your Lord has done for you filter through your heart, mind and soul, you will unavoidably desire to humbly come before Him, acknowledging that it was your sin that led to His sacrifice and recognize His Lordship in your life. And with this step of faith, the divine exchange is completed in your life, and along with it, the assurance of eternal life with a Lord whose love for you knows no bounds. If you have not done so already, we encourage you to take this time to contemplate the issue of your eternal destination and to take that step of faith that will make all the difference in your life, both now and eternally. Based on my experience and the experience of literally millions of others throughout history, it is the most satisfying, enriching and worthwhile choice you will ever make. Years of wonderfully inspiring spiritual growth await you and, if the Bible ever seemed confusing to you in the past, you will now find its wisdom leaping off the pages and into your heart.

If we at Stewardship Partners can be of any assistance to you in this all important matter of your eternal destiny, please do not hesitate to contact us. Like Jesus, we also greatly desire to share an eternal heavenly home with you!

The information provided herein is not a complete analysis of every material fact respecting any industry, security or investment. Opinions expressed by Stewardship Partners are subject to change without notice. Statements of fact cited by Mr. Leonard have been obtained from sources considered reliable. No representation, however, is made as to the completeness or accuracy of any statement or numerical data in the article. This publication may include technical or other inaccuracies or typographical errors. Stewardship Partners assumes no responsibility for errors or omissions in this publication or other documents which are referenced by or linked to this publication. This publication is provided "as is" without warranty of any kind, either express or implied, including, but limited to, the implied warranties of merchantability, fitness for a particular purpose or non-infringement. In no event shall Stewardship Partners be liable for any damages whatsoever, including without limitation, special, incidental, indirect, or consequential damages of any kind, whether or not advised of the possibility of damage, and on any theory of liability, arising out of or in connection with the use or performance of information in this publication. Other names, logos, designs, titles, words, or phrases in this publication may constitute trademarks, service marks, or trade names of other entities, which may be registered in other jurisdictions. This publication is intended for educational purposes. The information contained in this publication is periodically updated. No statement in this publication should be construed as a recommendation to buy or sell a security or to provide investment advice. Performance information is historical and should not be considered representative of current conditions or predictive of future results. All securities investments fluctuate and involve risks. Foreign securities may involve additional risks, including but not limited to changes in currency rates and the application of foreign tax laws, as well as changes in government, economic, and monetary policy.

STEWARDSHIP PARTNERS

Stewardship Partners Investment Counsel, Inc.
PO Box 157 Matthews, NC 28106-0157
Phone: (800) 930-6949 Fax: (800) 930-6949

E-mail: cgoddard@stewardshippartners.com
Website: www.stewardshippartners.com