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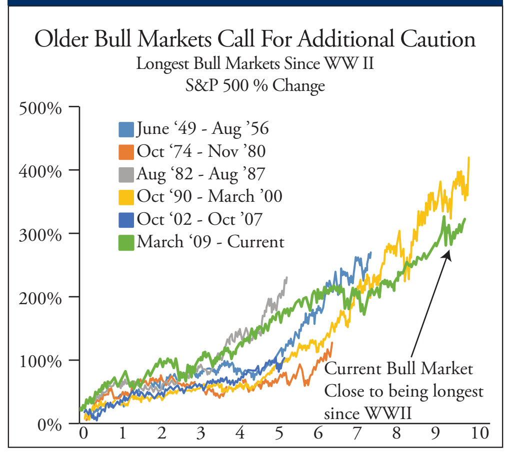
US Equities Soared in Q3 but Q4 is off to a Bad Start

"Some of the wise will stumble, so that they may be refined…" Daniel 11:35

At Stewardship Partners, we entered the third quarter cautiously. While most our client's portfolios had performed admirably during the first half of the year, the equity markets overall had not done very well. Additionally, the third quarter of an midterm election year has historically produced subpar returns. Given the US bull market is already already nearly ten years old and close to being the longest bull market since World War II (Chart 1), and because we already had a significant advantage over the indices, we saw little reason to be fully invested during a seasonally weak period towards what might be the end of one of the longest bull markets ever. Finally, the largest holding in our client's portfolios seemed poised to at least maintain, if not continue, the very strong run it had over the previous two years. Unfortunately, the reverse of just about everything we thought might happen in the third quarter happened and, therefore, our performance was poor. Despite our underperformance, however, most of our client portfolios remained ahead of their performance benchmarks for the full year and we are hopeful for a reversal in our fortunes in the fourth quarter.

Chart 1



One of the odder aspects of the third quarter is the S&P 500 had one of its best quarters in years (Table 1) during what is normally the weakest season of the year for equities. Moreover, nothing particularly noteworthy changed for the positive during the quarter which would justify the strong advance. Perhaps the jump in share prices was just the market recovering from its poor performance earlier in the year which occurred even while corporate earnings were soaring. There were plenty of good reasons why the market should have had more subdued returns between July and September, most notably rising interest rates and clear indications the Fed was planning to tighten monetary policy further over the next 12-18 months. Housing related stocks certainly got the message as they have been one of the worst performing sectors of the market all year. These stocks are often considered a leading indicator for the trend in economic growth and a measure of whether the Fed is tightening too quickly. Energy, materials and emerging market stocks also struggled during the quarter and were seemingly providing some early warning signs that monetary policy was already starting to reduce the growth prospects of the global economy, if not also the US economy.

Table 1

3Q18 Total Returns

US Indices	3Q18	YTD	5y Ann
S&P 500	7.7%	10.6%	13.9%
S&P 500 Value	5.9%	3.5%	10.9%
S&P 500 Growth	9.3%	17.2%	16.6%
NASDAQ	7.4%	17.5%	17.7%
S&P 400 (Mid Cap)	3.9%	7.5%	11.9%
S&P 600 (Small Cap)	4.7%	14.5%	13.3%
Treasury Bonds	-0.6%	-1.7%	1.3%
High Grade Corp. Bonds	1.0%	-2.3%	3.5%
High Yield Corp. Bonds	2.4%	2.6%	5.5%
Gold	-4.8%	-8.5%	-2.1%
Global & International Indices			
MSCI World	5.0%	5.4%	9.3%
MSCI EAFE	1.4%	-1.4%	4.4%
MSCI Euro	-0.4%	-3.6%	3.9%
MSCI Far East	3.0%	0.7%	6.7%
MSCI China	3.7%	1.6%	6.8%
MSCI Japan	-7.5%	-9.1%	7.9%
MSCI Emerging Markets	-1.1%	-7.7%	3.6%
US Economic Sectors			
Energy	0.6%	7.5%	1.3%
Materials	0.4%	-2.7%	8.8%
Industrials	10.0%	4.8%	12.9%
Consumer Discretionary	8.2%	20.6%	16.1%
Consumer Staples	5.7%	-3.3%	9.2%
Health Care	14.5%	16.6%	15.4%
Financials	4.4%	0.1%	13.5%
Information Technology	8.8%	20.6%	22.4%
Telecom	9.9%	0.8%	6.7%
Utilities	2.4%	2.7%	11.1%

Both the US economy and its stock market, however, have stood out relative to other nations by their superior performance in 2018. On most any measure, the US has shown signs of continued strength whereas outside the US, economic growth is faltering and the risk of one or more emerging market nations, including China, buckling under the stress of higher US interest rates and tariffs is clearly growing. We are finally starting to see a negative market reaction to these rising concerns and our cautious portfolio positioning, which we put in place previously in anticipation of this weakness occurring in the third quarter, now looks like we were just a little early. In early October, the gains from the third quarter have been erased and overseas markets have been hit even harder. China's equity market has fallen as much as 12% this month and is down over 26% year-to-date. Most markets in Europe are also down by double digit amounts thru mid-October and only the NASDAQ still holding onto small gains in 2018 in the US. Every market in Asia, whether in a large or small country, is facing losses this year and only tiny markets like Macedonia and Ukraine have gains this year in Europe. The big questions now are whether the poor performance of the US market in October is an indication losses overseas are spreading here and whether the end of the long bull market might be near.

We have been waiting for a sell-off to transform our portfolios from cautiously positioned to being invested more normally. Given how old the current bull market is and how the Fed's tighter monetary policy is negatively impacting global growth so soon, we have dragged our feet so far in putting the cash we hold to work. While we are biased toward getting more fully invested during this sell-off, we will still proceed cautiously.

Global Economic Trends Weakening, Will the US Weaken Too?

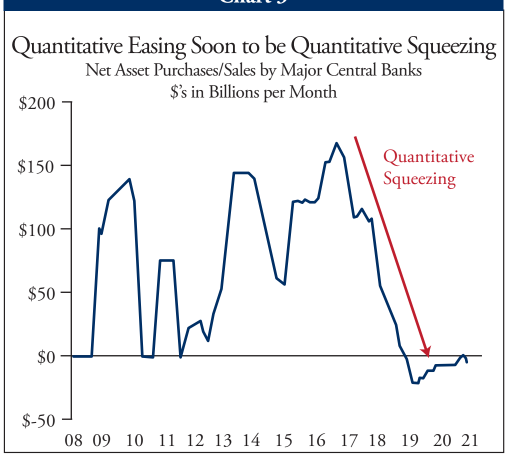
"They will all respond, they will say to you, "You also have become weak, as we are" Isaiah 14:10

The stock market clearly has been nervous about the future recently, but the average American's confidence in Trump's economic policies is still strong. As revealed in Chart 2, US consumers are feeling pretty good about what is happening on the economic front, with confidence running on par with the levels seen at the peak of the Reagan administration, but still trailing the heights seen late in Clinton's presidency and into the pre-9/11 portion of the Bush presidency. Given the acceleration in US economic growth in 2018, it is no surprise the populace is feeling pretty good about their economic prospects right now. Incomes are rising and consumer debt levels, outside of student loans, are less burdensome than in the past. With economic performance in the US running at a high level, the threat of an imminent recession seems particularly low. At the same time, looking at the historical trends in Chart 2, recessions have often not been too far away once confidence in the government's economic policies rose near this level. The fact that everyone is feeling really good about the economy can unfortunately be a recession warning.

Chart 2

Source: University of Michigan

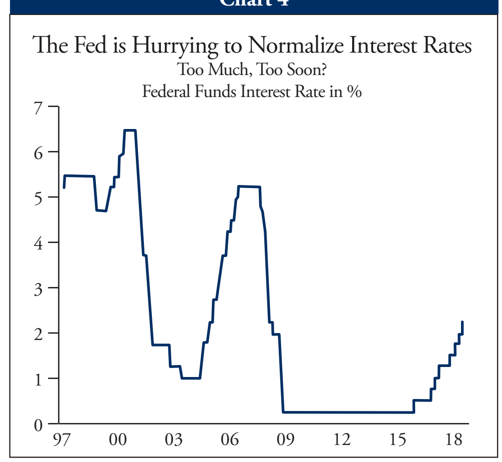
Chart 3



Source: Thomson Reuters, CE

One reason for the economic optimism in the US is the continuing, if now diminishing, benefits of both President Trump's tax cuts and his efforts to slash the regulatory burden on businesses. As we have noted in the past, however, the highly expansionary fiscal policy represented by those tax cuts, in particular, came at a time when economic resources were already being highly utilized. As a result, the tax cuts were something akin to throwing gasoline on an already lit fire. The pace of economic growth did rise quickly but, given the timing of the fiscal stimulus was less than ideal; it also sparked inflationary pressures. This higher level of inflation has also begun undercutting rising wage gains workers had just begun to enjoy. Future economic gains will be harder to achieve in the US as the boost from tax cuts wears off and the Fed tightens monetary policy.

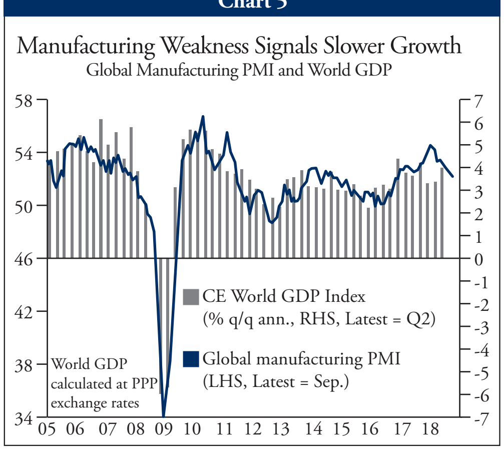
Chart 4



Source: Bloomberg

While inflation is hardly out of control, the Fed's monetary response has been two-fold. First, they are backing away rather quickly now from the unusual monetary policy accommodation the Fed had implemented since the Great Recession. Some central bankers outside the US are planning to do likewise, with the net effect being central bank assets will begin shrinking in early 2019, following an already sharp decline in the rate of growth of those assets over the last two years. No one knows exactly what the economic impact from this policy will be, but it likely will constrain economic growth. The Fed's other policy action - increasing short term interest rates (Chart 4) is certainly restraining economic growth in the US and even beyond our borders. It is no surprise President Trump is unhappy with the Fed's interest rate policy as it is minimizing the impact of his tax cuts and regulatory reform. The risk is the Fed will overshoot in trying to slow the US economy down to control inflation and cause a recession. Weakening overseas growth is not helping either.

Chart 5

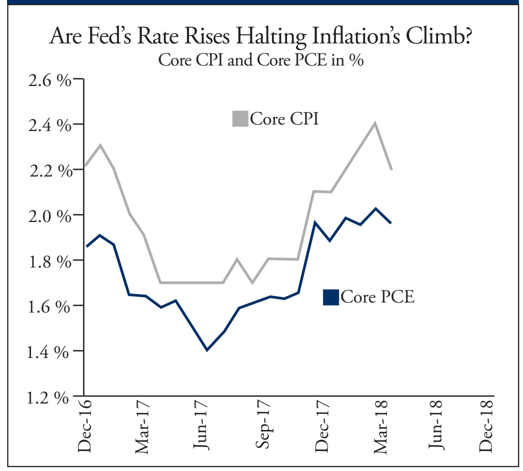


Source: Thompson Reuters, Markit, Capital Economics

There are already signs of growing stress in the US economy due to these policies, most notably in interest rate sensitive sectors like real estate. There are also negative ramifications for economies around the world. As US interest rates rise, the risk of a financial accident both here and abroad rises, but the risk outside the US is greater than within. Among the world's emerging market nations, some may have taken on more US dollar based debt than they can likely safely handle. As interest rates advance, the pressure on companies in these countries, and their banking system, grows and a financial "accident" becomes a real possibility. While global economic growth is still at a good level (Chart 5), the trend in global manufacturing has been moving lower in recent months and it typically translates into weaker economic growth before too much time passes.

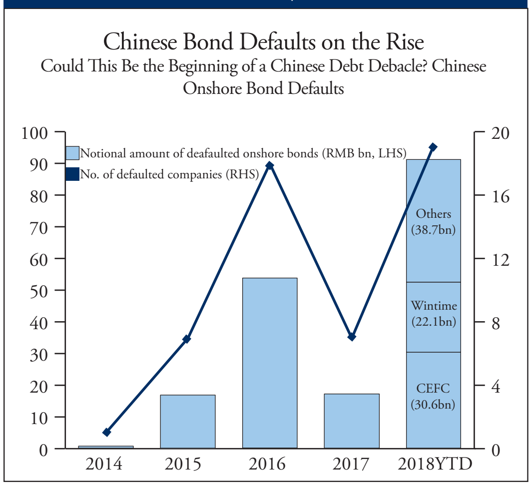
Only the US economy seems to be evading the threat of deteriorating economic growth right now among the world's major economies. More constrictive monetary policy, however, might also be starting to have a restraining effect in the US as well. The most recent core inflation reports turned lower after rising consistently since late in 2017 (Chart 6), indicating the Fed's attempts to cool the economy may be working better than planned. Moreover, while the tariff battle with China is still in its early days - with much more bark than bite at the moment - global trade trends clearly have already been adversely impacted. Should the tariff tiff with China turn into a full blown trade war, the disruptive economic consequences will accelerate and may prove to be more destabilizing to global economic growth than currently imagined. Our main concern is whether China could withstand stiffer trade sanctions without suffering a recession. As long time readers of Stewardship Partners Quarterly Commentary are aware, the risk of an uncontrollable meltdown in China's heavily indebted economy is our greatest concern. For many years, the Chinese government has been able to prevent the Chinese economy from slipping into a recession, but the financial excesses, particularly debt, just keep getting larger which will make the eventual correction more painful. Recently, S&P credit analysts wrote in a report on China's growing debt burden, "The potential amount of debt is an iceberg with titanic credit risks". Chart 7 highlights the recent increase in defaults in Chinese corporate bonds. While defaults are still at manageable levels, S&P highlights it recently determined a previously unknown $5.8 trillion in debts has been discovered hidden off the balance sheets of various provincial governments. That means debt equal to 40% of China's GDP had been somehow hidden from credit analysts. China's total debt load is likely now near 350% of its GDP. Should its economic growth falter, many of those debts will end up in default and the resulting collapse in China's economy could create a significant blowback into the global economy. This is one reason why President Trump has the upper hand in tariff negotiations with China but it is also why Ned Davis Research is estimating the chance of a global recession at over 90% right now.

Chart 6



Source: Goldman Sachs

Chart 7



Source: Wind, Bloomberg, Company announcements, Goldman Sachs Global Investment Research

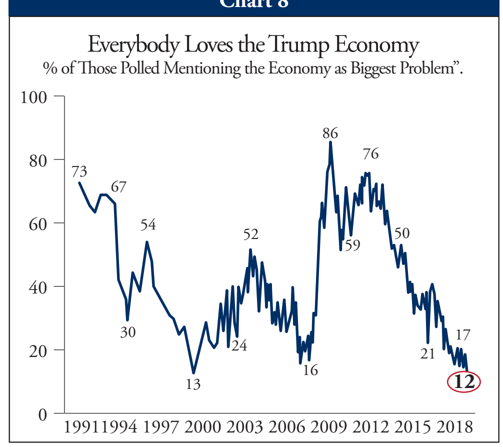
Even so, it is nearly impossible to determine when China will no longer be able to steer its economy around any potential debt-related accidents. They have already done so far longer than we imagined and may be able to continue for longer than we think is likely. In Europe, on the other hand, Italy's debt problems have come to the forefront again. Back when Greece's debt problems were unnecessarily causing upset in the world's financial markets, we noted the global economy would not face real issues until Italy's debt problems began to percolate. In recent weeks, investor skepticism about Italy's ability to manage its debt has led to weakness in the Italian financial markets. The most notable risk in this situation is the potential for French and German banks to be caught up in an Italian debt default, putting the integrity of the European banking system at risk. Given the very serious consequences, we believe Europe will choose to "kick the can down the road" much like it did with Greece's debt problems. Still we are paying close attention to developments in Italy in case this proves unachievable.

Midterm Elections: What Will Be the Impact on the Financial Markets?

"I heard, but I did not understand. So I asked, "My lord, what will the outcome of all this be?"" Daniel 12:8

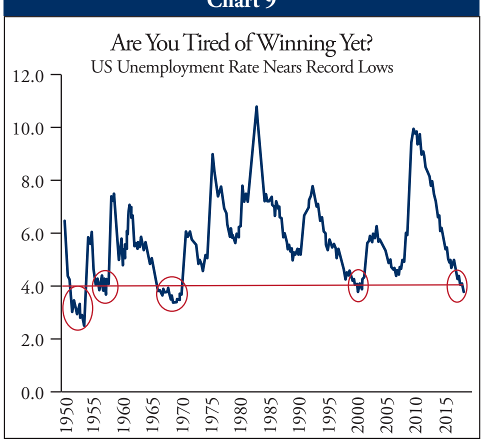
Another big issue for the markets is the midterm elections in the US. Clearly, the stock market has approved of President Trump's management of the US economy as it has performed nicely since he was elected. While the stock market might approve of Trump's presidency, voters will shortly get their first opportunity to render a judgement on his job performance in the midterm elections. Trump has one advantage every President would love to have going into an election – a strong economy. Chart 8 reveals a historically low percentage of those polled by Gallup considered the US economy to be the country's biggest problem. Good economic and stock market performance has been consistently true so far in Trump's presidency, yet the president's overall approval numbers have only recently started to rise. Interestingly, Trump's approval numbers have also been rising among the historically left-leaning African American and Hispanic population. Should these polling numbers translate into votes at the ballot box for Republican candidates, President Trump may surprise the pundit class again with a better than expected election outcome for his party, but that will be very hard to achieve.

Chart 8



Source: Gallup, The Wall Street Journal and @SoberLook

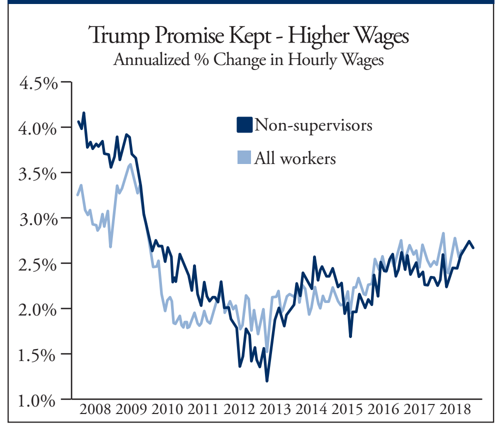
Chart 9



Source: St. Louis Fed

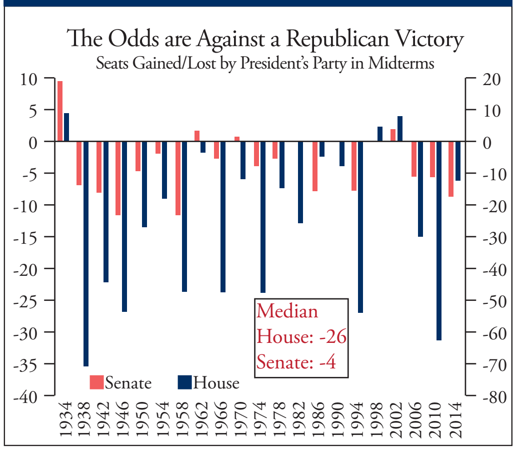
One reason for President Trump's recently rising popularity is the electorate recognizing he is actually is keeping his campaign promises, something most elected officials seem to forget about shortly after taking office. For example, unemployment rates are near record low levels as President Trump has been able to extend the gains seen under President Obama (Chart 9). Moreover, record low levels of unemployment have been achieved in a variety of minority groups as well. Despite these achievements, President Trump's sometimes caustic personality will surely cost him votes in the midterm elections. The big question is how many? While many people voted for Trump, despite his very rough edges, because they could not countenance Hillary Clinton as President, neither Hillary nor Trump is on the ballot in the midterms. As a result, some voters may ignore Trump's success at delivering good economic performance and working hard to keep his campaign promises, and instead seek to reprimand him for his sometimes childish behavior by voting for democratic candidates. Among college educated women, polls suggest there is very strong animosity against republican candidates in this election, at least in part, no doubt, to the Presidents boorish antics but also due to the Kavanaugh Supreme Court battle. It remains to be seen whether strength in other demographic segments will be sufficient to overcome the unusually large losses republicans face among college educated women.

Chart 10



Source: Bureau of Labor Statistics

Chart 11

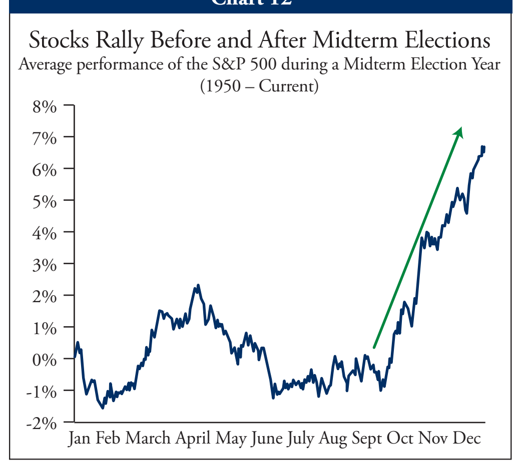


Source: US Congress website, Deutsche Banks

Despite Trump's obvious shortcomings which disproportionately impact certain segments of the electorate, in most elections, voters tend to "vote their wallets". In light of the benefits voters have experienced from the Trump tax cuts, the advancing stock market boosting their retirement savings and more rapid wage gains than seen previously (Chart 10), almost all voters have seen their wallets grow fatter under president Trump. Even those voters whose dedication to left-leaning policies make them despise Trump have to acknowledge the Trump economy is nowhere near the disaster they likely assumed it would be by this point in his presidency. If, as a result, a majority of the independent voters, and just some of the normally democratic minority voters, turn to the republican side, President Trump may be able to hold both the Senate and the House. Still, that would be a huge surprise.

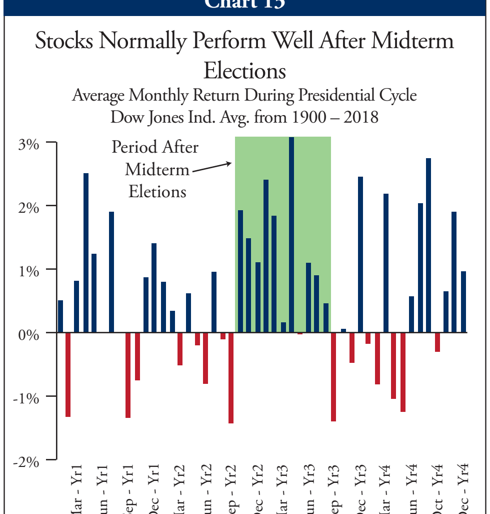
It would be a huge surprise because the President's party almost always loses seats in midterm elections (Chart 11). Turnout from the key voting segments will drive this election's results. Given the extent of the outrage about the Trump presidency among younger people a high turnout from this normally low turnout group could easily swing the House of Representatives to the Democrats. Of course, the Kavanagh Supreme Court battle fired up the conservative base. If emotions are still running hot in November among republicans, conservatives may manage to barely hold onto the House. Even with that, however, there is a very narrow pathway for republicans to hold their majority in the House. Unless something changes dramatically in the short time between now and the election, republicans are highly favored to maintain control of the Senate and might even increase their lead slightly, despite the historical odds being heavily against such an outcome.

Chart 12



As voters, we all have our preferences for the outcome of the elections. As investors, however, we really should not care very much. Just as we have seen so far in October, historical trends reveal the run-up to a midterm election often leads to a rise in volatility in the financial markets as investors struggle with the uncertainty of the outcome. In addition to the political ambiguity present in this election, there is also concern about an economic crisis in China and worries about the economic and political situation in Italy, which could hurt its banking system. Still, the normal pattern for the US stock market around the time of a midterm election is for the market to hit a low point in early to mid-October and then rally strongly right through the election and into the end of the year (Chart 12). In fact, the year-end rally in midterm election years tends to be stronger than the typical year-end rally. While there is no guarantee such a rally will occur in 2018, the odds favor such an outcome. As a result, from an investment perspective, the market normally likes the lack of uncertainty a completed election process brings more than the actual political outcome of the election. Surprisingly, which party actually triumphs has historically been largely irrelevant to investors.

Chart 13



Source: The Lyons Share

The normal midterm election rally, however, does not come to an end at the end of the year. On average, the first eight months of the following year tend to be single best part of a presidential term (Chart 13). Apparently, after the voters have spoken, the politicians behave better than normal for a number of months and actually try to get helpful legislation enacted before rancor sets back as the next presidential elections comes into focus. In the current situation, if President Trump faces a democratically controlled House, we find it hard to believe the current political divisiveness will diminish at all. In fact, it may even intensify. Therefore, little useful legislation may get passed in 2019, but the market often likes it when legislators are unable to interfere in the economy.

Strong Profits, Reasonable Valuations Provide Hope for Investors

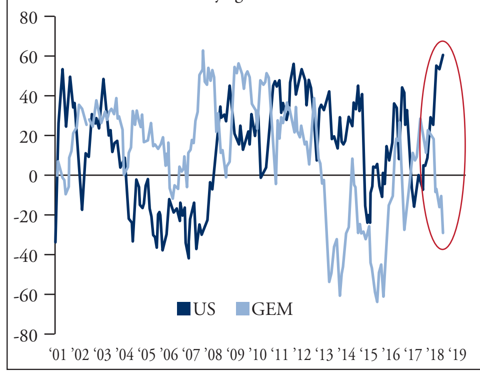
"There is surely a future hope for you, and your hope will not be cut off." Proverbs 23:18

Whatever the outcome of the midterm election may be, the outlook for the US economy and corporate profits remains favorable. As we have noted previously, prospects outside the US, on the other hand, are not especially encouraging. Chart 14 portrays the unusually divergent outlook for corporate profits in the US and the emerging markets among fund managers. China's highly indebted economy is the biggest risk facing investors at the moment as a collapse in its economy would have negative impacts on financial markets around the world. Recent proclamations from government officials in China suggest they are taking extraordinary actions to keep things under control and, as in the past, they will likely be able to prevent an uncontrolled, bad debt-induced economic meltdown. While keeping a very wary eye on China, and emerging markets in general, as this is the most obvious weak link in the global economic system right now, we are not yet ready to utilize hedging to protect our client's portfolios from this possibility. But our perspective on this could change quickly.

Chart 14

The US is Doing Much Better than Emerging Markets

% of those Polled Saying the Profit Outlook is Positive

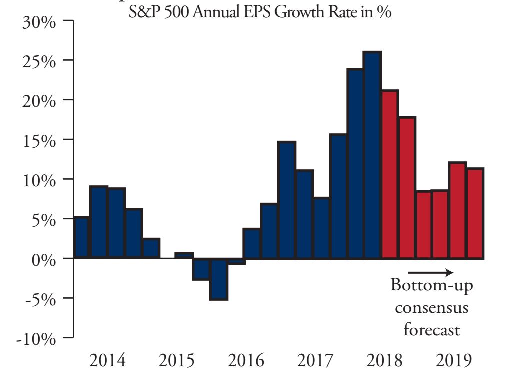


Source: BofA Merrill Lynch Global Fund Manager Survey

Chart 15

US Corporate Profits Growth to Slow in 2019

S&P 500 Annual EPS Growth Rate in %



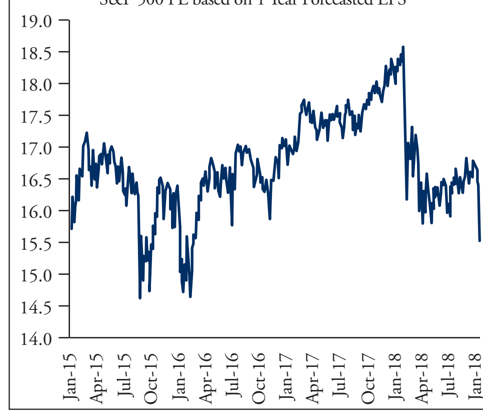
Source: FactSet, Compustat, and Goldman Sachs Global Investment Research

Should China, the other emerging markets and Italy not cripple the world financial markets with an actual crisis versus just a potential crisis, the already old US economic expansion stands a good chance of remaining vibrant. Corporate profits should also continue to expand, albeit at a lower, yet still healthy rate (Chart 15). The fiscal stimulus and corporate tax reductions which boosted 2018's profits dramatically will not be repeated in 2019, although the positive impacts of the tax cuts will linger to some extent. Normally, the very strong corporate profit growth seen in 2018 would produce quite a bit of excitement in the US stock market, but so far this year the market has lagged well behind the expansion in profitability. As the corporate profitability growth rate has likely already peaked, some wonder if share prices will be even weaker in the months ahead. Unless an economic accident from overseas that sends share prices lower occurs, we believe equities might start to catch up to the big run higher in corporate earnings in the months ahead.

Chart 16

US Stocks are Getting Cheaper!

S&P 500 PE based on 1 Year Forecasted EPS



Source: Factset, UBS

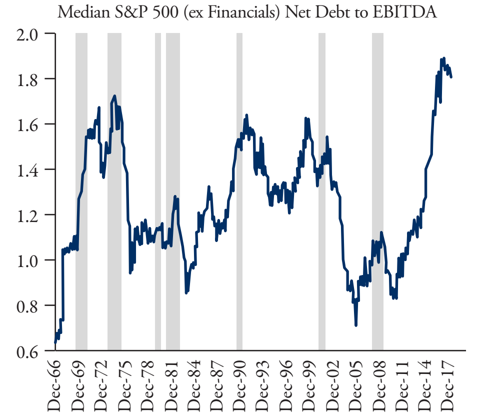
One reason for such optimism share prices might recover from the current October swoon is the much better valuations now versus earlier this year. The combination of very strong earnings and sub-par share price performance has caused the price earnings multiple of the S&P 500 to drop considerably (Chart 16). While share valuations are not yet in the bargain basement, they do offer more comfort to investors looking to avoid losses than they did earlier this year. The biggest domestic threat to our hope for rising share prices is the Fed, which the market is clearly worrying may be tightening monetary policy to much too soon. It is possible the market will mostly ignore the lower valuations until the Fed relents on its current efforts to raise rates and reduce its balance sheet.

Chart 17

Corporate Debt Could Be a Problem

Debt to Cash Flow the Worst in over 50 Years

Median S&P 500 (ex Financials) Net Debt to EBITDA



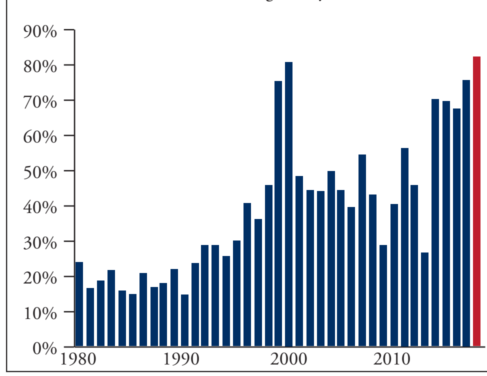
Source: Compustat, Deutsche Bank

Investors are justified in their concern about the Fed as US companies have loaded up with debt in recent years while interest rates were low. Chart 17 indicates the relationship between corporate debt and the cash flow companies have to service those borrowings is at its worst level in over 50 years. Should anything cause corporate profits to falter, some companies are going to be in trouble pretty quickly. While US consumers are much better off than in the past with regard to debt, US companies are taking too many chances with borrowings for investors to be complacent.

Chart 18

Speculation Indicator?

% of IPO's That are Losing Money When Listed



Source: Jay Ritter

Meanwhile, we are always on the lookout for speculative activity that might signal the stock market is over-heating. There are not an abundance of such indicators right now, but there are some. Chart 18 shows the percentage of IPO's losing money when brought public has reached the levels last seen in the internet bubble back in 1999 and 2000. While such data is concerning, valuations overall are hardly at speculative levels at this time and the weight of evidence clearly shows we are not facing a buying frenzy in stocks.

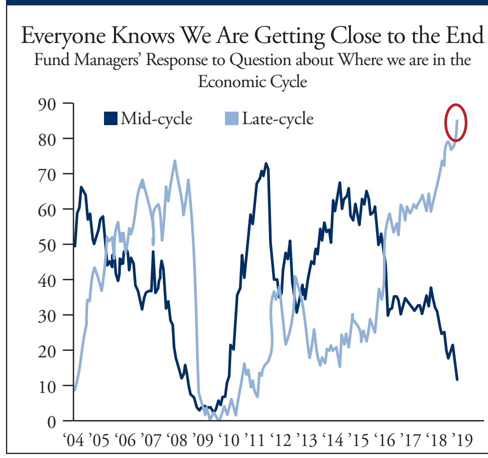
STEWARDSHIP PARTNERS MARKET COMMENTARY

Hoping to Move from Cautiously Positioned to Cautiously Optimistic

"But if we hope for what we do not yet have, we wait for it patiently." Romans 8:25

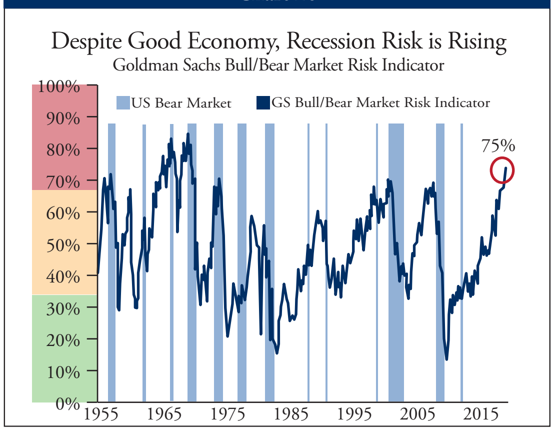
Given its poor recent action, especially outside of the US, the overall market is clearly not in the midst of a speculative bubble. Still, there are always some sectors of the market that are. For example, Cannabis stocks have gone bonkers recently. Obviously, such stocks are not something Stewardship Partners would invest in with our client's assets as our aim is to glorify the Lord with our investing. More recently, we have even seen the speculative fever in the FANG stocks (Facebook, Apple, Netflix and Google) cool. But while speculation may not be a big risk facing this particular market environment, it is not without risks as we have delineated earlier in this commentary. Another concern, heightened by the near record length of the current economic expansion, is that we are very late in the economic cycle. Chart 19 highlights this concern as there is an almost unanimous opinion among fund managers we are late in this cycle. This means a recession might not be that far off, but there is still little evidence to suggest a US recession is nearby.

Chart 19



Source: BofA Merrill Lynch Global Fund Manager Survey

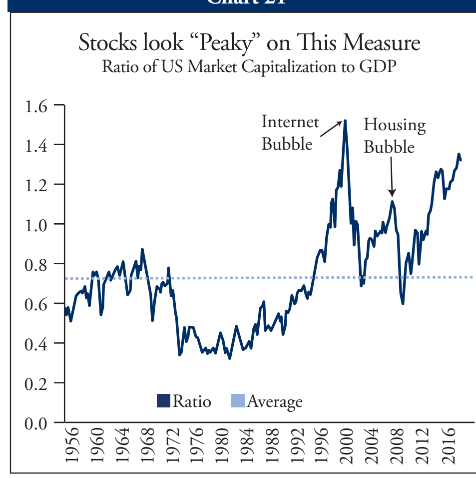
Chart 20



Source: Shillet, Haver Anlytics, Datastream, Goldman Sachs Global Investment Research

Bear markets typically do not occur without an accompanying recession. When earnings are growing, it is very difficult to get investors to sell enough of their shares to cause a 20% drop in share prices, which is the definition of a bear market. But it is not impossible for that to happen, particularly when the Fed is tightening faster than the market thinks is sensible. In such an environment, stocks can fall as they anticipate an end to the current attractive corporate earnings picture. Goldman Sachs developed a model that correlates well with past bear markets and it is now suggesting a bear market could be imminent (Chart 20). So far, the fall from the markets high in September reached a maximum of 10% but it is not inconceivable the sell-off could accelerate to the point where it would fall 20%. The emerging markets are already in a bear market and developed markets outside the US are not far behind and there has been no recession yet in either area.

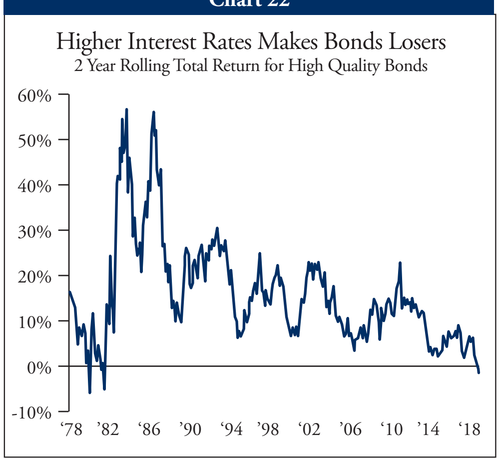
Chart 21



Source: Real Invetsment Advice

Moreover, even though valuations are not at frothy levels, other measures of value put the current US market in the vicinity of where other peaks in equity prices were reached in the past. Chart 21 highlights the ratio of the combined market capitalization of all US stocks compared to the size of the US economy. Because stocks have risen much faster than economic growth over the last decade, aided by the Fed's quantitative easing policy, this ratio is getting closer to the peak levels seen just before the internet bubble burst. With the Fed now engaged in quantitative squeezing as they shrink the size of their balance sheet, and doing so at the same time they are raising interest rates, we would not be surprised to see a situation evolve where the economy grows faster than stock prices rise for a period of time. This might mean more modest equity returns over a considerable time period.

Chart 22

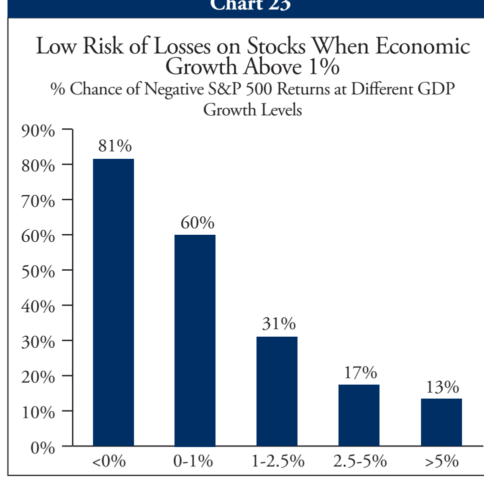


Source: LPL Research, Bloomberg

Bonds have already been seeing much more modest returns, even losses. Over the last two years, bonds have suffered small losses (Chart 22) and this may continue as the Fed raises rates and sells bonds in its quantitative squeezing program. In our more conservative portfolios, we have steered away from most bonds in recent years but we are beginning to get more interested in fixed income investments due to now higher rates and the prospect of slower economic growth in the future.

History suggests the risk of losses in the equity market is low as long as economic growth is above 1% (Chart 23). While encouraging, there has never been a time in history where the Fed was both raising rates and selling assets from its balance sheet simultaneously. Accordingly, a degree of caution remains warranted, but we hope to shift to a cautiously optimistic stance soon.

Chart 23



Source: Shillet, Haver Anlytics, Datastream, Goldman Sachs Global Investment Research

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 *<u>justice and mercy for the defenseless</u>* 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 *<u>justice and mercy for the poor</u>* 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 *<u>compassion for those addicted and/or engaged in sinful lifestyles</u>* 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 *<u>protect marriage and the family</u>* 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, Qualcomm, and one we avoid, Tesla. Qualcomm is a holding in some Stewardship Partners portfolios while we actively avoid ownership in Tesla 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 – Qualcomm – Blessing All of its Stakeholders

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

In 1985 seven communications industry veterans gathered together in the San Diego home of Irwin Jacobs and laid the groundwork for what would become one of the most successful business start-ups of its time - Qualcomm. While not as well-known as Microsoft or Apple whose products are sold directly to consumers, Qualcomm – which stands for quality communications – has had a pivotal role in developing the infrastructure and technology needed to support the explosive growth in wireless communications. The company, true to its engineering roots, has thrived on creativity and innovations and has always seemed to be several steps ahead of its competitors. Founder Irwin Jacobs almost missed his calling. His high school guidance counselor told him there was no future in engineering and his first major was in hotel management. Fortunately, for the literally the whole world, Jacobs changed his major to engineering after being teased for his easy course work in hotel management by a fellow student, ended up getting a doctorate in engineering at MIT and later moved to San Diego to teach. Soon thereafter he formed a consulting firm from which Qualcomm later emerged. Due to the company's massive success in pioneering the technology backbone of the wireless communications industry, billions of people each day utilize the products the company invented via their cell phones, computers and tablets. Its first technological breakthrough was what is known as CDMA technology for cell phones which powers all of the world's 3G cellular networks and still generates billions in royalties for the company. Naturally, the company has continued to innovate and is currently rolling out 5G cellular technology as well as creating developing and marketing semiconductors for a wide range of products.

Qualcomm's long term success in a highly competitive field has been built on both innovation and integrity. The company's culture is centered on helping its many engineers and scientists to work in a collaborative and visionary environment so the company can stay on the leading edge of technological developments in its industry. The company's Code of Conduct manual is entitled "The Qualcomm Way" and it begins with this statement from the company's CEO: "Every day we are each committed to doing business with the highest level of integrity, respecting our customers, business partners and each other. We trust each other, and collaborate to accomplish our goals together, while holding ourselves individually responsible for our work and accountable for our actions. We work together in a professional manner that celebrates our diverse backgrounds, skills and viewpoints. We work collaboratively, and openly share information, ideas, concerns and suggestions. We take initiative to succeed and constantly seek out new and innovative ways to do things. This is what it means to be a Qualcomm employee… this is The Qualcomm Way." The guide goes on to explain the principles and rules every employee is expected to abide by. First it highlights the importance of maintaining an ethical culture and explains how ethical issues will be handled by the company. Many resources are provided for employees to address real or potential unethical behavior at Qualcomm, including an anonymous hotline. The guide then lays out in great detail the responsibilities employees have to the company, to each other, to Qualcomm's customers and business partners, to Qualcomm shareholders and to the communities in which Qualcomm operates. Given the breadth and depth of the guide to the Qualcomm Way, there can be no doubt Qualcomm takes its commitment to integrity very seriously.

Qualcomm goes the extra mile in taking care of their most important asset, its employees, as is befitting a highly profitable enterprise. Indeed, the benefits package it offers its staff is very extensive. On the health end of the company's benefit spectrum, well, we don't have room here to catalog all of the benefits. Qualcomm provides employees with all the normal healthcare insurance, including prescriptions, dental and vision but also goes well beyond that. Staff can get 12 weeks of family time off at 100% pay for a range of family issues they may face. Part time employees also get access to many critical health and other benefits. The company also has a leave of absence policy that would be the envy of employees at other companies with leaves approved for educational, military, medical and even if the need arises for you to care for a close relative who was injured in military service. Another service is called "Best Doctors" where employees can present their health situation to experts who will then match them with a recognized expert to diagnose and resolve their health issue. Qualcomm also provide its staff with a personalized health advocate which help them navigate insurance plan choices, resolve medical billion options and aid them with what questions they should ask their doctor about their medical condition. Qualcomm employees also enjoy a variety of programs to help them build their wealth, including a 401k, an employee stock purchase plan, a HSA and flexible spending accounts. Qualcomm encourages adoption by providing financial assistance as great as $15,000 and also assists its staff with education, finances and flexibility for helping to care for older family members. The extent of Qualcomm's employee benefits is truly remarkable and we have only touched on some of them in this description. One suspects employee turnover at Qualcomm is very low given the ebefits a departing staff member would be giving up in leaving the company.

Company founder Irwin Jacobs and his wife Joan are retired now and philanthropy is now one of their main areas of focus. They have signed the Buffet Giving Pledge in which they commit to giving away half of their wealth before they pass away. Areas of focus have been on STEM programs for youth, engineering programs at MIT, Cornell and other colleges, and cultural institutions in the San Diego area in particular. The company also encourages charitable work by matching employee gifts to charity and offering a grant of $250 to any charity an employee donates 15 hours of service time to. Qualcomm has also sought to bring wireless technology to places in the world that would not otherwise receive service. In the last ten years, the company has instituted 119 such projects in 47 countries that have given more than 12 million people access to cellular technology. Another company program is helping the Philippine government gather critical healthcare data in poverty stricken provinces so that the needs of these communities can be better addressed. This program has helped 160 clinics in 28 provinces serving 1.3 million patients. Patient care has improved and the number of clinic visits has increased because doctors and nurses are now able to more efficiently treat the poor patients coming to their clinics for care.

Qualcomm'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 all those it comes into contact with and is an organization we can be proud to be known as part-owners!

The Bad – Tesla – Troubled Leadership

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

Tesla is the world's foremost electric car manufacturer that has garnered a reputation for building truly inspiring and environmentally friendly vehicles. The company also operates a division which makes solar panels called Solar City. It was founded in 2003 and now well-known entrepreneur, Elon Musk, who currently serves as the company's CEO, is counted among its five founders. Indeed, Musk has built something of a cult following among investors and customers of the company enjoying a degree of popularity similar to what Steve Jobs once enjoyed as CEO of Apple. Unfortunately, while Tesla does not fail any of the screens our sister company the Biblically Responsible Investing Institute (BRII) performs on public companies, we have chosen not to invest in Tesla out of concern about the behavior and activities of CEO Musk. Recently, Musk was fined $20 million by the SEC and Tesla another $20 million and he was required to forfeit his role as Chairman of the company's board of directors due to his obvious attempt to mislead investors by claiming incorrectly in a tweet that he had secured funding to take Tesla private at a price much higher than what its stock was trading for at the time. Additionally, Musk accused one of the men in the recent rescue of a boys' soccer team from a Thailand cave of pedophilia when his efforts to help with the rescue were deemed a publicity stunt. He also is a known drug user and was recently filmed smoking marijuana. He adopted a "Hollywood" lifestyle after divorcing his first wife and began dating movie stars, marrying and divorcing one twice. This poor man's life is a mess, something he himself recently admitted, even while he is still held in high esteem by many. While his company may continue to be a success, it is heavily indebted, burning cash and suffering from his micro-management. While we should pray for his soul, we think it best to not invest in his company's stock as he clearly is testing the limits of our Lord's grace on many fronts in his life.

We seek to avoid investing in companies like Tesla. 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.

STEWARDSHIP PARTNERS MINISTRY COMMENTARY

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 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 – Strategic Resource Group

"Everything must be done so that the church may be built up." 1 Corinthians 14:26b

Strategic Resource Group (SRG) is one of the more unusual Christian ministries in existence, but this uniqueness is what makes it so attractive. Founded in the late 1990's by businessman Paul Schultheis, the blandly named SRG chose to focus on one of, if not the most difficult, areas in the world to evangelize and make disciples – the Middle East and North Africa. The inexpressive name of the ministry is meant to not draw undue attention to its work from potential enemies in the region who might seek to do it harm, but is also does accurately reflect the ministry's strategic approach to gathering the needed resources to carry out its mission. SRG' has many distinctive attributes which separate it from most, if not almost all, Christian ministries. The first one is its sole focus on the Muslim nations in the Middle East and North Africa, which are the most inhospitable countries in the world to the gospel. Other ministries might include the region as a portion of their work, but few focus on it alone. In fact, it is estimated that less than 1% of all giving to Christian causes goes to the Middle East. It is very hard work and SRG has embraced the huge challenges which come with evangelization and discipleship in the Middle East and North Africa.

Several other aspects of SRG's ministry model are also unique. The first of these is that the ministry operates on a partnership model but it also resembles a mutual fund for giving. The goal is to raise funding needed for the ministry to carry out its work from wealthy "resource partners", largely located in the US and Europe. There are no donors to SRG, only resource partners. The money raised is then distributed to ministry partners in the field in the Middle East and North Africa. These ministry partners are typically native Christian ministries in the various countries and SRG seeks to bring both financial and operational aid to them. SRG employs a staff of portfolio consultants who each have specific country and sector research responsibilities, as well as manage funds targeting specific needs in the region, and they are tasked with identifying the best ministries for SRG's resource partners to fund. While others are now seeking to emulate SRG's well-run approach to funding Christian ministry in other areas of the world, we are not aware of any other group who has advanced to the high caliber of operations displayed within SRG. Moreover, resource partners themselves make up the vast majority of the management and board of SRG. So, the chances money raised by SRG is used poorly is minimized since the people overseeing the funding of the Christian ministries are the same people who actually gave a lot of the money in the first place. One sizable constraint for most interested in becoming a resource partner, however, is an expectation a resource partner will give at least $1 million to SRG over the course of several years. Rusty Leonard serves on the board of SRG, so please feel free to contact him if you have the capacity and interest to become a resource partner with with this unique and effective ministry.

Strategic Recource Group is a very strategic ministry which takes the steps needed to promote church growth in regions of the world where churches and sound biblically-based teaching can be hard to find. With greater resources, ICM would be easily able to replicate its proven model in other areas. Additionally, the ministry effectively utilizes the financial resources donors entrust to it as reflected by the Four Star Financial Efficiency Rating earned from MinistryWatch.com. ICM is also very transparent about its finances and is worthy of consideration for your 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 – Calvin Edwards & Co.

"We carry the offering, which we administer in order to honor the Lord." 2 Corinthians 8:19b

Calvin Edwards & Company is a leading donor advisory consulting firm, which helps individuals, families and foundations maximize the good they achieve through strategic giving. Founded in 2001 by long-time ministry and Christian financial services veteran Calvin Edwards, the firm seeks to assist thoughtful, high-capacity donors with customized services to help ensure their generosity is as effective as it can be. Calvin and his team help guide a prospective donor through the creation of a donor profile which helps identify the donor's giving personality. A Giving Plan is then produced to help guide and manage the donors giving. In this process, Calvin Edwards & Company provides information, perspective, and judgment that informs and guides their clients' decisions about the charities that best match the client's giving goals. Calvin and his staff regularly prepare very professional, in-depth research reports which help define the important issues a wise donor should consider when evaluating a potential ministry for a sizable gift. The company can also assist in formulating the appropriate accountability methods for how a gift is utilized and can aid donors in structuring gifts so that the intended effect can be optimized and common barriers to effectiveness minimized.

Calvin Edwards and Co. also serves nonprofit organizations with products and services to improve its management and program effectiveness. It provides its analysis and insight in bound reports written in a style suitable for giving to a donor or prospective donors. Research on specific charities, charitable sectors and important issues facing charities are produced which are both comprehensive and enlightening. If you are a significant donor or ministry seeking to improve its operations, we would highly recommend that you consider enhancing your giving with the assistance of Calvin Edwards & Company. Via a ministry Calvin Edwards & Co. serves, we have personally seen this firm's work and it is exemplary.

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!

STEWARDSHIP PARTNERS

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