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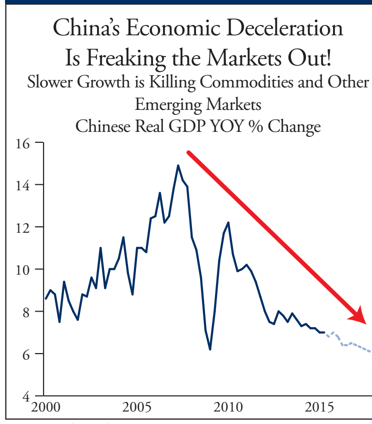
Not Yet Safe Enough to Exit Our Storm Shelter

"For in the day of trouble he will keep me safe in his dwelling" Psalm 27:5

The title of our last Quarterly Commentary accurately asked the queston if the second quarter of 2015 was "The Calm Before the Storm?". Having seen danger on the investment horizon, Stewardship Partners positioned its portfolios defensively thereby helping protect our clients from the worst of the turbulent financial markets during the third quarter. China's declining economic growth (Chart 1) has been the epicenter of the current turmoil and its often bumbling policy responses made it even worse. China's bursting stock market bubble, and its subsequent devaluation of its currency, triggered investor fears about a potential global recession and caused the MSCI Emerging Markets Index to fall nearly 18% in the quarter. Developed share markets also declined with the MSCI World ex USA Index falling 10.6% and the S&P 500 dropping by 6.5% in the third quarter (Table 1). Due to our defensive positioning, however, almost all Stewardship Partners portfolios outperformed the indices during the quarter.

Chart 1



Source: Bloomberg

China's decelerating economy has had a broad global impact which is reaching well beyond equities. In particular, commodity prices have plummeted to multi-decade lows with nations and companies supplying natural resources to China suffering greatly as a result. Brazil is in the midst of a deep recession triggered by China's problems (but exacerbated by many issues of its own making) while Canada, Australia and other natural resource and energy oriented countries are also feeling the burden of China's economic troubles. Russia's economy is also in recession largely due to falling oil prices. The global bond market has responded to China's weakening with falling yields on high quality debt but much higher yields on riskier junk and commodity related bonds. As these yield spreads widened, investors became increasingly alarmed China's worsening economy could lead to rising corporate defaults, thereby constricting credit and causing a global recession. Speculation has grown that large commodity trading firms, such as Glencore, Noble or Trafigura – companies with over $100 billion in debts that few people are familiar with – might succumb to the crash in commodity prices. Moreover, such defaults could have a Lehman-like impact since it could trigger further defaults among those company's many trading counterparties. At the moment, such a scenario seems avoidable, but it is one we are still closely following. Additionally, the prospect of widespread bankruptcies in China's industrial sector remains significant. The massive overbuilding of industrial plants in China means many have little or no chance of being able to repay their debts or even service the interest on those debts. Government bailouts may forestall Chinese corporate failures but there can be no guarantee of such. These are just some of the bigger risks China's deceleration has brought about.

Table 1

3Q15 Total Returns

US Indices	3Q15	YTD	5y ann
S&P 500	-6.4%	-5.3%	13.3%
S&P 500 Value	-8.3%	-8.7%	11.9%
S&P 500 Growth	-4.8%	-2.2%	14.7%
NASDAQ	-7.1%	-1.6%	15.7%
S&P 400 (Mid Cap)	-8.5%	-4.7%	12.9%
S&P 600 (Small Cap)	-9.3%	-5.5%	14.0%
Treasury Bonds	1.9%	1.8%	2.6%
High Grade Corp. Bonds	0.4%	-0.1%	4.3%
Gold	-4.9%	-5.9%	-3.1%
Global & International Indices			
MSCI World	-8.4%	-6.0%	8.3%
MSCI EAFE	-10.2%	-5.3%	4.0%
MSCI Euro	-8.9%	-6.0%	2.6%
MSCI Far East	-12.7%	-1.8%	4.5%
MSCI Japan	-11.8%	0.2%	4.9%
MSCI Emerging Markets	-17.9%	-15.5%	-3.6%
US Economic Sectors			
Energy	-17.4%	-21.3%	3.9%
Materials	-16.9%	-16.5%	6.7%
Industrials	-6.9%	-9.8%	12.3%
Consumer Discretionary	-2.6%	4.1%	19.3%
Consumer Staples	-0.2%	-1.0%	14.2%
Health Care	-10.7%	-2.1%	19.0%
Financials	-6.7%	-7.1%	11.6%
Information Technology	-3.7%	-3.0%	14.2%
Telecom	-6.9%	-3.9%	8.3%
Utilities	5.4%	-5.9%	11.0%

Source: Bloomberg

Outside China's industrial sector, however, its economy appears reasonably healthy. Retail sales remain strong, its housing sector seems to be recovering and China's financial position remains strong. While it has liquidated some of its ample supply of foreign reserves to keep its currency from falling further, China's national finances are not at risk of collapse, at least based on reported numbers. While there may be a Chinese instigated global recession occurring, so far it has been relegated only to the energy, commodity and industrial sectors of the world economy. Weakness in these sectors has slowed overall global economic growth in many nations, but those not too reliant on those sectors for growth and employment continue to expand, if only at a reduced pace. For much of the developed world, however, the benefits of lower oil prices and low inflation resulting from China's weakness is helping to compensate for the slower growth in the affected sectors.

At Stewardship Partners, we have slightly reduced our defensive portfolio positioning to reflect lower share prices and some early evidence the recession can be contained to just the energy, commodity and industrial sectors. At the same time, however, there remains some risk the problems in these areas could overflow into the wider economy and, in particular, the banking sector. If so, the market will almost certainly plumb new lows in the months ahead. As a result, our portfolio positioning remains very conservative given the real potential for financial system and recession fears to rise again in the short term.

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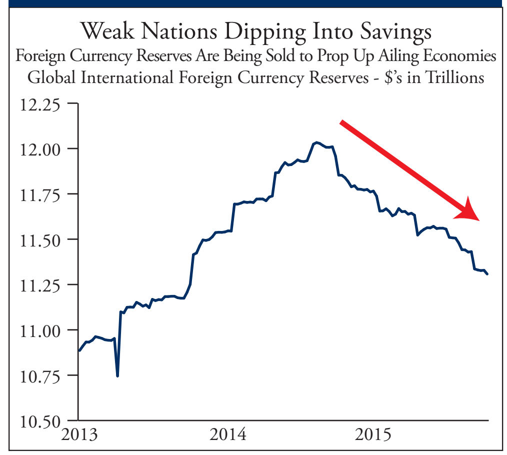
Will "Quantitative Squeezing" Hurt the Global Financial Markets?

"We are hard pressed on every side, but not crushed; perplexed, but not in despair;" 2 Corinthians 4:8

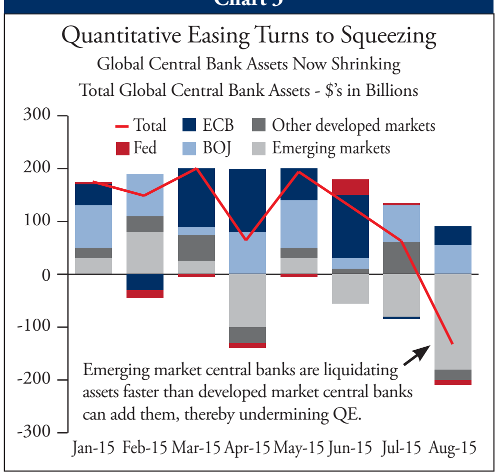
Chart 2



Source: Bloomberg

Share price corrections, like that seen in the third quarter, have been a relatively rare occurrence in recent years. Many believe the unusually long periods of steady market advances since the market hit bottom in March 2009 can be traced to central banks adopting quantitative easing (QE) policies whereby money is pumped into the financial markets through central bank purchases of securities, normally government debt. The US Federal Reserve initiated QE in 2009 and three separate QE policies were put in place since, the last for all practical purposes ending in the Fall of 2014. Subsequently, both Japan's and Europe's central banks have also implemented QE policies in an attempt to help their economies recover from long periods of sub-optimal growth. As a result, even after the Fed ended its latest QE effort one year ago, the expansion of central bank balance sheets continued, when viewed globally, thereby providing continued liquidity to the global financial markets. More recently, however, a new dynamic has emerged which some are referring to, somewhat jocularly, as Quantitative Squeezing. Chart 2 highlights one aspect of this – the decline in international reserves, which has exceeded $500 billion since late in 2014. As emerging market nations, in particular, have been hit by the negative impacts of China's economic deceleration, they have been forced to liquidate some of their reserves, or savings, in order to support their flagging economies and currencies. China itself is a big component of this decline in reserves but the drop goes well beyond China. Countries like Saudi Arabia and Norway have been selling US Treasuries and other assets, including equities, in order to help balance government budget deficits which have been impaired by the dramatic decline in the price of oil. Clearly, having governments liquidating financial assets, rather than purchasing as had been the case for many years, is a new dynamic which will impact both the financial markets and, perhaps to a lesser extent, economic activity as long as it continues.

Chart 3

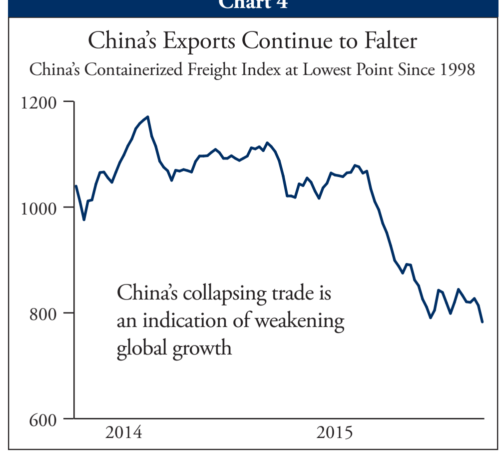


Source: BCA Research

Another way of observing this development is to look at the transition which just recently occurred from global QE to global Quantitative Squeezing. Chart 3 portrays the recent transition to Quantitative Squeezing late this summer as emerging market central banks shrunk their balance sheets. The resulting decline in global central bank assets was surprising given the scope of QE being undertaken in Europe and Japan. While academics may struggle in drawing a direct linkage between the onset of Quantitative Squeezing and the market's drop in August, it is hard not to notice the connection. If QE has indeed propped up the markets in recent years, then it is reasonable to expect Quantitative Squeezing to have the opposite effect. Economists may disagree on the connection between the size of central bank assets and both the pricing of financial assets and economic growth, but it is clear that investors perceive there to be a relationship. Since perception is often reality in the short run, it seems reasonable to expect investors to grow increasingly concerned with this trend if it persists.

Since China's declining international reserves and central bank assets make up a considerable portion of this new Quantitative Squeezing and because it is the deteriorating health of the Chinese economy which is behind these trends, a recovery in China's economic prospects, or at least a stabilization in its economic growth rate, would likely be necessary for Quantitative Squeezing to revert to Quantitative Easing. For the moment, unfortunately, there is not much evidence a recovery has yet begun. Most economic trends and leading indices in China still paint a picture of continued deceleration of economic growth. One leading indicator of China's export trends is the China Containerized Freight Index (Chart 4). As can be seen, this index remains in a downtrend and now has a value lower than 800, which was the level it was first established with in 1998. Indeed, trade numbers have been crashing around the world due to the collapse in China's industrial sector. Weak trade has led to crumbling shipping rates which are, in turn, imperiling the survival of many shipping companies and threatening the soundness of the banks specializing in shipping finance.

Chart 4



Source: Bloomberg

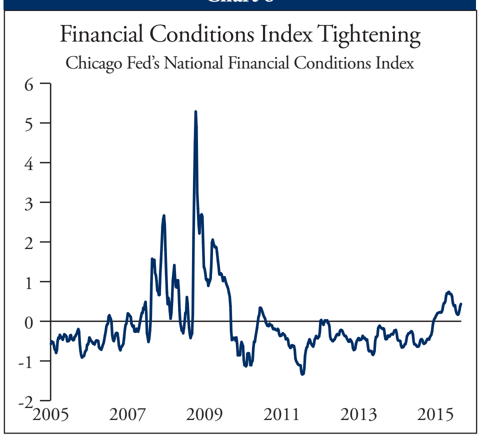
China is hardly the only contributor to Quantitative Squeezing in the emerging markets. Brazil's economy is in far worse shape and its policymakers have had to sell foreign reserves to help support the tumbling value of its currency. Chart 5 shows the weakness in Brazil's economy is already almost as bad as in 2008. We are now more concerned an unwanted financial system breakdown may occur first in Brazil than in China. Given Brazil's banking system is more interconnected with the developed markets' financial system than China's, it may also pose a greater risk of a contagion which could punish the global financial markets should it occur. Moreover, there is as yet little evidence Brazil's economy has stabilized or begun to recover, so the risk of a financial accident there is still growing as it is in China. Of course, we cannot be sure a financial accident will occur or, if one does ultimately happen this cycle, where it will originate from. What we do know is the conditions for such a development are now present and those conditions continue to worsen.

Chart 5

Source: Markit

Accordingly, one can more easily understand the Fed's reluctance to begin raising interest rates. While US economic growth appears strong enough to justify reducing further the Fed's unusually accommodative monetary policy, the risk such a move could set off a financial system accident in the emerging markets is good reason to delay. Such an accident could easily trigger a wider global recession, thereby undermining the Fed's objective of maintaining economic growth and low inflation. Moreover, the fall in equity prices and the rise in yield spreads for lower quality bonds have already effectively caused a tightening of monetary policy, as seen in Chart 6. Should financial markets calm down as the fourth quarter unfolds, the financial conditions index should ease and the timing of a Fed rate hike will be more appropriate. If the markets remain roiled in the fourth quarter, however, the chance of a Fed rate hike in December will drop considerably.

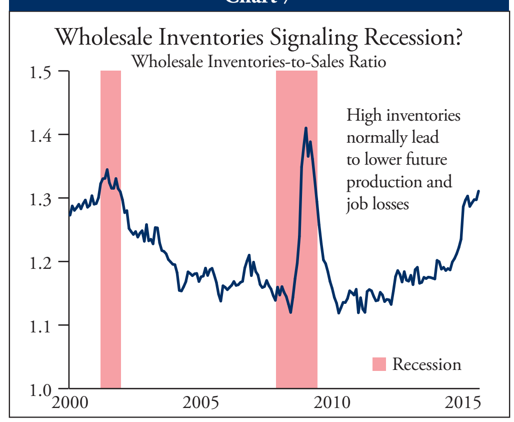
Chart 6



Source: Bloomberg

While the Fed should be anxious to return monetary policy to a more normal footing given the strength in employment and other indicators of an improving US economy, not every indicator is favorable. Inventories are building at an alarming rate and have already reached levels seen in the last two recessions (Chart 7). Moreover, third quarter GNP expectations for the US have fallen below 2% indicating an inability for the nation to sustain the 3%+ growth seen in the second quarter. Inflation expectations have also receded once again. As a result, the Fed is likely not only concerned about overseas developments impacting the US economy. With economic growth and inflation expectations still too low, Fed governors may decide the need to continue the extraordinary accommodative measures remains. Increasingly, this is what the financial markets believe, so if the Fed does hike interest rates in December as it has threatened to, it may ruin Christmas for investors.

Chart 7



Source: Bloomberg

Russia's Presence in Syria Risks a Geopolitical Accident

"All those gathered here will know that it is not by sword or spear that the Lord saves; for the battle is the Lord's" 1 Samuel 17:47

A Fed interest rate hike or financial system accidents are not the only possible ways in which Christmas could be ruined for investors. In our fourth quarter 2014 Quarterly Commentary we addressed the ramifications of lower oil prices and commented specifically about the possible reaction from Russia and Iran:

> "While this aggressive US/Saudi strategy to force oil prices dramatically lower might be seen as brilliant short term foreign policy, it does not come without serious risks. Only time will tell if Russia and Iran will buckle under the extreme pressure they face or if they will strike out in a dangerous manner. Logically, they should admit defeat and resolve the situation. But logic often does not prevail and who knows how or when either nation might react. Neither Putin nor the Iranian Ayatollah inspires much confidence. With nuclear weapons at Russia's disposal and nuclear material in both nations' hands, the possibility for war and terrorism should not be ignored."

Frankly, at the time, we believed the likelihood of a Russian/Iranian backed terrorism plot against Saudi oil fields was the most likely risk since Russia and Iran both desperately need higher oil prices in order to rescue their plummeting economies. If a plot could be successful in disrupting the oil flowing out of Saudi Arabia, energy prices would certainly have jumped dramatically and would have pulled both nations out of recession very quickly. Instead, the Russian/Iranian alliance, which also increasingly includes Iraq, chose to effectively annex the remaining part of Syria

Bashar Assad still controls by establishing a significant military presence in the country. Needless to say, this action dramatically alters the balance of power in the Middle East and will almost certainly have very meaningful geopolitical consequences for many years in the future. Given the kaleidoscope of combatants currently present in Syria, it is virtually impossible to discern with any long term accuracy the potential ramifications of this strategic thrust by the Russian/Iranian alliance. Even so, any outcomes that might be speculated about are hardly favorable for the world or the markets. This is a decidedly negative development which raises the frightening prospect of a major war between two of the world's superpowers. In effect, there is already a proxy war going on and the risk of it escalating, whether accidently or intentionally, into a direct confrontation between US and Russian forces is obviously highly disconcerting. The next few months could easily turn out to be the riskiest period for a potential accident with severe geopolitical ramifications occurring as it will take some time for each nation, and all the other players in the country and region, to get their positions sorted out. Such an event might spur direct combat between the two superpowers. Even after this initial high risk period the situation will remain convoluted as the Middle East has proven over and over again to be such a quagmire of confusion for any involved that no one could reasonably forecast the future direction of events there.

Most analyses of Putin's motivations for engaging in this bold and provocative action give three rationalizations. First, Russia has a naval base in the Syrian port city of Tartous which is being threatened by non-ISIS rebel forces. Given the strategic military importance of this base to Russia, Putin needed to make sure Assad regime was not overthrown and access to the base lost. Second, some believe Putin sees Russia's involvement in Syria as a good way to distract the world from its aggression in Eastern Ukraine. If Putin actually believes this, we believe he will find he got that wrong. To us, it is more likely the West will now do more to help Ukraine fend off Putin as a means of penalizing him for his aggression. Third, and perhaps most importantly, Putin's Syrian initiative stands in stark contrast to Obama's "leading from behind" foreign policy which has caused so much damage to US interests in the Middle East. Putin's actions allow him to appear as a bold and trustworthy ally while highlighting Obama's lack of conviction and fecklessness. While Putin will no doubt encounter setbacks in Syria, there can be little doubt that so far he has been able to raise his global profile while diminishing that of Obama, the US and Europe. If he eventually turns his military forces on ISIS and succeeds in eradicating them, many will hail him as a hero. While President Bush's second term ended badly due to the financial markets crash, Obama's last year in office could easily prove to be a similar-sized disaster on the foreign policy front.

One concern is, in seeking to avoid embarrassment, Obama eventually responds aggressively to Putin's Syrian gambit. Of course, we struggle to know exactly what that would look like and how it would be received by the financial markets. Other than pushing the price of oil higher, the markets are largely ignoring the fast-moving developments in Syria. Basically, Putin is metaphorically kicking sand in Obama's face and is challenging Obama to confront him, knowing full well Obama does not want to go down that path. Our best guess is Obama will opt for strategies making it as uncomfortable as possible for the Russians in Syria, but will avoid a direct confrontation. We expect increasingly harsh language coming out of Washington, DC but Obama's bark may prove louder than his bite. Since 2016 is an election year, however, the potential for Obama to enter into a more forceful, and riskier, response is greater. Democrat candidates will not want the Republicans to be able to highlight Obama's embarrassing failures in Syria and the Middle East generally and tie them to that. The political image of a failed and weakened United States the Republicans would paint for the electorate is enough of a negative for Democrats, in what will likely prove to be a tight election, that party leaders will be pressing the Obama administration for dignity restoring, testosterone-filled action. Therefore, we believe the risk of a reaction from Obama which proves more dangerous than the markets would like is higher than the markets desire.

From a longer term perspective, if the Russian, Iranian, Syrian and Iraqi coalition holds together, the balance of power in the Middle East will shift dramatically. The US has been the unquestioned protector of Israel and the oil producing Sunni states for decades. Iran and Iraq had previously been at war with one another and Russia was not even a factor. Now that Shia Muslim leaders control Iraq, we can expect Iraq and Shia Iran to work together to undermine the power and influence of the US Sunni Muslim protectorates to the South (Saudi Arabia, Kuwait, the Emirates, etc.). The coalition of Russia, Iran and Iraq could prove to be a powerful force within OPEC (even though Russia in not a member, Iran and Iraq will implicitly carry Russia's weight behind them). Indeed, it would be our contention this was the real reason behind the effective Russian annexation of Assad's portion of Syria. Russia's mere presence has caused oil prices to rise. Add to this the fear of Russian military assets being so close to the Gulf States may lead Saudi Arabia to think better of its current overproduction strategy. You can be sure the Crown Prince of Saudi Arabia and his advisors are wondering if Obama would truly protect them from Russian military aggression. With the capacity for the US to be energy independent in the near future and Obama's proven reluctance for warfare, the Saudis and their Gulf cohorts may conclude it would be wiser to stop overproducing, allow oil prices to rise and make other peace overtures towards the Russians. No matter how things work out in this chaotic situation, the chances are now higher oil prices rise rather than fall as the many possible repercussions of Putin's move into Syria play out over time.

Naturally, as Biblically Responsible Investors (BRI), we are also struck by the connection these events seem to have to Biblical prophecy. Many believe Ezekiel 38 predicted an alliance between Iran and Russia in the end times. For hundreds of years the two countries had no time for one another, but now they are partners. Given the weak Iran nuclear deal with the US and Western powers, the emergence of Russia on the scene and the Obama's administration's clear disdain for Israel, it is not hard to draw up a scenario where a weak US is unwilling to risk a possible confrontation with its fellow nuclear superpower to come to the defense of Israel. While the pace of developments in the Middle East has been very rapid of late, don't be surprised if it speeds up further as Russia and Iran will want to accomplish as much as possible in the short time Obama has left in office. Should Israel still have designs on attacking Iran's nuclear capability through the air, the presence of Russian fighters right next door in Syria certainly would increase the high drama already surrounding such an unlikely, but still potentially possible, air strike. Israel, however, might want to see if a Republican wins the election in 2016 before attempting any such military action. In the end, however, the Bible tells us Israel will be abandoned by the world and will look to the Lord for protection. And there is no better protection than that, which is why we place our hope in the Lord as well.

Earnings, Profit Margins and Valuations Still at Risk

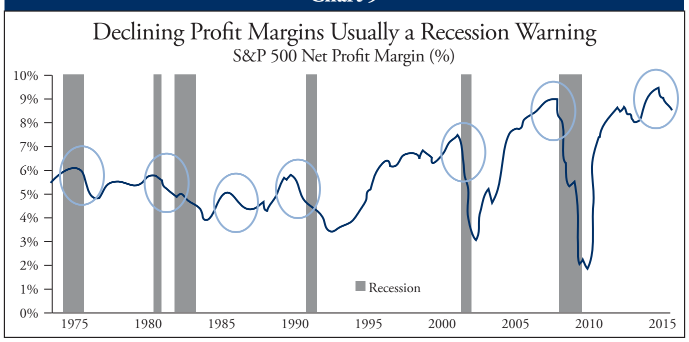
"So people will be brought low and everyone humbled" Isaiah 2:9

We can only weakly speculate on future developments in the ever-chaotic Middle East which may be of concern to investors and everybody else. There are, on the other hand, a number of cold, hard facts which make us question if the third quarter market weakness is more the beginning of an extended bear market decline rather than the normal, small correction in an ongoing bull market we previously envisioned. First, we have shown QE has turned into Quantitative Squeezing, which may have a negative impact on financial asset prices. We suspect Quantitative Squeezing will not last long and may be offset by higher QE from Europe, but it is hard to know for sure when or to what extent, QE will regain the upper hand. Second, recoveries in China's and other emerging market economies have not yet been observed. Moreover, inventories have built to levels in the US which increase the risk of an economic slowdown and US financial conditions have tightened recently. With global economic growth expectations continuously being revised lower, corporate earnings are facing meaningful headwinds. These obstacles are evident in Chart 8 which reveals expected earnings have fallen into negative territory as we approach 2016. While share prices can rise during periods of weak earnings if valuations expand, falling profits are normally a high hurdle for equities to overcome.

Chart 8

Source: Bloomberg

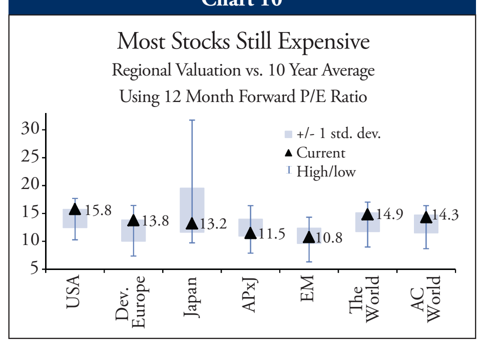
Chart 9



Source: Barclays Research

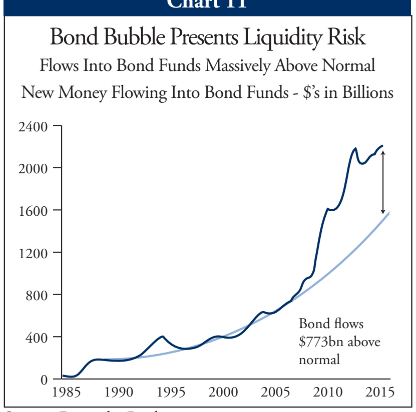
Corporate profitability is now threatened not only by declining sales but also by peaking profit margins. Chart 9 displays most past periods when profit margins turned down were associated with further weakness in margins and also recessions. As we have earlier noted, certain sectors of the economy are already effectively in recession and this accounts for much of the initial downturn in profit margins. While we have little evidence to suggest these profit problems are spreading to currently unaffected sectors, we also have little evidence such a risk is no longer an issue. Particularly in the US, the ever tightening job market may soon trigger further margin pressure in terms of higher wage costs. Risng interest rates may also be on the horizon and these will further depress margins. The strong dollar is also hurting US corporate profit margins. Should the Fed raise interest rates in December, this could result in further appreciation in the US dollar, thereby applying more pressure to margins. There are some offsetting positive developments for margins, such as lower energy and commodity prices, but these will not likely prove large enough to fully compensate for the downward pressure on profits. Falling margins and excess inventories typically lead to plant closings. Since lower employment triggers falling consumer spending, this is why falling profit margins are often associated with recessions. We are still hopeful the global recession in the energy, commodity and industrial sectors will not spill over into other parts of the economy, but we are paying careful attention to these trends as it remains too close to call.

Chart 10



Source: Goldman Sachs

Chart 11



Source: Deutsche Bank

With the trends in both earnings and profit margins continuing along a negative path, share prices could find it difficult to appreciate meaningfully until this data reverses. Another impediment to higher stock prices in most parts of the world is extended valuations. Chart 10 reveals price earnings (P/E) ratios on next year's expected earnings for different regions of the world. Both the US and Europe are facing above average valuations, even after the market's third quarter fall. Normally, P/E ratios are somewhat constrained as the Fed begins to raise interest rates, so this could add another hindrance to higher share prices in the US. This is not the case in Europe, however, and P/E ratios are not as extended there. Japan is trading more toward the lower end of its historic valuation range but no one expects Japanese P/E's to rise anywhere near the high end of its historic range unless earnings were unusually weak. The emerging markets are where the best investment values can be found now, but the high and still rising threat of a financial system meltdown in China, Brazil or some other country weakened by China's decelerating economy cannot be overlooked. When the turn in the global economic cycle occurs, the emerging markets should offer investors the highest long term returns.

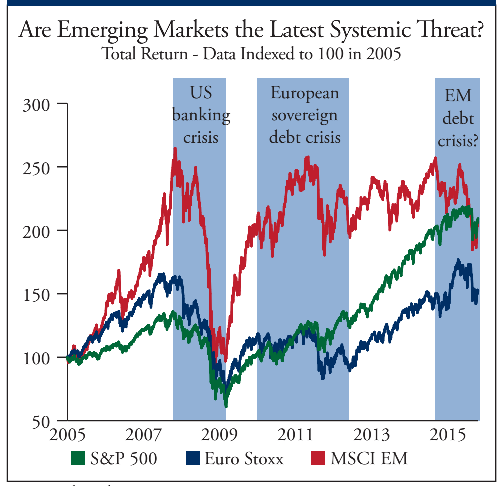
Another threat to financial markets during a period of generally heightened risk is the potential absence of liquidity in the fixed income markets should investors become fearful. As shown in Chart 11, inflows into bond funds in recent years have been massive. Any turn of events leading to sizable selling of bond funds could cause severe illiquidity leading to extreme dislocations across a variety of markets as fund managers sell what they can rather than what they want.

Remaining in the Storm Shelter for Now

"In the shelter of your presence you hide them from all human intrigues" Psalm 31:20

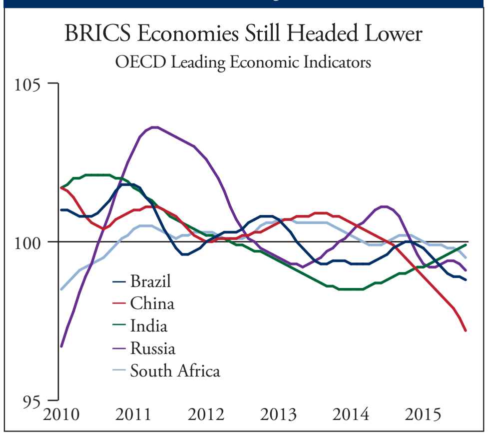
At Stewardship Partners, our natural bias is to try to buy at the point of maximum pessimism and to remain optimistic about the long term prospects for equities. Throughout history share prices have always recovered from depressions, recessions, high inflation, low growth, poor profitability and wars. Those who bought when others were selling, managed to remain solvent during panics and had the courage of their convictions to hold on to their positions when their emotions were arguing strongly for the opposite reaction, have always been rewarded. Accurately determining the point of maximum pessimism and having preserved capital in the run-up to that point is critical to achieveing the best long term investment results. Of course, no one can ever perfectly pick the lows in markets consistently, but even coming relatively close can result in handsome rewards. We have remained in a defensive position during 2015 because we were trying to preserve our client's capital during what we expected to be a difficult year for the markets. While we did slightly reduce our hedges and add to a few names in many of our portfolios during the recent correction, we have kept our portfolios nearly fully hedged. We anticipate this will continue to be the case until we see enough evidence to support the contention the correction will not morph into a full scale bear market. We are particularly concerned about the still too high probability of a financial accident which could lead to investors, and more importantly, the speculators who now dominate the market, to fear another systemic financial system failure. With little evidence China or Brazil have yet turned the corners in their respective economic crises and scant indications the massive debt undertaken in the emerging markets and elsewhere during this period of low interst rates has cleared what appears to be a rising default risk, we are content to stay cautiously positioned and wait for what might yet be a generational point of maximum pessimism.

Chart 12



Source: Bloomberg

Chart 13



Source: OECD

Chart 12 portrays how the markets have behaved during the three big market events since 2008. Having faced a systemic failure of the US banking system in 2008 and barely avoiding another systemic failure to the European banking system in 2011, we are concerned the next potential threat of a systemic collapse will come from the emerging markets. We sense the collapse in commodity prices could yet be seen as a precursor to coming defaults coming from that sector. We have also shown in an earlier commentary that the Chinese banking system is a suspected black hole of bad debt that is currently being largely obscured by government policy. Moreover, we know corporate debt in the emerging markets generally has exploded in recent years and much of it was issued in US dollars. As the dollar has strenghtened, the vice has tightened on those companies owing money in US dollars that keeps growing in size due to their own weakening currencies. We suspect it is for this very reason the Fed has not yet begun raising interest rates in the US. Higher US interest rates would spur even greater strength in the US dollar versus most emerging market currencies, thereby raising the risk of default further. The last thing the Fed wants is to trigger a systemic banking crisis in the emerging markets as the risk of contagion to the developed world would be meaningful. In the end, we doubt the normal correction in the markets in the third quarter adequately accounted for this still growing risk. Indeed, leading indicators are still falling sharply in all the major emerging market nations. The collapse in trade around the globe and a recent spurt of renewed weak economic reports in the developed markets is also telling us all is not yet well.

Offsetting these concerns is the normal seasonal strength in the equity markets during the fourth quarter of the year. It is difficult to maintain a cautious stanace in front of such a strong and reliable seasonal pattern. Moreover, it seems reasonable to assume central banks would once again spring into action with a variety of policy maneauvers should defaults start to grow and the emerging market banking system appear threatened. The markets would no doubt respond favorably to such intervention as they have consistently in the past. It is also not easy to determine exactly when such debt stresses would begin to translate into defaults, if ever. Therefore, if such troubles do not appear imminent, the favorable seasonal forces may dominate in the fourth quarter and push share prices higher. To the extent we see this happening, we may move to a more typical fully invested posture at some point in the quarter. Such a change, should we even implement it, may well be temporary unless emerging economies begin to improve soon.

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, Celgene, and one we avoid, Volkswagen. Celgene is a holding in some of our Stewardship Partners portfolios while we actively avoid ownership in Volkswagen 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 – Celgene – Passion, Innovation and Courage

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

Celgene is one of the world's largest and most innovative biotechnology companies. Founded in 1986 by two doctors, the company has grown rapidly over the years by developing and commercializing a variety of drugs used primarily to treat cancer and immune system disorders. Historically, Celgene has focused on finding drugs that help those patients with limited treatment options. Fortunately for patients, they have been unusually successful in creating needed new therapies. The company's historic emphasis on taking bold approaches in the drug discovery process is largely responsible for its success in helping patients overcome serious threats to their health and even their lives. Passion, innovation and courage are the three key words Celgene uses to describe its many medical achievements and breakthroughs. Backed by one of the largest percentage of sales spent on research and development in the biotechnology sector (30%), Celgene scientists are encouraged to pursue and set the highest standards of medical advancement. This environment has resulted in an explosion of creativity which has led to the discovery of many new promising drugs. Celgene currently holds more than 400 patents and recently had 30 prospective drugs in pre-clinical trials, 21 in clinical trials and 30 more in the final stage of drug testing (phase 3). This is in addition to the many drugs the company already has successfully brought to market. Moreover, in a recent eighteen month period, Celgene's scientists authored or co-authored 373 articles for professional medical journals highlighting their commitment to sharing their findings so that medical science in the life-saving areas in which they are experts can advance faster. One drug Celgene has brought to market best describes the company's tenacity in pursuing solutions which could help patients. Thalidomide was a sleep aid drug whose reputation was destroyed in the 1960's when it was found to cause hideous birth defects. But Celgene scientists saw promise in the drug, licensed it from its owners and developed a novel and safe treatment from it to help HIV patients suffering from wasting. This is a unique company which has greatly enhanced and saved many patients lives, creating billions in economic value for both the economy in general and shareholders specifically in the process.

Celgene's remarkable scientific and financial success can be at least partially attributed to the impressive culture it has developed over its nearly 30 year existence. The company has described it culture as being a function of four values and four behaviors it encourages. The first value is "passion for the patient". By keeping the end goal of caring for the very personal needs of patients with serious health issues in mind, Celgene maintains the motivation to press on to find therapies and cures for hard to beat diseases. Its second value, "courage to face our challenges and the unknown", has been a critical aspect of the company's scientific success. The third value is "trust in our words and actions", which the company maintains includes assuming the best in one another, treating each other with respect and dignity so that it is easy to build lasting relationships and perform groundbreaking work. The fourth value is "excellence in delivering exceptional results". Celgene's history highlights their commitment to this value as the company has attained the highest standards in quality, ethics and science. Celgene's success in attaining the high standards it has set for itself reflect can be partly traced to the four behaviors it encourages throughout its operations. The first is "assume the best", which simply means diverse points of view and differing opinions among its staff are presumed to come from a motive to achieve the best for patients and the company. The second behavior is "debate is open, honest and complete". Disagreements are not frowned upon but are used as a pathway towards discovering the optimal result. The third behavior is "decisions are made objectively and transparently". Roles are clear, the correct people are included in discussions, all the appropriate facts are considered and no meaningful information is withheld from other stakeholders. The final behavior is "we align and follow through". Once a decision is reached, the Celgene team come together around it and measure their progress implementing it. In view of these values and behaviors, it is no wonder Celgene has achieved so much. The company's wide-ranging corporate governance policies are also commendable and even include a policy on the governance of its sustainability efforts, something we have never seen previously.

As one might expect from a fast growing, highly profitable company which relies so heavily upon its workers for its success, Celgene treats its employees exceptionally. Naturally, the company offers its employees comprehensive compensation, vacation, retirement and insurance benefits, but this is just the beginning of the many ways in which the company invests in the long term well-being of its highly valued staff. Celgene also places great emphasis on the safety of its employees. Given the nature of the scientific work being performed at many of its facilities, the company's safety training is of critical importance. Celgene's safety training is extensive and is based on regional and regulatory requirements as well as best practices in the biotechnology field. Safety programs range from dealing with radiation and blood-based pathogens to properly operating a forklift. The company shows its concern for its workers overall health via a myriad of other programs meant to guide the employee to a healthy lifestyle. Included among these are healthy dining options at company cafeterias, a Weight Watchers program, the availability of onsite exercise facilities, health fairs which include blood pressure screenings and individualized health assessments, flu vaccinations, free mammograms and "lunch & learns" covering a variety of relevant health topics. Given the company's focus on discovering pharmaceuticals which will treat, and hopefully eventually cure cancer, management has implemented a specially designed effort to combat cancer among its own staff. If there is any way to discourage smoking among its employees, the company will pick up the cost for it. Additionally, all of the companies worldwide are smoke-free. Incentives are given to obtain regular physicals and encourage healthy pregnancies. Finally, the company will reimburse the cost of membership in offsite health clubs. Celgene is determined to fight cancer among its own staff via nutrition, exercise, anti-smoking initiatives, screenings and high quality treatment should an employee contract this dreaded disease. As can be seen, Celgene's treatment of its employees is comprehensive and admirable.

Celgene's work, by its very nature has a charitable component. By restoring health and limiting hospital stays with its drugs, Celgene has provided literally billions of dollars of economic value via its patients not only avoiding being a burden to society during an illness but also by being able to contribute to economic growth since better health meant they could remain employed. Moreover, the company works with patients who struggle financially to be able to access their medicine from Celgene. Charitable donations are also made to non-profit patient support groups and advocacy charities. The company also supports a wide variety of community non-profits, funds medical education costs and gives annual grants via its Innovation Awards project. Examples of some of Celgene's recent community-based giving includes over $105,000 given for the Red Cross to assist with hurricane relief work in the Philippines and donations to the YMCA, American Cancer Society, Living Beyond Breast Cancer and National Organization for Rare Disorders, among many others. Celgene also puts particular emphasis on supporting the Leukemia and Lymphoma Society, raising nearly $220,000 for the organization and providing many volunteers for its annual "Light the Night" campaign. Celgene also excels in its efforts to protect the environment and improve the sustainability of its operations. Management has established clear long term goals for environmental improvement with a focus on obtaining significant, measurable advances.

Celgene'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 benefits those it comes into contact with and one we can be proud to own!

The Bad – Volkswagen – Cheating Scandal = Environmental Damage

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

Volkswagen, the world's largest carmaker due largely to its leading market share in the booming Chinese automotive market, recently admitted to a huge cheating scandal regarding 11 million diesel engine cars it produced over the last seven years. In order to make its diesel powered cars appear to be meeting governmental emission standards, the company designed software to trick the emissions measuring devices into recording Volkswagen's cars passed the test. Actually, the company's diesel cars were producing dangerous emissions at a shocking rate of as much as forty times greater than allowed by government standards. The company, which employs almost 500,000 people worldwide, has been thrown into chaos by the revelation of its blatant deception. Its CEO has been relieved of his duties, sales of the affected vehicles were halted immediately, the company took an initial $7 billion charge to reflect the costs it will encounter as a result of this scandal, its stock price plummeted and various government authorities across the world have instigated investigations of the company's fraud. Some of these investigations are criminal in nature, as they should be. Volkswagen only admitted the presence of the malicious software when investigators for the US Environmental Protection Agency asked the company to explain the vast difference between good meter readings when a machine was attached to the car and actual readings at the tailpipe. At the moment, it is not clear who within Volkswagen gave final approval to this scheme and we suspect the search is on for a scapegoat. Clearly, this is one of the most egregious corporate cheating scandals in history and the ultimate cost to the company will likely be well beyond the initial $7 billion charge. Moreover, the company's reputation in the marketplace has fallen dramatically as consumers did not expect the company to use its famed German engineering capabilities to mislead them.

Excluding Volkswagen 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 – Gospel for Asia

"So if you have not been trustworthy in handling worldly wealth, who will trust you with true riches?" Luke 16:11

Normally in this spot we feature a ministry we believe is doing admirable work for the cause of Christ and is worthy of your support. In this case, however, we feel it is sad but necessary to report bad news about a ministry that was previously featured in a positive light here. Gospel for Asia has had its membership in the Evangelical Council for Financial Accountability (ECFA) revoked. The ECFA maintains seven standard of responsible stewardship to which member ministries must adhere and the ECFA found Gospel for Asia had violated five of those standards, which indicates a shocking level of misdeeds at the ministry. This separation from the ECFA came about largely as the result of persistent blogging by Warren Throckmorton about alleged improprieties at Gospel for Asia and reports of wrongdoing from ex-employees of the ministry, which forced the ECFA to undertake an in depth investigation into Gospel for Asia's operations. This fourth month long investigative effort led to the ECFA's board voting to end its association with Gospel for Asia after 36 years. Indeed, the ministry was a founding ministry of the ECFA and one wonders how such comprehensive failures of the ECFA's standards escaped notice for so long.

Since the ECFA is first and foremost a ministry, rather than donor-supported organization, its allegiance is first to the ministry community. Therefore, when it discovers a ministry has violated its standards, it typically quietly disassociates itself with that ministry. A statement will appear on the ECFA's website noting the standards that were violated but giving no further explanation as to the breadth or depth of the problems at the ministry. The standards violated were Governance, Financial Oversight, Use of Resources and Compliance with Laws, Compensation-Setting and Related Party Transactions, Truthfulness in Communications and Giver Expectations and Intent. While we will not be getting any further details from the ECFA on the specifics behind these violations, it is safe to say we would be very troubled by that knowledge if we could obtain it. Fortunately, the ECFA has the ability to audit ministries and can discover such problems. We only wish they had been more proactive in doing so and perhaps discovered these problems many years earlier. For its part, Gospel for Asia claims it made changes in accordance with the ECFA dictates and hopes to become a member again in the future.

While donors to Gospel for Asia might be concerned all of their donations were wasted, we suspect that this was not the case. There is a reasonable chance that a significant amount of donated funds served someone in need. Unfortunately, it is 100% certain that not all of a donor's gift was utilized in the manner expected. MinistryWatch.com recommends donors immediately cease giving to Gospel for Asia as it is clear the organization is no longer worthy of a donor's trust and no leadership changes have taken place.

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 – Stewardship Ministries

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

Stewardship Ministries was founded by Jay Link as a means of providing his seemingly unlimited energy and excellent stewardship teaching resources to as many Christians as possible. Jay believes the concept of stewardship (God's ownership) is one of the most exciting and life-transforming concepts in the entire Bible, yet it is very poorly taught in churches and even more poorly understood among believers. Stewardship Ministries is committed to helping believers understand and apply this compelling truth knowing it will transform every area of their lives – home, careers and church. The principle means of sharing Jay's comprehensive teaching on life stewardship and generosity is via the ministry's latest initiative, The Steward's Way. The Steward's Way is a comprehensive, integrated, three-year discipleship initiative developed by a host of stewardship-based ministries committed to equipping and resourcing a church over a period of years to grow an army of mature, committed and obedient disciples. Complemented by outstanding video modules, a book and other study materials, The Steward's Way program is sure to provide a compelling understanding of each Christian's responsibility to be a good steward of all the gifts the Lord has given. The program is designed to be utilized in a three year format which can easily be adapted for Sunday School programs or Bible Studies. Filled with refreshing and compelling insights into what the Bible teaches us about how each person can be the best possible stewards of their lives, the Good Steward video teaching modules are certain to lead to meaningful changes in hearts and actions.

While some may believe The Steward's Way is just about money, they will be pleasantly surprised to experience the teaching goes much deeper than that using Biblical wisdom as a guide. Topics covered include: The Stewards Focus – The One Question That Changes Everything, Examining Our Life Purpose – Are You Living Your Life on Purpose or by Accident?, Controlling Our Time – What is Our Most Valuable Possession? and Loving the Unlovable – Pressed Down, Shaken Together and Running Over. Naturally, one of our favorite modules is Investing God's Resources – Does God Care How We Invest?

Stewardship Partners Founder and CEO, Rusty Leonard currently serves as Chairman of the Board of Stewardship Ministries. We highly recommend readers strongly consider contacting Stewardship Ministries and inquire as to how easy it is to start The Steward's Way study. You and your church will be blessed.

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!

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