STEWARDSHIP PARTNERS

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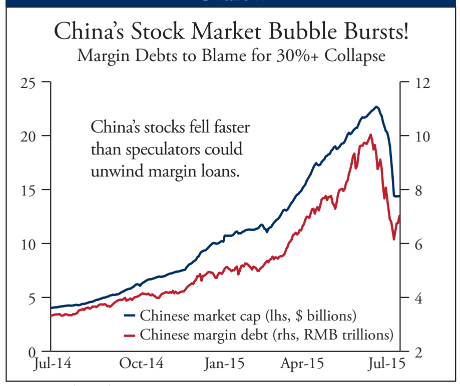
The Calm Before the Storm?

"I would hurry to my place of shelter, far from the tempest and storm" Psalm 55:8

An eerie calm descended upon the world's equity markets in the second quarter. While there was plenty of both good and bad news which normally should have caused market volatility, it was not until the last few days of the quarter when US stock prices began to drop reflecting growing problems in Greece and China. Table 1 below highlights the lack of movement in the major indices during the quarter. Sometimes small movements in share prices over the course of a quarter can mask much wider swings occuring from week to week, essentially canceling each other out. In this case, however, watching the markets each day was like watching paint dry. As new economic, earnings and/or geopolitical information entered the market, investors simply gave a collective yawn regardless of whether the data had a positive or negative tone to it. Currencies, commodities and bonds, however, were more volatile. Fear of imminent Fed rates hikes led bonds, and anything resembling a bond, such as REITs and utility stocks, to perform poorly. Overseas equity markets were more volatile in local currency terms but any move in most foreign share prices always seemed to be offset by an roughly similar move in the opposite direction by the US dollar, yielding little movement in these stocks for US-based investors. Despire the apparent calm, however, storms were forming.

Chart 1



Source: Bloomberg

The most consequential storm could prove to be China. Early in the quarter, Chinese equities soared to ridiculous valuations, even in the face of a steadily weakening Chinese economy, as seemingly every farmer and cab driver in China began speculating on stocks. Even public companies began speculating in the market creating an enormous bubble, one encouraged by Chinese government officials hoping rising equity prices would support flagging economic performance. Naturely, borrowed money played a huge role in igniting China's bubble (Chart 1), as inevitably happens when markets go mad. When MSCI, given the bubble, refused to grant representation to Chinese shares in their global indices in mid-June, the market began to tumble. The collapse quickly gained momentum as margin calls began and as the speculators began to lose their life savings. This sell-off continued into the early third quarter causing the Chinese government to intervene in a variety of astounding ways to prevent the collapse from causing serious harm to its economy, and more importantly the Communist party's political power. Included in these methods were banning some investors from selling, forcing other groups to buy, threatening short sellers with arrest and allowing thousands of companies to suspend trading in their shares. The scale of the government's intervention in China's markets is unprecendented, far exceeding anything we have ever seen and massively distorting reality. While the government was able to temporarily stymie the collapse after a roughly 30% decline, we fear more trouble looms for Chinese speculators in the months ahead. The big question is how will China's economy respond and what impact might this debacle ultimately have on the global economy. We will address this in greater depth later in this Commentary, but China's economic growth rate will slow further.

Table 1

2Q15 Total Returns

US Indices	2Q15	YTD	5y ann
S&P 500	0.3%	1.2%	17.3%
S&P 500 Value	0.2%	-0.5%	16.0%
S&P 500 Growth	0.3%	2.8%	18.7%
NASDAQ	2.0%	5.9%	20.2%
S&P 400 (Mid Cap)	-1.1%	4.2%	17.8%
S&P 600 (Small Cap)	0.2%	4.2%	18.4%
Treasury Bonds	-1.8%	-0.1%	2.8%
High Grade Corp. Bonds	-2.7%	-0.5%	5.3%
Gold	-1.0%	-1.0%	-1.2%
Global & International Indices			
MSCI World	0.3%	2.6%	13.1%
MSCI EAFE	0.6%	5.5%	9.5%
MSCI Euro	-1.9%	3.2%	8.4%
MSCI Far East	3.2%	12.5%	9.0%
MSCI Japan	3.1%	13.6%	8.8%
MSCI Emerging Markets	0.7%	2.9%	3.7%
US Economic Sectors			
Energy	-1.9%	-4.7%	10.6%
Materials	-0.5%	0.5%	14.5%
Industrials	-2.2%	-3.1%	17.0%
Consumer Discretionary	1.9%	6.8%	23.4%
Consumer Staples	-1.7%	-0.8%	16.6%
Health Care	2.8%	9.6%	23.8%
Financials	1.7%	-0.4%	14.1%
Information Technology	0.2%	0.8%	17.6%
Telecom	1.6%	3.2%	14.1%
Utilities	-5.8%	-10.7%	12.5%

Source: Bloomberg

Greece also created a storm as its new socialist leadership tried to extract debt concessions from its European paymasters. While quite an interesting spectacle, the truth is Greece is a very small economy and its debt is no longer owned by European financial institutions. As a result, it is not a grave threat to the global economy and is very unlikely to create a systemic financial collapse. To put it in perspective, the dollar value investors lost in China's market rout was about 15 times the size of Greece's GNP. No matter the ultimate outcome for Greece, we are hopeful it will be largely inconsequential for investors.

Stewardship Partners' defensive portfolio positioning, which we have had in place since January, neither hurt nor helped much since share prices went nowhere during the quarter. Fortunately, however, most of our portfolios still outperformed the relevant indices as good stock picking helped us produce favorable results during the quarter.

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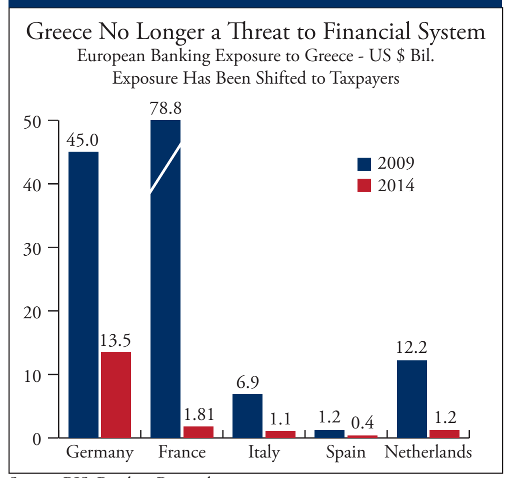
Greece Is Just a Small Squall, Storm Clouds Dissipating in the US

"but those who hope in the LORD will renew their strength" Isaiah 40:38a

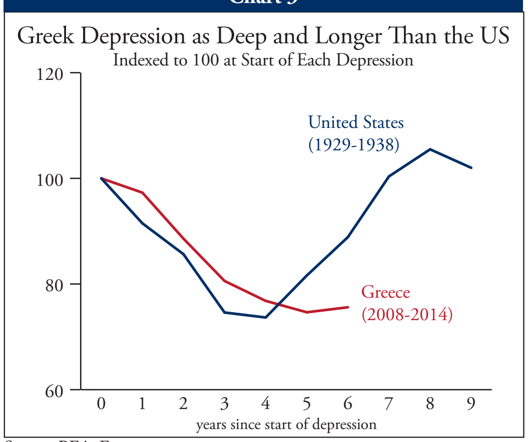
At Stewardship Partners, we are more concerned about the potential consequences of China's bursting economic and stock market bubbles than about any threat from the potential demise of Greece. While Greece has often been in the headlines over the last five years as it struggled with its enormous debt and bloated government finances, it accounts for only 1.8% of European GNP. Should its economy continue to shrink, Europe would hardly be impacted and the rest of the world would not even notice. Even if the ultimate outcome for Greece were a chaotic collapse as it exited the Euro, its impact on the world's financial markets, other than from a sentiment perspective, should not be significant or long lasting. This was not always the case, however. When Greece's problems first emerged, German, and particularly French banks, had a very significant exposure to Greek debts. Had Greece exited the Euro back then, the European banking system would have collapsed, most likely sparking another 2008-like financial market meltdown and global economic depression. To avoid such an unpleasant outcome, Europe instead strung Greece along while German and French banks eliminated their exposure to Greek loans (Chart 2). Greek debt was effectively shifted from European banks to European and international governmental institutions. Proceeds from rescue loans from the IMF and others to Greece were used to pay back bank loans. Now, should Greece ultimately exit the Euro and default on its debt, the European banking system would be able to easily handle its much smaller Greek exposure. Naturally, taxpayers once again would foot the bill via the IMF, the ECB and several other European bailout groups' losses, but a global market and economic debacle has likely been avoided.

Chart 2



Source: BIS, Barclays Research

Chart 3

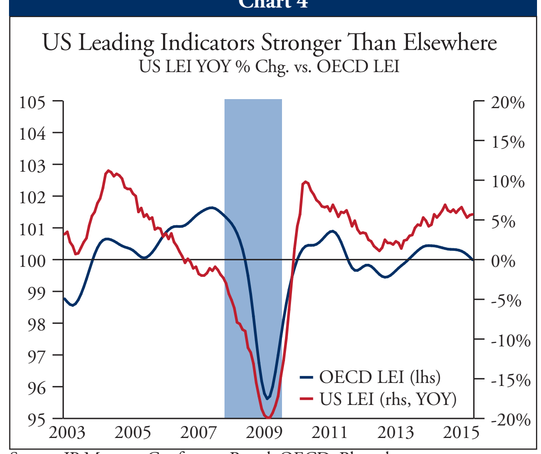


Source: BEA, Eurostat

While investors and the global economy will likely feel neither substantial nor long-lasting pain from Greece's demise, make no mistake Greece's people are suffering greatly. Chart 3 highlights how brutal the collapse in Greece's economy has been. It has been just as severe as the US's Great Depression and the duration of the decline has exceeded it. Moreover, it is almost a certainty Greece will need to endure further economic weakness before a recovery begins. Plans are already being made to ship emergency medical and food supplies to Greece as its economy is on the brink of ruin. While none of this may seriously impact investors in the short run, the potential humanitarian crisis is distressing and the political ramifications could ultimately have implications for the financial markets. We are keeping a particularly close eye on the continued rise in the polls of nationalist political parties in Spain, Italy and France. Should such groups rise to power, just as Syriza did in Greece, investor concern will mount quickly and be reflected in share prices, particularly European share prices. While the Greek drama may play out for many more months, this political pressure led once again to a "kick the can" further down the road solution. Ultimately, however, a meaningful amount of Greece's debts must be effectively written off as the country cannot possibly pay them, even under an optimistic scenario for future Greek economic growth.

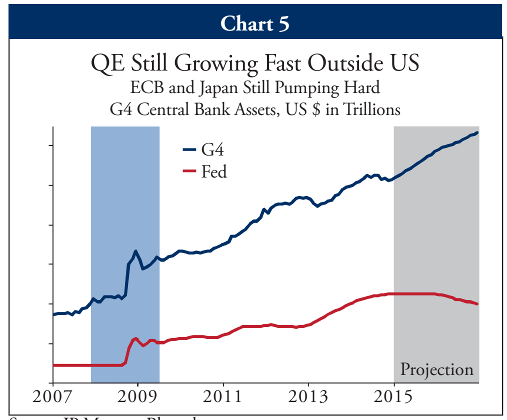
As both the Greek debt crisis and China's bursting stock market bubble have been dominating headlines recently, the US economy has begun to hesitantly gather strength. Following a surprising, but tiny, drop in GDP in 2015's first quarter, economic growth appears to have rebounded to the 2.5% - 3.0% range in the second quarter. The trend in US economic data clearly turned up during the second quarter following unusual weakness in the first quarter (which may have been influenced by faulty seasonal adjustments which negatively biased the data). Even so, there have been enough dubious data releases in the US to leave investors, and no doubt the Fed, worried about the sustainability of an economic advance as we move through the balance of this year and into 2016. Chart 4, however, reveals that the US Leading Economic Indicator Index (LEI) continues to project decent US economic growth even while the Global LEI remains moribund. Despite Greece, the European economic outlook has been improving somewhat, but weakness in China, Japan, Latin America and Russia are all weighing on global economic growth prospects. Recently, the IMF once again lowered its 2015 global economic growth forecast to 3.3% and our sense is further revisions lower are likely. China's growth could easily continue to disappoint given the potential domestic economic ramifications of its stock market bubble burst adding to its already weakening growth rate. Moreover, there is not much reason for short term optimism in Japan, Russia or Brazil. Should European growth falter, it will be difficult for the US to grow fast enough to offset lost growth elsewhere.

Chart 4

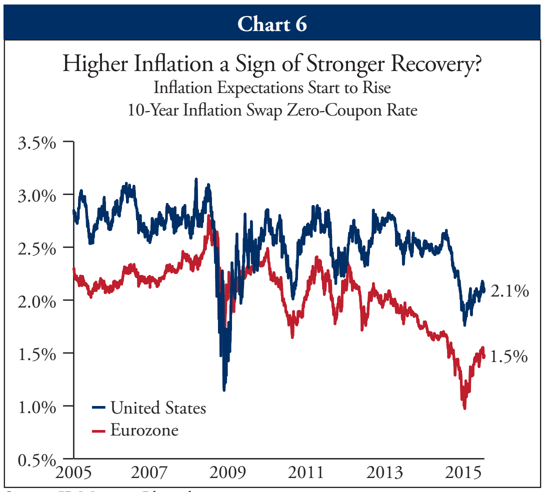


Source: JP Morgan, Conference Board, OECD, Bloomberg

Reflecting this uninspiring global economic growth, central banks outside the US continue to expand their balance sheets to reignite growth through low interest rates and higher asset prices. Chart 5 indicates the expectation for further rapid growth in assets at the world's largest central banks. Actually, with the end of its QE program last year, the Fed is not expected to be part of the next round of central bank balance sheet expansion. Given better economic performance in the US, the Fed is trying to normalize its policy and reduce further its still highly accommodative monetary policy. Lagging economic growth elsewhere in the world, still somewhat sketchy economic data reports in the US and crises like Greece and China, however, have clearly delayed the Fed's desire to reset its policies. Fed Chair Yellen recently reiterated her desire to raise short term interest rates in 2015, but investors are clearly signaling they don't believe the Fed will move until 2016 at the earliest. One reason the Fed is anxious to restore policy to a more standard mix quickly is the fear that they will not be able to respond with typical approaches should a new recession arise soon. If interest rates are still at 0% when the next recession arrives, the Fed's options to help would be limited.



Source: JP Morgan, Bloomberg



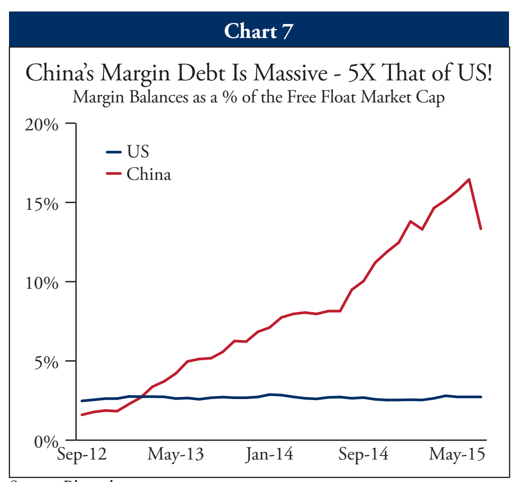
Source: JP Morgan, Bloomberg

One indicator which should give the Fed hope that, despite the extended length of the current economic recovery, a recession is still far off is early signs of increased inflation expectations (Chart 6). Indeed, inflation has been rebounding from the disconcertingly low deflationary levels seen not that long ago. Ideally, this turnaround in inflation expectations represents improved prospects for economic growth and not a response to the excess liquidity QE programs have pumped into the economic system. Little could be worse for the Fed and the ECB than if inflation returned even while economic growth remained sluggish. It would be forced to take on inflation with higher interest rates, likely causing a recession in the process. In the US, at least, we suspect the Fed will not have to contend with such a scenario. Instead, the Fed might be faced with a question of whether to further delay raising rates while enduring rising inflation expectations to help promote growth outside the US. While Fed officials would deny even thinking in such a way, we suspect there may be a willingness to let inflation get a little hotter than normal before raising interest rates in order to not undermine already weak growth overseas. On the other hand, higher US interest rates would strengthen the US dollar further and raise US imports, thereby encouraging foreign economic growth. One thing is for sure, economic uncertainty is higher than normal and economic policymakers may soon be facing much more complicated issues as inflation may have hit a critical long term inflection point. If so, it may be a very long time before bonds offer attractive returns.

Will Chinese Market Typhoon Drench Outlook for Global Equities?

"the sky grew black with clouds, the wind rose, a heavy rain started falling" 1 Kings 18:45

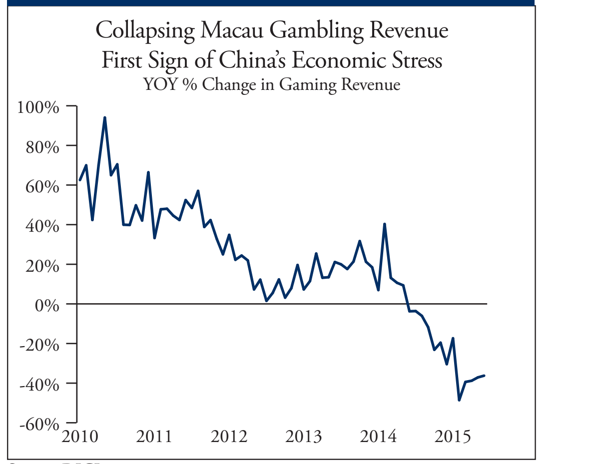
While inflation expectations have been rising in the US and Europe, actual reported inflation has not yet moved to disturbing levels. And while the US and European economies have been trending more optimistically of late, growth remains far short of robust. Regular readers of our Quarterly Commentaries know we have long been concerned about China's massive economic bubble and, more recently, its enormous stock market bubble. The bursting of these bubbles will have multiple impacts on the US and other global economies, both positive and negative. In the intermediate term, however, the negative impacts may outweigh the positive ones. Even though Chinese stocks have initially recovered after a roughly 30% drop from the June 12th highs, there is definitely scope for further substantial declines. Chart 7 portrays just how much more margin debt was utilized to fuel the Chinese bubble than what has typically been seen on the New York Stock Exchange. Furthermore, some believe unofficial margin debt obtained from sources other than brokerage firms exceeds the officially reported margin debt. If market forces are actually allowed to operate, it is clear selling pressure on the Chinese stock exchanges could continue for some time. Chinese stocks bounced off their lows recently aided by massive government manipulation of the market (to the point calling it a market is probably a misnomer now), but with roughly half the stocks not trading at all recently, it is hard to know where Chinese stock indices would actually be if all the shares were actually trading. The reason most of these shares were suspended from trading is these companies have themselves been speculating in the market and have pledged the company's own shares as collateral for margin loans. Had company officials allowed their stocks to trade, the pledged shares would be subject to margin calls leading to forced sales of their own company's shares, incurring large losses.



Source: Bloomberg

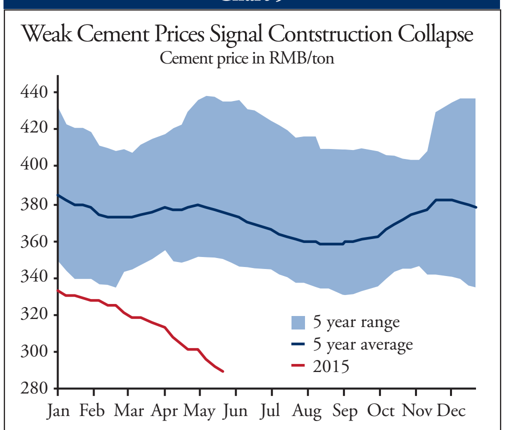
Just based on the losses many have already incurred, the Chinese economy is sure to be negatively impacted. The total loss in market capital is in excess of $2 trillion currently. As we suggested in our last commentary, many Chinese individuals will have lost their life savings as a result of the bubble bursting. Certainly not every Chinese citizen was speculating in the market, but it is estimated about 15% of the population was. Many of these may have been able to get out of the market prior to losing significant savings since the market had risen by 150% in the twelve months before the recent correction. Still others, however, will have been seriously harmed. Given the government's cheerleading of the market's advance, many illiterate Chinese people were convinced to "invest" just in recent months. As a result, many are holding the government responsible for their losses thereby risking social stability, something the Communist party goes to great lengths to protect. Indeed, we feel certain this is why the government has resorted to so many incredible and abusive behaviors to halt the market's collapse. While the government may be able to limit the damage in the short run, we are skeptical of their ability to totally restore order to the markets. Even after the decline, many Chinese shares still sell at P/E ratios greater than 50x.

Chart 8



Source: DICJ

Chart 9

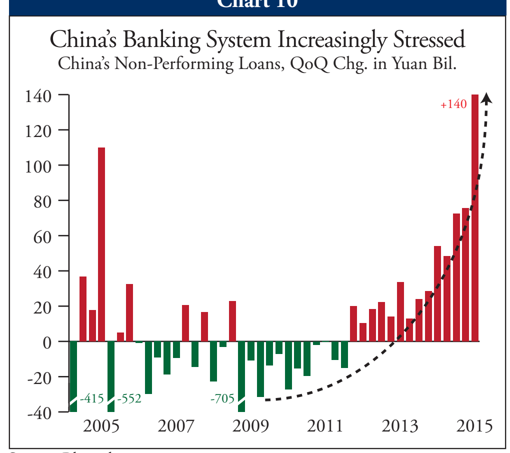


Source: Digital Cement, JP Morgan

If our only concern was the fallout from the Chinese stock market bubble bursting, the threat to the rest of the world from China might not be very severe. Unfortunately, the Chinese government was seeking to promote wealth through the equity market as a means of offsetting the rising negative impact from the country's perhaps even more massive economic bubble. Many indicators of growing trouble on this front are apparent. Perhaps the most reliable indicator is plummeting gambling revenue in Macau (Chart 8). Starting in mid-2014, gambling in China's version of Las Vegas began to tumble, falling 40%, as the country's wealthy began to see the writing on the economic wall. Most of the concern initially surrounded China's property market, the problems of which, including the nation's many "ghost cities", we have documented in past Commentaries. Falling residential property prices flashed a warning the real estate portion of the China economic bubble may have begun to pop. We suspect the commercial real estate market was also suffering from reduced demand. Indicative of the slowing real estate sector is rapidly deteriorating construction-related commodity prices such as steel rebar and cement (Chart 9). Clearly, it is not just the stock market bubble that has become unglued; the real economy is also showing signs of significant deterioration. If Chinese citizens are facing both a hit to their wealth via the stock market and real estate weakness and a threat to their income from a weakening economy, things could turn ugly quickly. Moreover, the government will likely behave even more erratically as they try to scapegoat foreigners (which is already happening due to the stock market debacle) and search for ways to contain the damage of multiple bursting bubbles. The risk of bad economic policy decisions being implemented in such a scenario is high. At the moment, however, China is still holding together, if only precariously.

While Chinese economic growth rate has been slowing, at least according to suspect official statistics, it continues to expand. While the real estate sector has been under pressure, other parts of the Chinese economy apparently continue to expand sufficiently to offset that deterioration. Nevertheless, the financial losses seen in the stock market from both individual and corporate investors must be leading to increased stress in the financial system. Even before the stock market mess, non-performing loans had been climbing sharply (Chart 10). Again, most independent observers believe these non-performing loan totals are grossly underreported. Ratings agency Fitch reports that 40% of loans in Chinese banks are backed by real estate and these loans have grown by an astounding 400% since 2008. To quote Fitch, "A protracted downturn in property markets could therefore threaten the solvency of Chinese banks". Fitch also notes the reported levels of non-performing loans shown in Chart 10 are almost certainly seriously understated.

Chart 10



Source: Bloomberg

Clearly, Chinese government officials have a lot to worry about, which means investors do as well. China is concurrently dealing with a chaotic collapse in the nation's stock market bubble, weakening economic activity and a banking system no doubt at greater risk than many are willing to admit. In light of these significant risks, is it any wonder the government has quite obviously panicked in reaction to the stock market's sudden decline? Since China's financial system is not well-integrated with the rest of the world, any serious problems that may arise will not likely have a huge impact on the global banking system. Still, global financial markets would certainly be rattled by a Chinese recession and hard evidence of fragility in its banking system. The Chinese government still has many tools it could utilize to forestall any such collapses, including QE, but the markets may begin to take notice of the growing risk. As with the market crash, even the government's best efforts may come up short of what is required to stop the bleeding.

High Valuations Increase Chance of Storm Damage

"wide is the gate and broad is the road that leads to destruction, and many enter through it" Matthew 7:13

If it turns out the Chinese government's inability to avoid the stock market crash in China was just a precursor to the much more damaging prospect of them losing control of the entire Chinese economy and banking system, then the world's equity markets may be facing significant headwinds. The high valuations seen in most developed world stock markets today, abetted by years of central bank monetary policy largesse, clearly highlight the potential for downside risk in these markets, even if such concerns only cause P/E multiples to contract to more normal levels. Chart 11 reveals that the S&P 500 is currently valued at more than one standard deviation above its average, a level that has led to lower P/E multiples in the past. Should the S&P simply return to the average P/E of 15X, the index would lose around 250 points or more than 10% of its current value. As seen in Chart 11, P/E declines usually lead the indices' P/E ratio to actually fall well below its average. We suspect Greece's struggles are not sufficient to directly cause such a correction in valuations, but should the dollar strengthen further as a result of what yet might transpire in Europe, then it could have an indirect impact. Should China's economy enter a recession, however, the uncertainty for global growth and corporate profitability could easily trigger investors to be less eager to pay high valuation multiples.

Chart 11

US Stocks Are Not Cheap

S&P 500 P/E Ratio Using Forecast EPS

Source: Bloomberg

Table 2

Foreign Stocks and US Bonds Also Not Cheap

Metric	Now	5 Yr Ago	10 Yr Ago	Now vs. 5 Yr	Now vs. 10 Yr
S&P 500					
P/E (Trailing)	**18.3x**	15.7x	16.5x	+2.6	+1.8
P/E (Next Twelve Months)	**17.5x**	14.1x	15.1x	+3.4	+2.4
Price to Book	**2.8x**	2.3x	2.4x	+0.5	+0.4
Foreign Markets P/E (NTM)					
Canada (S&P/TSX Composite)	**18.1x**	15.2x	15.3x	+2.9	+2.8
UK (FTSE 100 Index)	**15.7x**	11.7x	11.9x	+4.0	+3.8
Eurozone (Euro Stoxx 50)	**14.7x**	11.2x	12.0x	+3.5	+2.7
Germany (DAX Index)	**13.7x**	11.5x	12.6x	+2.2	+1.1
Japan (Nikkei 225)	**19.2x**	17.1x	18.3x	+2.1	+0.9
China (Shanghai SE Composite)	**17.4x**	10.0x	13.6x	+7.4	+3.9
MSCI EM	**12.6x**	11.1x	11.4x	+1.5	+1.2
Fixed Income Multiples					
US Bonds (10yr)	**42.5x**	42.2x	31.2x	+0.3	+11.3
Munis (10yr AAA)	**43.1x**	44.8x	34.8x	-1.7	+8.3
JP Morgan US Liquid Index	**24.7x**	24.7x	19.6x	+0.0	+5.1
JP Morgan High Yield Index	**14.3x**	14.8x	12.6x	-0.5	+1.7

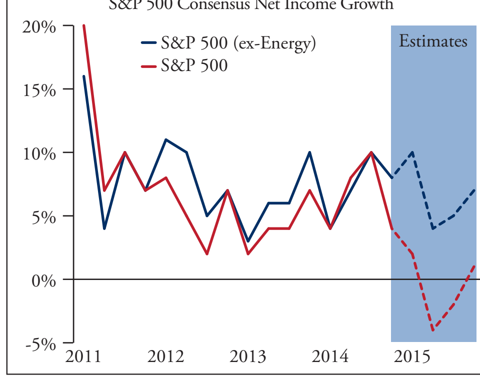
Source: JP Morgan, Bloomberg, FactSet

High valuations are not restricted to just the US. As seen in Table 2, P/E multiples based on forecasted earnings are currently above the 5 and 10 year median levels in all major markets highlighted. Again, excess liquidity created by the world's central banks has helped boost equities to these heights. With QE still ongoing in Europe and Japan, however, valuations in those regions may prove more resistant to decline. Moreover, China may end up resorting to QE as well as it seeks to continue to prop up its markets. Still, we have seen a dramatic increase in European government bond interest rates in the last few months, even in the face of aggressive purchases of such bonds by the ECB, indicating QE may prove insufficient to halt a correction in valuation levels for equities as well. The very significant increase in European government bond yields from the odd negative levels seen earlier this year in the face of aggressive ECB QE, coupled with the inability of China to prevent its equity collapse, may be indicating a loss of effectiveness for governmental efforts to distort financial markets. If so, this would have major ramifications for valuations and investment returns. Obviously, with no QE now taking place in the US currently, US valuations may be at greater risk of correction. Moreover, we believe the bar to restart US QE is very high. Note as well that bonds remain even more expensive than shares as a result of years of direct purchases of government bonds by the world's major central banks. If investors begin to lose confidence in the belief that markets cannot fall any longer because of government interference in the markets, a significant correction could be on the horizon.

Chart 12

Earning Trends Weak, but Slightly Better ex-Energy

S&P 500 Consensus Net Income Growth



Source: JP Morgan, FactSet

Chart 13

Big Jump in Share Buybacks Supporting US Stock Prices

Announced Share Repurchases in Last 3 Months, $ Bil. - S&P 500

Source: Bloomberg, FactSet, Deutsche Bank

In the US, share prices are also not getting much help from earnings at the moment. Earnings growth in the last two quarters was nearly non-existent and current expectations for the second quarter are for earnings to fall slightly, despite a rebound in US and European economic activity. The strong dollar and the oil sector continue to hold down earnings performance for the largest US companies. As can be seen in Chart 12, earnings performance excluding the oil sector is anticipated to be a bit better for the remainder of 2015. Even so, the threat to future earnings from a still stronger dollar, a further potential decline in oil prices and reduced global growth is rising due to the crises in Greece and China as well as weak economic performance in Japan, Russia and Brazil. On both the earnings and valuation fronts, this does not seem to be an ideal time to be taking big risks as uncertainty on both fronts is growing.

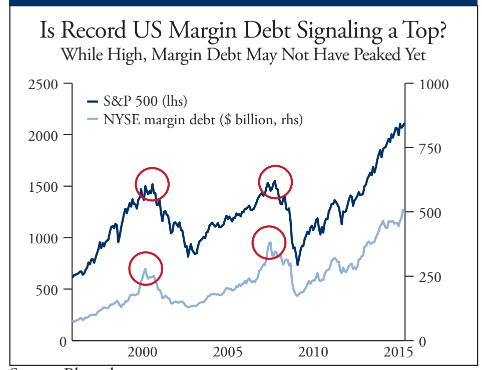
Offsetting these concerns, and keeping stocks from entering a correction phase already, has been a big jump in corporate share repurchases (Chart 13). Maintaining the current unusually high level of buybacks may be a challenge, however, particularly if the economic outlook grows sketchier.

Remaining Sheltered From Possible Market Storm Seems Best for Now

"When the storm has swept by, the wicked are gone, but the righteous stand firm forever" Proverbs 10:25

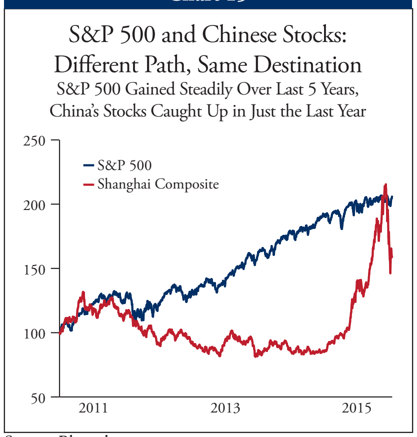
Stewardship Partners moved all of its clients' portfolios to a strongly defensive stance in January of this year based on high valuations, weak economic and earnings performance, concerns about the implications of the oil price shock and a number of other factors. Initially, most markets continued higher but by mid-year the accumulating problems facing investors caused a retreat in share prices. While no one has ever consistently forecasted the short term direction of the equity markets, we believe the various risks investors now continue to justify a cautious stance. Not only is the third quarter of the year tyically the weakest for the market, but also the market's advance is quite extended in both time and scale. In our view, even if risk was not elevated, restraint would be called for simply because markets correct from time to time and the US market is well overdue for a correction. Moreover, while margin debt in the US is significantly lower as a percent of market cap than China, Chart 14 suggests both margin debt and the S&P 500 may be nearing a short term peak. Given the situations in Greece, China and Puerto Rico (which is going through its own debt crisis) it would not be surprising to see speculators using margin to trim their sails a bit.

Chart 14



Source: Bloomberg

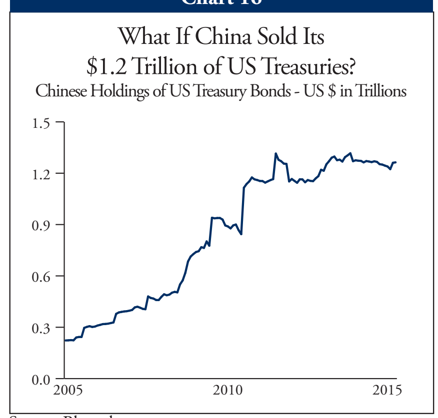
Chart 15



Source: Bloomberg

Interestingly, prior to the Chinese market collapse, both the US and Chinese markets had advanced about the same amount over the last five years (Chart 15). As can be seen, however, both markets took very different paths to end up in the same place. The US market, backed by a variety of QE programs and other stimulus efforts, enjoyed a relentless advance which was rarely interrupted by pullbacks. China's market, on the other hand, languished until the middle of 2014, reflecting the rising strains the nation was facing from its economic bubble. At that point, however, the government began encouraging investment in equities as part of its effort to reinforce its struggling economic growth and speculation took off. Due to the more even-paced nature of the US advance and fewer signs of speculation, we would not expect as dramatic a correction as China has recently experienced. Even so, healthy markets normally correct from time to time in order to build a stronger foundation for further appreciation. For now, at least, that is all we expect US stocks to do. A 10-15% retreat appears to us to be a reasonable expectation at this point. The recent 4% decline may be a leading indicator of future declines. Fortunately, our defensive positioning has helped hold most of our portfolios steady in the face of these initial declines. Many were even able to appreciate a little in the face of the market's drop due to good stock picking and wise hedging.

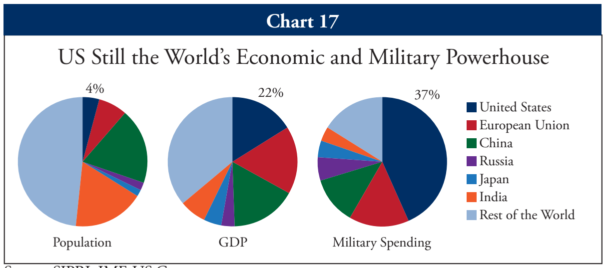
Chart 16



Source: Bloomberg

We remain concerned about a chaotic decline in China's economic activity as the consequences of its economic and market bubbles play out. Still, it is unlikely the economy will evolve as badly as the Chinese stock market. Government officials have the ability and the willingness to take strong measures to see to it the rebalancing of China's economy follows a smoother path. Still, the stresses the Chinese economy faces combined with the existential threat economic calamity has for the ruling Communist party make the risk of policy errors greater than normal. We continue to be very focused on developments in China hoping the worst can be avoided. If not, it is worth remembering China owns over $1.2 trillion of US Treasury bonds (Chart 16). Should China need to sell some of those to help stabilize the economic home front, that could prove to be a significant market disruption. On the other hand, it is also worth remembering China is home to $21 billion in savings and is increasingly allowing some of that money to flow overseas. This huge reservoir of savings could result not only in increased purchases of US Treasuries, but also of equities and real estate. Both the US and Japanese real estate markets are already benefitting from increased buying from China. If China can manage to let the air out of its economic bubble adroitly, the longer term outlook for global financial assets should be impressive.

Chart 17



Source: SIPRI, IMF, US Census

It is also worth remembering just how strong the US is. Chart 17 shows that with just 4% of the world's population, we account for 22% of world GDP and 37% of global military spending. While cultural trends in the US may be extraordinarily disappointing at the moment, we remain an economic powerhouse and the greatest nation on earth. Long term market appreciation remains a very good bet even if we may have to endure a normal market correction first.

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

Biblically Responsible Investing (BRI) – Investing as Jesus Would

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

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

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

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

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

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

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

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

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

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

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

BRI in Action – Comparing Good and Bad Corporate Behavior

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

Below you will find an example of both a company exhibiting exemplary attributes, Praxair, and one we avoid, Allergan. Praxair is a holding in some of our Stewardship Partners portfolios while we actively avoid ownership in Allergan 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 – Praxair – Environmental and Commmunity Stewardship

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

Praxair supplies industrial gases to a wide range of industries throughout the globe in an environmentally friendly fashion. Its mission is to protect our planet while making its customers more productive. Given the industrial customers Praxair serves, helping these companies to achieve higher environmental standards is a significant positive. Founded over 100 years ago, the company is the largest industrial gas company serving the Americas and one of the largest in the world. Praxair was the first company in the United States to produce oxygen from air using a cryogenic process and continues to be a major technological innovator in the industrial gases industry. The company produces, sells and distributes atmospheric, process and specialty gases, and high-performance surface coatings. Praxair products, services and technologies aim to make customers more productive by bringing efficiency and environmental benefits to a wide variety of industries, including aerospace, chemicals, food and beverage, electronics, energy, healthcare, manufacturing, primary metals and many others. Currently, three major industry sectors – Manufacturing, Metals and Energy – account for more than half of the company's $12.4 billion in annual revenue. Just over half of the company's sales come from North America. Praxair employs over 27,000 employees in 50 countries. The company is also very successful from a financial perspective, achieving the highest shareholder returns in its sector. Roughly half the company's cash flow is returned to shareholders via both dividends and share repurchases. While providing good financial returns to shareholders is important to Praxair, it is obvious from the company's well thought out efforts that caring for its workers, suppliers, community and the environment as well as maintain a high level of integrity are all key focuses of the management team and the board of directors. Having examined the diligence of hundreds of companies in implementing admirable goals in these areas, we can confidently state that Praxair can be counted among the best at achieving its worthy objectives.

Praxair states it corporate vision as: "To be the best performing industrial gases company in the world as determined by our customers, employees, shareholders, suppliers and the communities in which we operate". Clearly, the company recognizes that financial success at the expense of others is no success at all. To help guide the company to achieve this lofty objective, Praxair has stated six "Core Values". The first speaks to the company's emphasis on caring for the welfare its employees – "Safety First". Working with industrial gases can be a dangerous activity so stressing safety above all else is wise. The goal of safety extends beyond Praxair employees and to the company's suppliers and customers as well. The second Core Value is "High Integrity". Emphasizing honesty, ethical conduct and full compliance with the law has enabled Praxair to establish a good reputation and they intend to enhance that as time goes by. The third Core Value is "Results Driven". The company seeks to reward all of its stakeholders through flawless execution, operational discipline and continual improvement. The fourth Core Value is "Customer Satisfaction". Praxair emphasizes product quality and reliability while working closely with its clients to help them overcome challenges and achieve their goals. The fifth Core Value is "The Right People". Praxair places special importance on attracting and developing talented people from diverse background but sharing a common desire to make the company more successful and the world a better place. The sixth and final Core Value is "Environmental and Social Responsibility". The company's desire is to help improve their customers' environmental performance while simultaneously reducing Praxair's impact on the world's ecosystem. Moreover, the company seeks to maximize its positive impact on the communities it serves. Now, it is one thing to have worthy goals such as these and quite another to show intentionality in living up to such high standards. In Praxair's case, there is ample evidence the company is doing much to back up its "talk" of being an exemplary corporate citizen.

At Stewardship Partners, we believe how a company values its employees speaks volumes about its character and trustworthiness. As already noted, "Safety First" is the company's preeminent Core Value, reflecting right priorities. If employees are not working in a safe place and manner, any other benefits the company might bestow upon them may not ever get to be enjoyed. Praxair publishes a variety of statistics revealing a low incidence of accidents as well as the annual improvement in these measurements. Praxair trucks drive 266 million miles per year, often delivering hazardous materials, so the company employs experienced drivers whom they train extensively. Last year the company experienced a very low 2.69 accidents for every 1 million miles travelled. Its overall safety record was 20 times better than the OSH average. Beyond safety, Praxair offers a broad complement of benefits to its employees. Health care plans covering medical dental and vison are provided as well as insurance for life and long term disability. Plans are also available to help with dependent care costs and legal services are also offered. Retirement security is encouraged via a retirement savings plan to which Praxair contributes as well as giving access to retirement planning tools and resources. In an attempt to help employees avoid sickness or minimize the impact of chronic conditions, Praxair operates a Healthy Living program through which an employee can obtain a health risk assessment, participate in condition management and lifestyle management programs as well as have 24 hour access to a nursing assistance center. Praxair also goes out of tis way to optimize their employees' life/work balance. Generous paid vacation and flexible work arrangements help in this regard but, additionally, the company offers leaves of absence, employee assistance programs and survivor support programs, among other useful options. Praxair also prioritizes military veterans in its hiring and gives educational reimbursements.

Reflecting its desire to make the world a better place and to positively impact its communities, Praxair and its employees have been active in a variety of charitable endeavors. In 2014, Praxair's Global Giving Program contributed $6.6 million to help provide educational opportunities, promote cultural diversity, improve access to health & wellness programs and preserve and protect the environment around the world. In 2014, 380 of the company's worksites participated in the Global Giving Program. Through this program, 244 separate charitable projects were undertaken around the world. Over 14,000 employees contributed more than 78,000 hours of volunteer work in carrying this work. Moreover, these employees raised a further $1.3 million from both their own donations and by soliciting help from others. In 2014, employee community engagement projects benefited nearly 336,000 people globally—more than 12 beneficiaries for every Praxair employee. Over 20,000 pounds of clothing was donated and 218,000 pounds of food was distributed to those in need. Over 45,000 students received assistance and almost 15,000 trees were planted. These philanthropic efforts expanded at a rapid rate in 2014 as company employees clearly began to catch the vision for how much good they could do by working hand-in-hand with each other and Praxair. It will be interesting to observe how these charitable activities continue to grow in the future.

Praxair'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 – Allergan – Profiting From Abortion

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

Allergan, the result of the recent merger with Actavis and Allergan, is a global pharmaceutical company headquartered in Dublin, Ireland with $23 billion in sales. Included among its many drug offerings are well known drugs such as Botox and Restasis as well as over 1,000 generic drugs. Allergan is the third largest manufacturer of generic drugs in the US and holds a top five position in 20 global markets. The company has significant market positions in a number of important drug categories including eye care, dermatology, cystic fibrosis and cardiovascular. Allergan has been a very successful growth story for many years and its recent merger with Actavis catapulted the company into an even greater level of global impact in the pharmaceuticals industry.

Unfortunately, one of Allergan's key product categories is women's health. While women's health is obviously a worthy endeavor for the company, it also puts a seemingly pleasant wrapper around drugs the company sells which induce abortions. These drugs include "emergency contraceptives", more commonly referred to as the morning after pill. The recent release of undercover video of a Planned Parenthood doctor discussing how she carefully crushes the skull of an unborn child, and not its torso, during the abortion process in order to save internal organs for later sale to research groups reminds us all once again what an unfathomably horrific act abortion is. Seeing that doctor casually discussing her own barbaric behavior over a nice lunch highlights the capacity of some people to rationalize to themselves the most unthinkable of actions. Frankly, it was frightening to observe and brought to mind the mentality that must have existed in Nazi prison camps where cruel medical experiments were carried out upon prisoners. Allergan's drugs produce abortions at a very early stage in pregnancy; therefore using these does not involve the skull-crushing and other hideous actions the Planned Parenthood doctor described. Nevertheless, innocent, legally unprotected children's lives are regularly ended by Allergan's drugs and, any way you look at it, this is unconscionable. The highly disturbing Planned Parenthood doctor's revelations are a good reminder of just how horrendous abortion is, thus we thought it timely to once again highlight a company selling abortion drugs.

Excluding Allergan 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 – Mercy Medical Angels

"I was sick and you looked after me" Matthew 25:36

Mercy Medical Angels' mission and purpose is to ensure no financially-stressed patient is denied access to distant specialized medical evaluation, diagnosis or treatment for lack of a means of long-distance medically related transportation. Additionally, Medical Mercy Angels ensures the provision of urgent transportation in situations of compelling human need and homeland security emergencies. Mercy Medical Angels have several programs available to help achieve its objectives. The ministry administers charitable or deep-discount airline ticket programs for patients and patient escorts in cooperation with the major U.S. airlines. Ambulatory outpatient travel in excess of 750 miles necessitates the use of airline resources. About 8,000 patients/escorts are transported in this manner per year. There is also a special program for veterans and their immediate family members that transports nearly 4,500 clients per year. Mercy Medical Angels also coordinate volunteer civilian pilots to transport needy patients and provide free ground transportation should that be the most convenient solution. Volunteer civilian pilots transport about 900 patients per while roughly 4,000 patients per month utilize the ministry's help in providing ground transportation. Mercy Medical Angels also operate an 800 phone line to assist patients and engages in disaster response.

Mercy Medical Angels was founded in 1972 in the Washington, DC area and has assisted in nearly 155,000 patient trips covering over 100 million miles. In recent years, the ministry has asked patients to rate their experience with Mercy Medical Angels and 95% have given a good or excellent rating. Now headquartered in Virginia Beach, VA, Mercy Medical Angels is a relatively small ministry with $4 million in annual revenue, most of which comes from donations. The impact the ministry has for those who are ill and have a financial need, however, is immeasurable. While there is nothing on the ministry's website indicating it is a Christian ministry, it is a member of the ECFA and its names belies its Christian foundation. Six of the ministry's fifteen board members are retired US military veterans and legendary Dallas Cowboys head coach, Tom Landry, also a Christian, once sat on the ministry's board.

Mercy Medical Angels not only has performed many good deeds, but also has managed the ministry's financial affairs well. As a result, this ministry has attained a 4 Star Financial Efficiency Rating from MinistryWatch.com. We believe Mercy Medical Angels ministry is effective in helping those in great need and is worthy of your consideration for financial support.

The Christian Ministry Marketplace – Helping Donors Give Wisely

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

Much like the stock market provides for a sensible and efficient allocation of capital in our economy, the rise of a Christian Ministry Marketplace is providing donors with a myriad of helpful resources to maximize the impact and joy of giving to the work of the Lord. As donors begin to take their giving as seriously as their investing, they will find the assistance offered by the groups listed below to be invaluable. By utilizing these resources, donors are not only likely to make better personal giving decisions, but are also contributing to the growth in the marketplace itself. By so doing, they are helping to lay a foundation for wiser giving for all who follow in their footsteps. Accordingly, we encourage donors to investigate how these groups might help you to give more wisely, achieve a greater impact and create increased joy for both yourself and receivers of your gifts.

The Christian Ministry Marketplace
Resources for Christian Donors

WHY
to give to Christian ministries?

Teaching on Stewardship:

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

HOW
to give with a discerning mind?

Professional Advisors:

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

Donor Advisors:

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

WHERE
to invest in kingdom ministries?

Ministry Research:

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

Ministry Mutual Funds:

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

Featured Ministry Marketplace Participant – NACFC

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

The National Association of Christian Financial Consultants (NACFC) is a group of investment professionals committed to investment and financial planning disciplines centered upon Biblical principles. NACFC's mission is to provide educational resources, fellowship support, and Biblical standards for professional investment counselors seeking to integrate Bible-based investing principles within financial counseling practices. The group was founded in 1997 by The Timothy Plan's Art Ally and held its first annual conference in 1999. Currently, the organization is led by Jeff Armstrong, who also serves as the president of the Baptist Life Association.

Members of the NACFC are required to testify to their personal relationship with their Savior Jesus Christ. Additionally, they must be in good standing with industry regulators, commit to integrating biblical principles into their money management practice, commit to being good stewards of their clients assets by avoiding investing in companies whose products, services and/or corporate policies violate biblical principles and publicly proclaim that their businesses, indeed their lives, are gifts from the Lord over which they are accountable to provide good stewardship over. Members are encouraged to view their investment counseling practices as their ministry.

NACFC, in turn, provides members with educational resources and fellowship to enable financial advisors to excel in providing biblically-based investment services to their clients. The annual conference is the highlight of the year for NACFC members. Excellent speakers bring both sound Christian teaching and practice management advice to attendees. The most anticipated aspect of the conference is the opportunity to fellowship with other members and to meet vendors of relevant products who display their wares. Newsletters, e-mail updates, marketing materials and an internet based referral service are other worthwhile benefits members enjoy. Additionally, the NACFC offers the Christian Financial Counselor & Advisor (CFCA) designation for those members wishing to pursue this training.

Knowing Jesus Christ as Your Lord and Savior

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

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

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

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

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

STEWARDSHIP PARTNERS

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