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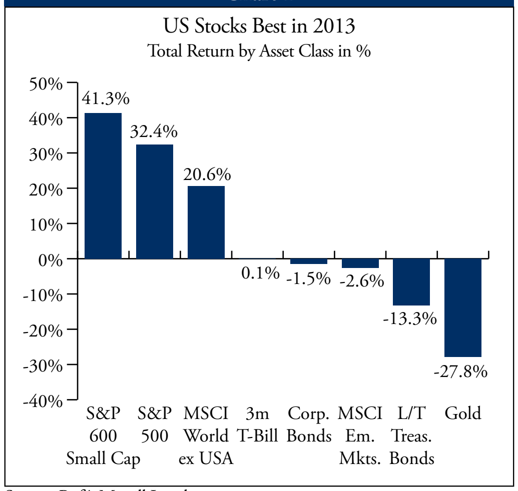
2013 – A Good Year for US Stocks, but Bad for Bonds, Emerging Markets

"Let them give thanks to the Lord for his unfailing love and his wonderful deeds for mankind" Psalm 107:8

2013 played out mostly as we had expected. As the risk of economic and banking calamity continued to recede, equities in most parts of the world performed admirably, led by the United States. It is unusual, however, for the US to be among the world's top performing equity markets simply because it represents roughly half the world's market capitalization. It just is not easy to get a "supertanker" market like the US to move faster than those much smaller than it. Small cap and lower quality stocks in the US, however, did rise at an even faster clip than US large cap stocks (Chart 1). This is indicative of rapidly declining investor fear levels as the US, and the world generally, begins to move well beyond the massive risks of financial collapse and depression present in the years following the 2008 market crash.

With these fears abating, however, the relative safety found in bonds was no longer as desired by investors. Accordingly, many bonds suffered losses during the year as the great rotation from bonds to equities which we have noted in the past played out, especially in the second half of the year. Oddly, the notable exception to poor bond performance was junk bonds, which produced positive returns in 2013. As with stocks during 2013, lower quality did better than high quality as investors became more confortable taking greater risk since the potential for financial catastrophe became less likely.

Chart 1



Source: BofA Merrill Lynch

Table 1

4Q13 Total Returns

US Indices	4Q13	YTD	3 years
S&P 500	10.5%	32.4%	56.8%
S&P 500 Value	9.8%	32.0%	54.6%
S&P 500 Growth	11.1%	32.8%	59.2%
NASDAQ	11.1%	40.1%	63.2%
S&P 400 (Mid Cap)	8.3%	33.5%	54.6%
S&P 600 (Small Cap)	9.8%	41.3%	66.1%
Treasury Bonds	-0.9%	-3.3%	8.4%
High Grade Corp. Bonds	1.0%	-1.5%	16.9%
Gold	-9.3%	-28.0%	-15.1%
Global & International Indices			
MSCI World	8.0%	26.7%	38.6%
MSCI EAFE	5.7%	22.8%	26.6%
MSCI Euro	9.9%	28.3%	30.2%
MSCI Far East	2.3%	23.3%	17.5%
MSCI Japan	2.3%	27.2%	17.9%
MSCI Emerging Markets	1.8%	-2.6%	-6.1%
US Economic Sectors			
Energy	8.4%	25.1%	37.0%
Materials	10.7%	25.6%	30.3%
Industrials	13.5%	40.7%	61.3%
Consumer Discretionary	10.8%	43.1%	88.2%
Consumer Staples	8.7%	26.1%	59.3%
Health Care	10.1%	41.5%	88.0%
Financials	10.3%	35.6%	44.9%
Information Technology	13.3%	28.4%	51.0%
Telecom	5.5%	11.5%	40.1%
Utilities	2.8%	13.2%	37.5%

Source: Bloomberg

Outside the US, equities could not keep up with the rapid pace being set by the S&P 500, but good double-digit gains were still achieved in many developed markets. Even the economically moribund Japan turned in good performance. Similar to the US, however, attractive returns on Japanese shares were influenced by central bank actions to boost the markets via quantitative easing (QE) and other measures. Meanwhile, the emerging markets index rather shockingly declined in 2013. Normally, when the developed markets are roaring, the emerging markets are soaring. With both US and Japanese central bankers stimulating their financial markets with abundant liquidity via QE, however, the speculators who now dominate short term trading pulled investments from emerging market nations in order to front run the central bankers in the US and Japan. These hedge funds simply chose to ignore the fact they were selling emerging market shares at attractively low valuations in order to chase significantly more pricey stocks in the developed markets. Such upside down reactions are one disturbing feature of governments so aggressively seeking to distort financial markets reality with their behavior. As seen in Table 1, the emerging markets have been negatively influenced by this trend over the last three years as well. With no quantitiative easing programs of their own to match those of the developed nations, emerging market economic and corporate earnings growth has been overlooked resulting in even more attractive valuations for these stocks. As the Fed begins to taper its QE activities in 2014, perhaps emerging market stocks will finally get the respect they deserve.

Commodities also turned in negative returns as global economic growth remained low. Concerns about waning Chinese economic growth weighed particularly heavily on commodity prices in 2013 given that nation's previously massive demand for raw materials. As fear dissipated and inflation remained low, gold prices fell sharply.

Stewardship Partners' equity portfolios achieved positive double-digit returns in 2013, but trailed the indices. While we were overweight the hot US market, our higher quality bias hurt our relative performance, as did our exposure to the attractively valued emerging markets.

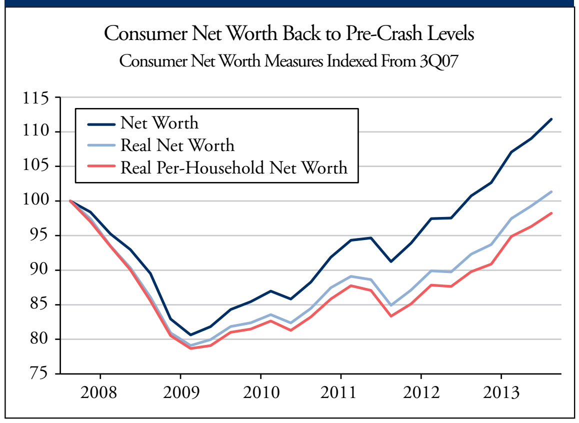
Table of Contents:

Flirting With a Normal Global Economic Recovery

"Did they stumble so as to fall beyond recovery? Not at all!" Romans 11:11 (NIV)

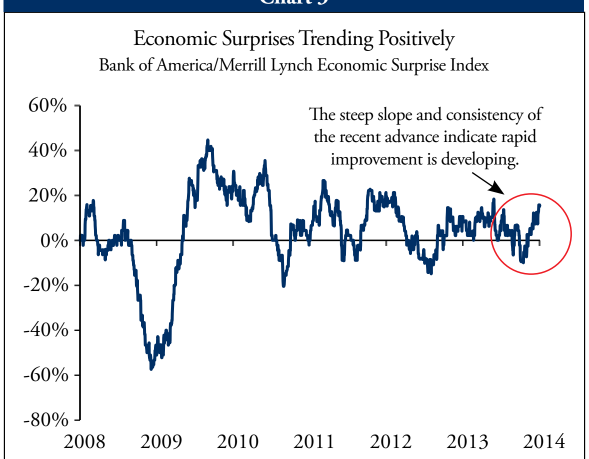
Now more than five years past the start of the Great Recession, it finally appears the global economy may be prepared to return to a degree of normality. Leading the way is the US and Northern Europe, principally Germany. As shown in Chart 2, the net worth of the average household has essentially returned to pre-crash levels when adjusted for inflation. A long awaited recovery in housing prices coupled with the faster and larger recovery in the financial markets has put the US consumer's balance sheet back in order. Lower interest rates, rising incomes and efforts to refinance and eliminate debt have also significantly reduced the average US consumer's debt service burden. Still high unemployment is a slight constraint to renewed economic growth, but employment gains have been steady over the last two years. As a result, US consumer confidence has been on the rise as the average person's financial situation has largely returned to a non-crisis state. This improvement has been reflected in stronger than expected auto and housing sales. Economic growth moved above 3% in the third quarter of 2013 and there is a good chance it reaches that level for all of 2014 as well. If the US consumer has finally returned to a more normal economic status then the economy is sure to follow. As Ben Bernanke leaves his position as Chairman of the Fed, he can rightfully take credit for much of this improvement. Had his efforts been unsuccessful in restoring confidence in the financial markets and undergirding a devastated housing market, the US consumer would not have recovered so quickly.

Chart 2



Source: Bloomberg, Federal Reserve, Fannie Mae

Chart 3



Source: BofA Merrill Lynch

Recent economic reports have been encouraging and the overall economy seems to have moved beyond the slow and uncertain recovery seen during most of the first half decade after the crash. Chart 3 highlights the uneven nature of the recovery thus far but also hints at the possibility of more favorable economic surprises to come. As Janet Yellen takes over for Bernanke, the Fed has gained enough confidence in the self-sustaining nature of current economic growth to slowly begin to reduce its latest QE program. Unlike the "taper tantrum" the financial markets experienced in June of 2013 when the Fed first announced its intention to taper QE, the most recent announcement in December was greeted with market calm. This indicates the markets now also believe extraordinary monetary measures are no longer needed to keep the economy growing and corporate profits expanding. If both the Fed and the markets are correct, 2014 may be the year when the US recovery makes the long-awaited transition to a largely unassisted, normal expansion. While still too early to declare victory, growth gives every sign of heading higher.

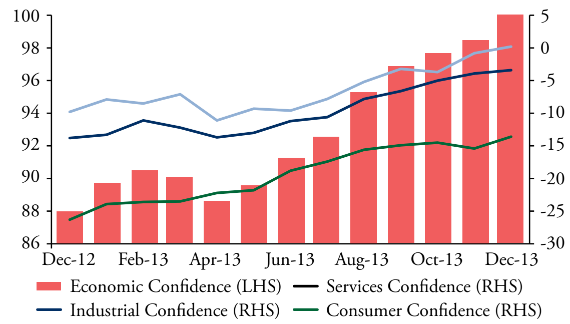
Aiding the recovery in 2014 is reduced fiscal drag now that the 2013 sequester and tax increase impacts have been largely assimilated. These costs were something of a ball and chain on the US economy last year. With recent legislation reducing the sequester impact further in 2014, fiscal drag should be about 1% less in 2014, thereby boosting the economy's growth potential. With elections approaching in November, politicians may be tempted to spend more than they should. Given the present political dynamics, however, we do not see much opportunity for additional government spending, which might eliminate the remaining fiscal drag in 2014. The biggest unknowns, and therefore risks, are the impact of the QE taper and Obamacare. We believe there is a decent chance tapering will occur without severely impacting economic growth (the markets may be another matter, however). Both we and the Fed will be watching this closely and we would expect the Fed to make adjustments as needed. As for Obamacare, its effect remains the great unknown. Individuals will be spending more on healthcare insurance in 2014, but no one is quite sure just how much more. At this juncture, we expect Obamacare's impact to be only slightly negative in 2014 due to it being phased in. 2015 may be an entirely different situation, however, as the full year will be impacted as many more consumers come under the influence of Obamacare. On the other hand, the November elections may change the balance of power in Washington, DC, leading to favorable changes in Obamacare, which might lessen its negative 2015 economic impact. The greatest risk may be Obamacare collapses due to its own internal deficiencies, creating uncertainty and consumer caution.

Outside the US economic progress is evident as well. In Europe, confidence in the economy has been experiencing a broad-based gain (Chart 4). While Europe is still much closer to the peak of its near banking and sovereign debt debacle in late 2011, there is little doubt the crisis atmosphere is now dissipating at an accelerating rate here as well. Given the proximity to the height of Europe's crisis, there remain greater risks of policy errors that might upend the progress. The European Central Bank (ECB), however, has retained significant monetary policy flexibility and should be able to provide support if progress wanes. Unlike the other developed country central banks, the ECB's assets have been falling, thereby allowing scope for a further increase if necessary. Additionally, inflation is hardly a threat. Indeed, deflation may soon be the issue for Europe if recent trends are not reversed. This increasing threat of deflation (Chart 5) also gives the ECB plenty of scope for action if needed. The same trend towards lower inflation and possible deflation is also present in the US while in Japan, deflation seems to have finally been overcome after a quarter of a century battle. Outside of India and a few other emerging markets, inflation is not an issue that will hinder central bankers at the outset of 2014.

Chart 4

Europe's Economy Has Turned the Corner

Euro-Area Economic Confidence Showing Broad-Based Strength

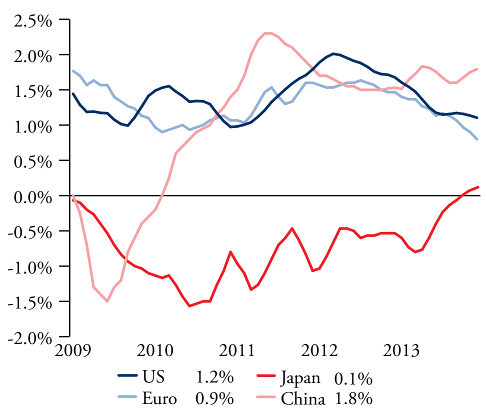


Source: Bloomberg

Chart 5

Low Inflation Gives Central Banks Flexibility

3 Month Moving Avg. of Annual Core Inflation Rate



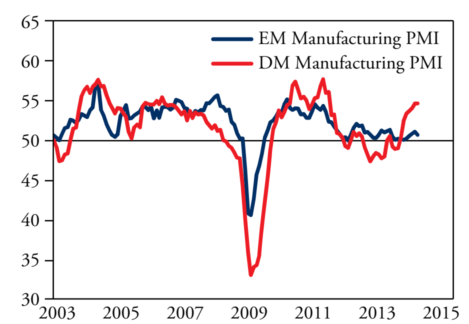
Source: Thomson Reuters, Datastream, Bloomberg

Developed market economic growth is now trending strongly higher as shown by the manufacturing index (Chart 6) while the emerging market manufacturing index is trending sidewards. While risks remain, perhaps most notably an overdue financial crisis in China, investors are entering 2014 with good reason to expect further improvements in the global economy as the emerging markets should follow the developed markets higher.

Chart 6

Manufacturing Growth Indicates Economic Strength

Developed and Emerging Markets Manufacturing Indices, Seasonally Adjusted



Source: Haver Analytics, Goldman Sachs

Can Financial Markets Also Return to Normal?

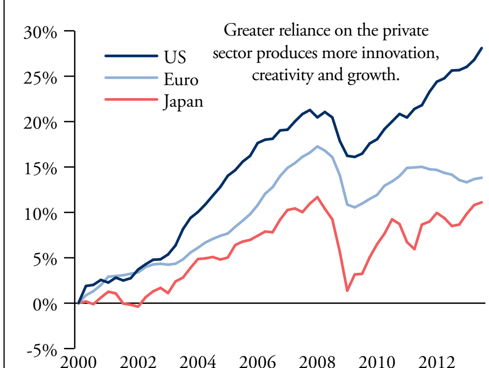
"Dishonest money dwindles away, but whoever gathers money little by little makes it grow." Proverbs 13:11 (NIV)

We have often noted in the past the remarkable strength of the capitalist economic system. Despite the many challenges capitalism has faced, as well as its own inherent weaknesses, it has always triumphed over alternative economic systems in creating wealth. As capitalism spread rapidly throughout the world since the fall of Communism, literally hundreds of millions of people have been pulled out of desperate poverty. Many of these previously poor people were located in China, which despite retaining its Communist political system, has adopted what arguably could be called the world's purest capitalistic economic system. While no country operates a textbook version of the capitalist system, the United States has historically allowed free enterprise and the financial markets the greatest freedom among the major nations of the world, which is why it still dominates the world economically (and militarily). Europe's socialistic overlay on capitalism, in our view, has limited its success. Japan's paternalistic version of capitalism, where the corporation historically existed more to create lifetime jobs for the masses than high profits for shareholders, also comes up well short of the capitalistic ideal. Not surprisingly, since the turn of the century, the US economy has outperformed both Europe and Japan by a considerable margin (Chart 7).

Chart 7

Capitalism Beats Socialism

GDP Growth Indexed to 2000

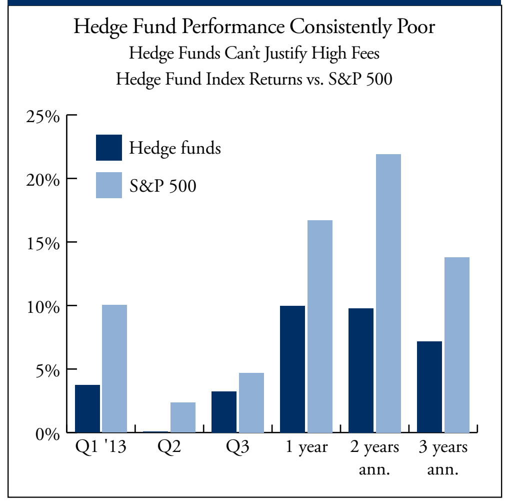


Source: Bloomberg

It has grieved us, however, to see the financial markets at the heart of capitalism's long term success become increasingly corrupted during this period. In our view, capitalism likely had its most positive impact on the global economy during the mid-1990's. While hardly a pristine, corruption free system, US capitalism at that time seemed to us to offer more rewards for a greater number of people in as fair a manner as could be realistically hoped for in view of man's inherent sin nature. While Wall Street did fabulously well during this period, Main Street was also profiting handsomely via its holdings in mutual funds, which increasingly included overseas investments where capitalism was spreading quickly. Mutual fund portfolio managers were focused on investing their clients' assets in as wise a fashion as possible with the objective of achieving long term gains. Such portfolio managers dominated the market and their long term investing approach was based on rationality and diligent analysis. Capital was therefore allocated in a reasonably sensible fashion and had been since the boom in mutual funds began in the early 1980's. Not surprisingly, the global economy went through an impressive, nearly two decade period of relatively stable growth and low inflation. Some countries never experienced even a small recession during this period of unusual economic harmony.

Unfortunately, such a long period of success eventually encouraged greater risk taking. If there is rarely going to be a recession, why not use margin debt to enhance investment returns? Such thinking gave rise to hedge funds which grew rapidly from the late 1990's to become the dominant players in the world's financial markets. Those hedge funds which were early to the party were able to rack up attractive returns, but this only encouraged many more funds to start up, particularly given the huge incentive of the enormous fees these funds charged. As investors, institutional and otherwise, inexplicably stumbled over each other to pay these outlandish fees to gain access to the promise of high returns fueled by margin debt, the investment world soon lost its bearings. The result was an incredibly myopic focus on short term earnings and increasingly bizarre analytical methods. The resulting insanity of the tech bubble came to an end in early 2000. Many corporate frauds were subsequently uncovered as CEOs bent rules and broke laws in an attempt to meet the demands of their hedge fund shareholders.

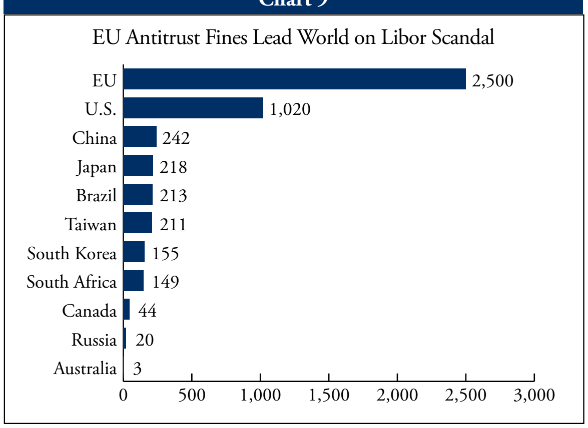
Chart 8



Source: Preqin, Quartz

After the tech bubble, a short period of normalcy returned to the markets as chastened hedge funds temporarily embraced more conventional investment analysis techniques. But hedge funds kept gathering assets and influence. Pretty soon the world's equity markets were no longer large enough for hedge funds and commodity markets, bond markets and foreign exchange markets all began to be influenced by both their presence and renewed short term focus. Even this was insufficient to satiate the hedge funds, so a new, gigantic, unregulated playground was created for their investment pleasure – the credit default swap market. This, among other distortions of the financial markets brought about by the lucrative incentives hedge funds enjoyed, ultimately led to the 2008 crash in the financial markets. Despite being thoroughly discredited in the 2008 crash, the hedge fund industry continued to expand over the last five years while becoming increasingly concentrated. This put unusual power in the hands of a relatively small number of funds. The pressure to justify their high fees with equally high performance ultimately led to both corruption and low returns (Chart 8). This fraud, however, spread to other institutions as well, including those who served the booming hedge fund industry. Major banks, brokers and insurance companies, jealous of the high fees being earned by their hedge fund customers, effectively set up their own hedge funds buried deep within their operations. Before long, many of these were also knee deep in unethical practices as power and greed spun out of control, with AIG's undoing being the most notable example of this trend.

Chart 9



Source: Allen and Overy

For years, the SEC and other regulators seemed unable to properly regulate these massive distortions in the financial markets. More recently, however, a degree of order has slowly begun to be restored. While we are still far from the high point of societal benefit derived from the capital markets last seen in the 1990's, the negative trends from the last decade and a half have been at least slowed and possibly reversed. In the past year, the largest hedge fund, SAC, was repeatedly targeted for misdeeds by the SEC and found culpable, as have several other hedge funds. While few perpetrators still go to jail, huge fines have been paid. SAC paid $1.8 billion in fines as it admitted to insider trading and other transgressions. Moreover, the firm is no longer allowed to manage money for outsiders. JP Morgan Chase has been hit with fine after fine over the last two years. Cumulatively, these fines have surpassed $20 billion and were imposed for everything from the firm's aiding and abetting Bernie Madoff, its corrupt "London Whale" trades, a variety mortgage frauds, its manipulation of energy and interest rate markets and its helping Iran and Cuba skirt banking sanctions, among many others. Chart 9 highlights banking regulators elsewhere have been active in disciplining such crimes as well. We never expect Wall Street to become totally sanctified and fully disown greedy behavior, but we are hopeful tough regulatory actions will continue. If so, Main Street may once again find it can get a relatively fair deal on Wall Street.

STEWARDSHIP PARTNERS MARKET COMMENTARY

HEDGE FUND NONSENSE – CAN A RETURN TO A LONG TERM FOCUS BE FAR OFF?

"A discerning person keeps wisdom in view, but a fool's eyes wander to the ends of the earth." Proverbs 17:24 (NIV)

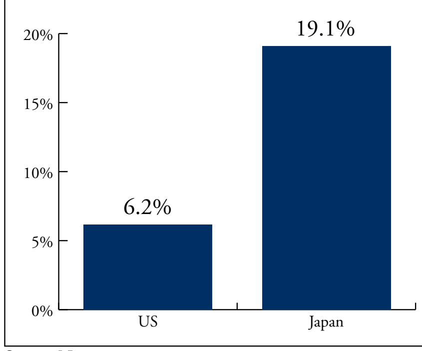
The growing dominance of a relatively small number of hyper short term oriented hedge funds in the last decade tended to distort the pricing of all asset classes, at least in the short term. Over the long term, however, prices will always gravitate towards true value, so investors with a long time horizon have the luxury of watching the often silly behavior of hedge funds with bemusement, or perhaps irritation, depending on your disposition. A good example of this occurred in 2013 in Japan. Japan's Prime Minister Abe launched a new strategy, referred to as Abenomics, meant to boost economic growth and drag Japan out of its quarter century of deflation. Abe weakened the value of the Yen, in part via massive quantitative easing, which was an astounding three times larger than that pursued by the Fed (Chart 10). The weaker yen helped Japanese manufacturers increase exports and profits. However, both Japan and Japanese companies are struggling against some huge roadblocks to long term economic success and Abenomics provides only minimal short term relief. First is the nation's enormous debt. Second is its rapidly aging population and abysmally low birth rates. Third is its worsening competitive position as Japan falls behind the US and other nations technologically and behind the emerging markets nations in cost competitiveness. Additionally, Japanese companies have historically been far less profitable than similar companies in other countries (Chart 11). Throw on top of this the still high risk of a devastating event arising from the Fukashima nuclear meltdown, and rational investors would likely conclude investing elsewhere might be best. But Abenomics was like throwing bloody meat to the hedge fund sharks. These funds rushed to short the Yen and buy Japanese equities with dubious long term prospects as Abe basically told them to do knowing this would help him accomplish his goal of jump-starting the Japanese economy. In this manner, Abe easily manipulated the Japanese stock market to a 55% gain in 2013 (in Yen terms) while crushing the value of the Yen. While it felt good in 2013, it will not be pretty when the hedge funds reverse course to chase the next hot deal.

Chart 10

Abenomics Uses Massive QE to Spike Equities

Central Bank QE as a % of GDP

Japan's QE 3x that of the US

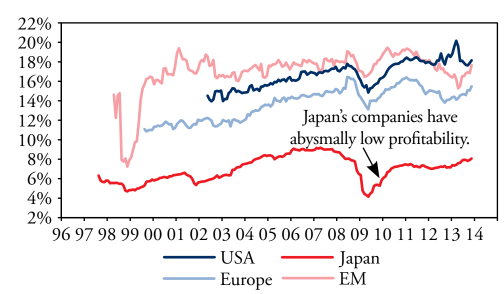


Source: Nomura

Chart 11

Japan's Companies' Profitability Well Below Global Average

Regional Operating Profit Margins



Source: BofA Merrill Lynch, MSCI, IBES

Emerging markets have also suffered from the hot money syndrome the hedge funds create in the short term. While some emerging market nations are admittedly struggling with fundamental economic problems at the moment, these already seem to be largely reflected in share prices. Since there was no quantitative easing taking place in the emerging markets, hedge funds bailed out of these cheap markets to buy more expensive shares in Japan, the US and Europe where central bank stimulus was in place. Emerging market price-earnings ratios have fallen from near parity with those in the developed world four years ago to greater than a one-third discount now (Table 2). These P/Es are now as low as seen at recent market lows but developed market stocks are now reaching new highs. Since hedge funds are less enamored with long term value and more with the latest headline, the emerging markets may continue to lag a bit longer. Ultimately, however, the accelerating recovery in the developed world will almost certainly translate into better headlines for the emerging markets and emerging market stock's earnings and valuations should recover in a big way.

Table 2

Emerging Markets Stocks Are Cheap

EM Valuations Quite Low vs. Developed Markets

Valuations Compared to Past Lows

Previous EM Troughs	Sep-98	Sep-01	Nov-08	Average of Last 3 Lows	Current Valuations
Trailing P/E	14.4x	10.8x	8.0x	11.1x	11.7x
% discount to DM	*-38%*	*-51%*	*-25%*	*-38%*	*-37%*
Forward P/E	9.6x	9.3x	7.2x	8.7x	10.1x
% discount to DM	*-50%*	*-47%*	*-25%*	*-41%*	*-35%*
P/B	1.0x	1.2x	1.4x	1.2x	1.5x
% discount to DM	*-66%*	*-47%*	*-5%*	*-39%*	*-45%*

Source: BofA Merrill Lynch, Bloomberg, MSCI

We are confident the nonsense perpetrated by hedge funds will ultimately end. In the short term, however, we continue to expect politicians and central bankers to manipulate their financial markets via incentivizing short-sighted hedge funds. Given the poor performance hedge funds have generated over a long period of time, however, one wonders how much longer they will be a dominant force in the markets anyway. If the regulators do not trim their sails, their clients surely will at some point. Still, we admit to being astonished it has taken so long for their clients to come to their senses. Such manic depressive investing has little chance of consistently succeeding in either the short or long term, and the data confirms it has not. Simon Lack, in his book *The Hedge Fund Mirage* calculates the cumulative fees paid to hedge fund managers exceed the cumulative profits produced for shareholders. In one version of his calculations, hedge fund shareholders actually cumulatively lost money after paying the exorbitant hedge fund management and performance fees. As he notes, putting a cynical spin on Churchill's quote about the sacrifice of British aviators in World War II, "Never in the history of finance was so much charged by so many for so little". As the dominance of hedge funds inevitably wanes, we trust most investors will return to a more prudent, long term investment focus. If so, we may be less bemused, but also less irritated, as share prices will increasingly be set by more rational market participants and market power distributed more equitably.

Corrupted Capitalism Leads to Socialism, So Keep the Clean-up Going!

"One whose heart is corrupt does not prosper" Proverbs 17:20 (NIV)

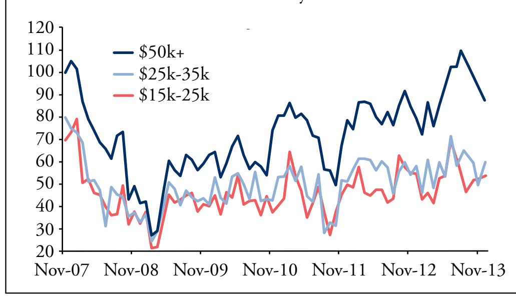
While what the SEC and others have been able to accomplish recently is just a start, we are very encouraged by the recent rapid acceleration in regulatory actions against corrupt and criminal behavior in the financial markets. It represents real hope capitalism, funded by rational and fair financial markets, can regain the confidence of the average investor/voter. If so, we are certain the financial markets will return to a place, as in the mid-1990's, where prosperity for all is promoted and achievable. The corrupted version of capitalism which ushered in the Great Recession set the nation on a path towards socialism. We still remember candidate Obama proclaiming something to the effect of, "we tried your way and it failed; now we need to try something different". That something different, while the word was never uttered, was socialism. Voters fed up with the carnage Wall Street had brought them, embraced this message and President Obama has since been working diligently to "fundamentally transform America" as he promised. Had the financial markets never have become so corrupted, we doubt the crash would have occurred and, even if elected, Obama would have had a much more difficult time promoting his government-centered agenda. Even as it is, he is having a difficult time putting his socialist agenda in place due to the deep roots capitalism has put down in this country. With regulators now doing a better job, hedge fund clients likely to soon be seeking better returns with a proper long term focus and Obamacare being revealed to be a train wreck, we believe a less corrupted capitalism may again win the hearts of voters in the years to come. If we are right, the future will be brighter than many now assume as innovation and creativity will flourish, creating prosperity for more people across the globe than any other approach could hope to accomplish.

Despite massive ethical lapses in the financial markets, US capitalism still created wealth. Unfortunately, one of the legacies of this period of corrupted capitalism is extreme income inequality as the wealth created increasingly ended up in fewer and fewer hands as demonstrated by the much lower consumer confidence of those with lower incomes (Chart 12). Despite this disparity actually accelerating on Obama's watch, it appears Democrats are making income inequality their 2014 theme. While income inequality is guaranteed in capitalism, it needs to be kept at levels most voters consider fair for the capitalist approach to maintain popular support. So, we agree with the Democrats that income inequality needs to be addressed, but we doubt Democratic proposals will offer worthwhile solutions. As the economic recovery continues over the longer term, however, employees will almost certainly gain a larger share of corporate profits regardless of any legislative efforts. If our government can focus more on eliminating corrupt and criminal behavior in the corporate world, thereby setting up a proper environment for capitalism to best succeed, we suspect the markets will do the best job of correcting income inequality. And if hedge fund investors would simply abandon the low returns, high fees and bad conduct offered by hedge funds, this alone would make a significant dent in income inequality while also helping to restore normality to the financial markets!

Chart 12

Income Inequality Evident in Consumer Confidence

Consumer Confidence by Income Level



Source: Bloomberg, The Conference Board

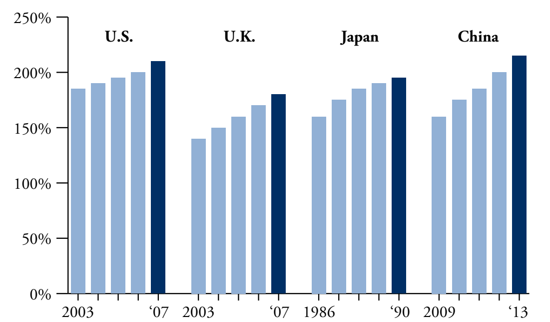
Beyond these long term issues, there are not many pressing concerns for investors as we start 2014. Perhaps the greatest risk to the calm seen in the markets presently is the ongoing threat of a systemic financial crisis in China as both its shadow and normal banking system appear poised to collapse under the weight of bad loans. China has been able to avoid this for several years already and may yet be able to sidestep disaster. Still, signs of extreme banking stress continue to grow. It is not clear how China's problems will impact the world's financial markets given the lack of integration of its banking system with that of the developed world. Nevertheless, should the Chinese government be unable to contain the mess it created by its own poor oversight of its markets, it would likely disturb the global markets for at least a short period of time. As seen in Chart 13, China's debt level and growth bears a remarkable similarity to that seen in other nations prior to severe banking problems erupting. At the same time, China's government maintains more ability to act quickly to address these problems than most democratic countries.

Chart 13

China's Debt Size and Growth Raises Risks

If Past Is Prologue, the Signs Are Not Good for China

Debt as a % of GDP



Source: Wall Street Journal, People's Bank of China, IMF International Financial Statistics, Fitch Ratings

Unless new negative developments emerge, corporate profits should grow nicely in 2014 and valuations for most stocks should be stable or even expand if the great rotation away from bonds and into equities continues. As a result, we anticipate 2014 will be a good year for investors, even if not quite as good as 2013.

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 (NIV)

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

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

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

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

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

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

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

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

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

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

BRI in Action – Comparing Good and Bad Corporate Behavior

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

Below you will find an example of both a company exhibiting exemplary attributes, SanDisk, and one we avoid, JP Morgan Chase. SanDisk is a holding in some of our Stewardship Partners portfolios while we actively avoid ownership in JP Morgan Chase 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 – SanDisk – Innovation, Righteousness and Generosity

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

SanDisk Corporation, founded in 1988, is a global leader in flash memory storage solutions with a strong history of technological innovation which has regularly been converted to commercial success. Flash storage technology allows digital information to be stored in a durable, compact format that retains the data even after the power has been switched off. SanDisk is the leading brand of flash memory drives in the consumer space. Roughly half of all retail flash memory devices sold are produced by SanDisk. Just about everyone reading this commentary likely owns more than one of the company's products even if you were not aware of that. SanDisk dominates the thumb drive market which has grown popular in recent years as a means of easily backing up or transporting files from one computer to another. Their products are also often found in cell phones, digital cameras, video game devices and GPS machines. Every leading mobile handset and tablet manufacturer uses SanDisk. Mobile devices of every sort have proliferated in recent years along with a soaring demand for HD quality video. SanDisk has grown right alongside this development by providing the needed memory devices which allow your mobile phone, laptop of notebook to easily transmit these large files. SanDisk also serves the corporate marketplace with an assortment of flash memory products designed on a larger scale specifically for the needs of larger enterprises. The company's focus on innovation is highlighted by the more than 4,500 patents SanDisk has acquired in its nearly 26 year history as well as a venture capital fund it runs to invest in innovative new start-ups in related technologies. SanDisk employs over 4,700 people located in facilities in California, Israel, England, India, China and Japan. Its products can be found in 167 countries and it has a leading market share position in most of those countries. SanDisk is also financially strong with significant free cash flow generation and a highly liquid balance sheet.

SanDisk lists four key principles which drive their corporate culture. All of these are focused not on the financial performance of the firm or on shareholders, but rather on righteous behavior within the communities the company operates within. The first principle is "treat everyone (particularly employees) with dignity and respect". There is evidence the company upholds this principle as SanDisk has never had a work stoppage led by employees and the staff apparently feels no need to seek unionization even though the company does not seek to impede unionization. The second principle is "comply with all laws and regulations and adhere to SanDisk's own ethical standards". SanDisk's own ethical standards include avoiding the use of "conflict minerals", or raw materials obtained from illegal mines in regions of conflict in Africa. The company has received awards from charitable groups for its efforts in this area. The third SanDisk principle is "Provide a safe and healthy work environment". SanDisk strives to minimize employee exposure to potential safety hazards through administrative controls, engineering, personal protective equipment and preventative maintenance. SanDisk's fourth principle is to "promote environmental responsibility". SanDisk has eliminated the use of heavy metals and toxic substances from its products, is working with suppliers to do the same and regularly audits its own and its suppliers facilities for compliance with these standards. They have also significantly minimized the amount of material used in packaging their products.

SanDisk's first principle of treating everyone, particularly employees, with respect is evident in the many benefits and opportunities the company makes available to its staff. Foremost among these is the company's emphasis on creating an environment for its workers where innovation and creativity can flourish, where employees are challenged to meet objectives and accept personal responsibility and where teamwork is a key ingredient to corporate success. Management makes it clear that the company values ethical behavior over business results. These values have, not surprisingly, led to financial success and the ability for the company to provide a wide array of attractive benefits to its employees. Medical insurance is provided from the first day of employment and dental and vision insurance plans are also offered. For employees facing unexpected complications in their lives, SanDisk maintains an Employee Assistance Program that provides help with emotional issues and dependent care problems 24/7. The company provides flexible spending accounts and dependent care accounts so its workers can save in a tax efficient manner for items not normally covered by health insurance plans. Short and long term disability insurance as well as life insurance is also provided at no cost to employees. Employees have the opportunity to participate in the company's success via stock options and an employee stock purchase plan. SanDisk will contribute up to 3% of a worker's annual salary into the firm's 401(k) program. Tuition reimbursement, free health club membership and a personal internet-based concierge service is available as well. Of note, SanDisk does not offer a wide array of specialized services to homosexual employees and has not used shareholder funds to support homosexual organizations.

Generosity is another of SanDisk's admirable qualities. Since 2003, the SanDisk Foundation has given away more than $16 million in over 800 separate grants. The company was named one of the top 10 most generous companies in Silicon Valley and has also received awards in Israel and India for its demonstrated social responsibility. Among the charities the company has made gifts to are the American Red Cross, the Samarthanam Trust for the Disabled and the SOS Children's Village. SanDisk also has matched roughly 600 employee contributions to charity. Employees have also been generous with their time with many volunteer hours being donated to groups such as the Second Harvest Food Bank, Habitat for Humanity, Sacred Heart Community Services and the Leukemia and Lymphoma Society. Overseas, SanDisk employees in Taiwan have donated to the Eden Social Welfare Organization to provide after school programs for disadvantaged minorities. Each year the company also provides $1 million worth of $10,000 individual scholarships to students from disadvantaged backgrounds. SanDisk partners with the United Negro College Fund and the Hispanic Scholarship Fund to identify students for these scholarships. Clearly, SanDisk is doing much to be a blessing to as many as it possibly can in the communities where it has facilities and well beyond.

SanDisk's good works are, of course, no guarantee of long-term investment success. As Biblically Responsible Investors, however, the company's commitment to excellent stewardship and its impressive treatment of its employees 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 that we can be proud to own!

The Bad – JP Morgan Chase – Poster Child for Corrupt Capitalism

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

JP Morgan Chase is one of the world's largest financial institutions. Via some of its far-flung operations it has been serving clients for more than 200 years. The company claims its success has been built upon the principle that it puts its clients' interests above its own. Jamie Dimon, JP Morgan Chase's CEO says, "Our aim is to be the world's most trusted and respected financial institution." As we have noted earlier in our Market Commentary, the company has come up far short of these ideals in recent years. In just the last two years, JP Morgan Chase has paid more than $20 billion in fines to various regulatory authorities due to a shocking number of misdeeds where the organization quite obviously put its own welfare above that of its clients while simultaneously undermining the proper functioning of a wide array of financial markets. The company paid its largest fines (a total of $17.5 billion paid so far with more fines likely to be paid in the future) for how it abused the mortgage markets. The company is also paying more than $2 billion for turning a blind eye towards Bernie Madoff's Ponzi scheme and has acknowledged breaking securities laws related to trading in the "London Whale" case, costing about $1 billion more. It also paid a $1.7 billion fine for allowing money laundering by countries like Cuba and Iran. Fines have also been paid for manipulating energy markets and interest rate markets. Clearly, JP Morgan has been at the center of the corrupted capitalism that infected Wall Street over the last 15 years or so. But the long list of fines the company has paid in the last two years indicates the regulators are in the process of restoring order to the financial markets.

Amazingly, the above list does not include all of the fines JP Morgan Chase has paid. JP Morgan is also one of the biggest supporters of homosexuality in corporate America. On the positive side of the equation, the company no longer supports abortion. At one point, it was the largest corporate donor to Planned Parenthood.

Excluding JP Morgan Chase 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 which 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 (NIV)

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 – English Language Institute of China

"It has always been my ambition to preach the gospel where Christ was not known." Romans 15:20 (NIV)

Following President Richard Nixon's efforts to reengage with Communist China in the 1970's, opportunities slowly arose for increasing cultural interaction between China and the US. By the late 1970's plans were being laid to send Christian English teachers to China in an effort to utilize this method to quietly bring the gospel back to this country which had been closed off to missionary activity for several decades. By 1981, the English Language Institute of China was able to send its first "undercover" missionaries to China. Over time, it has become easier to send such missionaries to China and now the English Language Institute of China (ELIC) has a large number of teachers at a variety of educational levels in China. The ministry is also in need of a name change as its operations now have expanded well beyond China to Laos, Vietnam, Cambodia, Mongolia and Myanmar. ELIC is also now making plans to enter the Middle East in order to use the same plan of using English language teachers to bring the gospel to those who might not ever hear it otherwise. ELIC's teachers have come from North America, the United Kingdom, New Zealand, Australia, Hong Kong and Singapore.

ELIC's flagship program is its University Teaching Program. Missionaries committed for the long term to serving ELIC work in a university setting in order to reach young people who are curious about Western ways. Besides teaching English, the teachers make efforts to meet with students outside of the classroom in order to have the opportunity to share with them about Jesus' atoning death and resurrection. Students often become life-long friends with their teachers. ELIC's Teaching Fellowship Program utilizes recent college graduates (up to the age of 25) for an 11 month teaching program. Teachers serve on a team of three to eight and teach in primary and secondary schools as well as in a university setting. Many who serve in this program go on to join the longer term University Teaching Program. ELIC also has three shorter term missions opportunities for young people as well as retired folks. Because of the sensitive nature of its work, ELIC's website avoids references to Christianity.

ELIC has served faithfully in somewhat difficult circumstances for over 30 years. Undoubtedly, the ministry is partly responsible for the rapid growth of Christianity in China over that time frame. ELIC has a four star Financial Efficiency Rating from MinistryWatch.com, indicative of its wise use of donor resources. We believe ELIC 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 (NIV)

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)
- Sound Mind Investing (soundmindinvesting.com)
- 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)
- Kardia (kardiaplanning.com)

WHERE
to invest in kingdom ministries?

Ministry Research:

- ECFA (ecfa.org)
- MinistryWatch.com (ministrywatch.com)
- Samaritan's Guide (acton.org/cec/guide/)
- Intelligent Philanthropy (intelligentphilanthropy.com)

Ministry Mutual Funds:

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

Featured Ministry Marketplace Participant – ECFA

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

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

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

Knowing Jesus Christ as Your Lord and Savior

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

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

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

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

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

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