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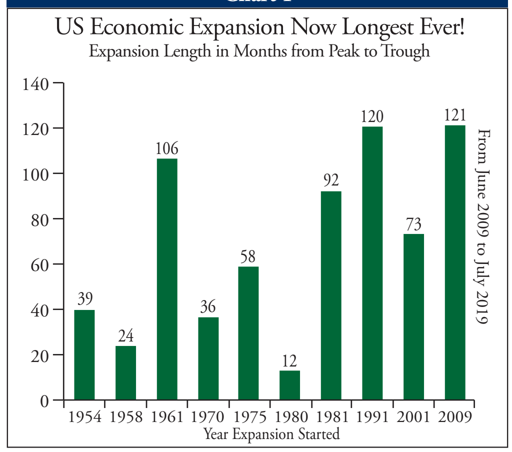
Fed Rescues Financial Markets from Trade War Scare

"From six calamities he will rescue you; in seven no harm will touch you." Job 5:19

Following the excellent returns virtually all assets achieved in the first quarter of 2019, it was not too surprising the second quarter performance in the markets was a bit rockier. In the end, equities managed to achieve a positive return during the quarter (Table 1), but it was certainly a volatile ride. Early in the second quarter, financial assets continued the first quarter advance. When China undercut the trade deal taking shape with the Trump adminsitration, which previously seemed like it was heading for swift and hopeful conclusion, investors rushed to cash in on some of the hefty profits already earned up until then in 2019. From early May until early June, the S&P 500 fell almost 8% on the back of the suddenly much hotter trade war and the associated risk of it undermining the global economy. Yet investors had barely enough time to get into full panic mode before the Federal Reserve abruptly signaled a more accomodative monetary policy stance, including a potential rate cut in July. Not surprisingly, equities reflexively turned on a dime, quickly recovering all of the May losses in a little more than two weeks, all the while ignoring the risk of an all-out war with Iran following Iran's shoot down of a highly sophisticated US spy drone. Once again, the markets reaffirmed the conventional investor wisdom of not fighting the Fed. For its part, the Fed was becoming more concerned about deflationary pressures re-emerging in the global economy and indicated that, despite a relatively strong US economy and full employment levels, it needed to do more to help push inflation up towards the top end of its long term goal of 2%. The Fed also seemed to signal it understood Fed policies have a meaningful influence beyond the US borders and its turn towards monetary accomodation reflected a growing concern weakness outside the US might ultimately drag down our economic growth prospects as well. Already, trends in the global manufacturing sector have moved sharply lower on the back of tariffs and trade war concerns generally. Other early warning signs of economic weakness in the US also have begun to appear, such as weak sales in certain real estate markets. Still, the US economic recovery, which just became the longest ever in the history of our nation (Chart 1), appears to be relatively healthy. Outside of the US, however, China's manufacturing sector has fallen into contraction and its debt problems appear to be mounting quickly. Our belief is that China can ill afford a significant trade war with the US at this moment when its economy seems to be teetering on the edge of a recession. Such a recession could also cause many of that nation's shaky debts to collapse into insolvency. In the end, this may be the situation the Fed feared the most as the impact of the Chinese debt bubble bursting would be, at a minimum, another damaging global deflationary wave.

Chart 1



Source: Oxford Economics, NBER

Table 1

2Q19 Total Returns

US Indices	2Q19	YTD	5y Ann
S&P 500	4.3%	18.5%	10.7%
S&P 500 Value	4.0%	16.7%	7.9%
S&P 500 Growth	4.6%	20.2%	13.1%
NASDAQ	3.9%	21.3%	14.0%
S&P 400 (Mid Cap)	3.0%	18.0%	8.0%
S&P 600 (Small Cap)	1.9%	13.7%	8.4%
Treasury Bonds	3.0%	5.2%	2.5%
High Grade Corp. Bonds	4.5%	9.9%	4.1%
High Yield Corp. Bonds	2.5%	9.9%	4.7%
Gold	9.1%	9.9%	1.2%
Global & International Indices			
MSCI World	4.0%	17.0%	6.6%
MSCI EAFE	3.7%	14.0%	2.2%
MSCI Euro	5.9%	16.2%	1.1%
MSCI Far East	1.3%	9.2%	4.9%
MSCI China	1.0%	7.7%	4.5%
MSCI Japan	-4.0%	13.0%	7.4%
MSCI Emerging Markets	0.6%	10.6%	2.5%
US Economic Sectors			
Energy	-2.8%	13.1%	-5.5%
Materials	6.3%	17.3%	5.4%
Industrials	3.6%	21.4%	9.3%
Consumer Discretionary	5.3%	21.8%	14.0%
Consumer Staples	3.7%	16.2%	8.4%
Health Care	1.4%	8.1%	10.6%
Financials	8.0%	17.2%	10.6%
Information Technology	6.1%	27.1%	18.5%
Telecom	4.5%	19.1%	5.3%
Utilities	3.5%	14.7%	10.0%

Source: Bloomberg

Due largely to the Fed's implied change of plans, basically all financial assets benefitted in June, from stocks to bonds to real estate and commodities. Seeing virtually all financial assets rise during a month is normally a rare event, but it has now happened twice in 2019 (January and June). In early July, these gains continued and the S&P 500 hit new all-time highs. Strangely, the level of investor pessimism remains unusually high even though the market is performing well. There are not many signs of investor exuberance which would normally be expected when the market is hitting new highs. A number of high profile initial public oferings (IPO's) have taken place in the last few months but, beyond that, the signs of excesses in the financial markets are limited mostly to the global bond markets where trillions of dollars of government debt are still offering negative yields (which means you pay the government for the privilege of lending them your money!!!). Indeed, the bond markets keep telling investors the global economy is moving quickly towards recession. Increasingly, we are concerned the bond market may be right.

Through the first half of 2019, many Stewardship Partners' portfolios attained worthwhile returns and most of our individual holdings have performed well. The largest holding in most of our portfolios, however, has so far not participated in the market's rally, something we do not expect to continue to persist over the longer term.

Recession Concerns Can No Longer Be Ignored

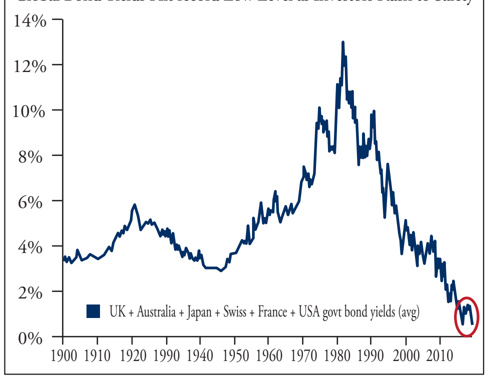
"Do not ignore the clamor of your adversaries…which rises continually." Psalm 74:23

The US economy continues to grow but recent economic data indicates a slowing from previous levels. This does not mean a recession is at hand, but in light of the new record just set for the length of the current economic expansion, investors should be increasingly wary about the ability of the US economy to continue its record run. As we have noted in the past, however, US economic growth has been trouncing those of most other large nations ever since the recovery from the Great Recession in 2008-2009 started. This reflects wiser and more aggressive monetary policy actions and just the natural strength and restorative powers of our particular brand of capitalism that promotes innovation, rewards hard work, and honors the rule of law. While hardly perfect, US capitalism has proven time and time again that it creates wealth better than any other economic system in the world. Nevertheless, it is not immune to recession and the economic trouble other nations are experiencing can hinder continued economic progress on the home front. At the moment, the world's bond markets are speaking loudly that a recession is nearby. As seen in Chart 2, the yields on global government bonds have collapsed in the last year to record low levels. US government bond yields have fallen with the benchmark 10 year US Government bond falling below 2% again recently. The bond market is screaming economic growth has stalled even while equities are hitting new highs (at least in the US), which is an unusual situation, to say the least.

Chart 2

Collapsing Global Bonds Yields are Screaming a Recession Warning

Global Bond Yields Hit record Low Level as Investors Rush to Safety

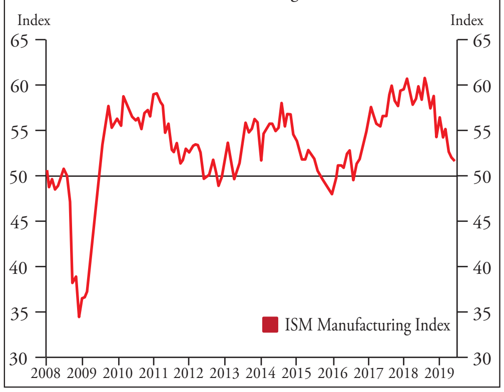


Source: BofA Merrill Lynch Global Investment Strategy, Global Financial Data, Bloomberg

Chart 3

Manufacturing Activity is Faltering

ISM Manufacturing Index



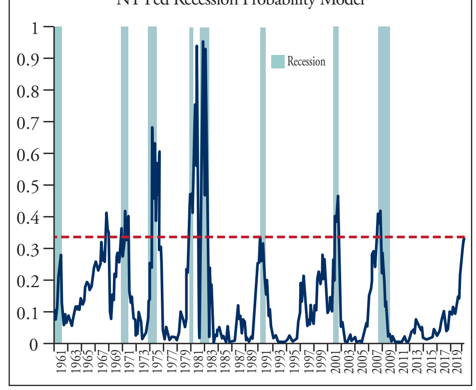
Source: Bloomberg

Rapidly slowing manufacturing activity around the world is causing the greatest concern on the US recession front. While the US measure of manufacturing activity remains in a growth mode (Chart 3), it has tumbled significantly over the last year and is now flirting with falling into a contractionary mode. Outside the US, global manufacturing indices already show plant activity is now shrinking rather than growing. While manufacturing activity is only one small component of overall economic activity, it is a leading indicator for a recession. The global manufacturing index has now dropped for 13 straight months, a new record for consecutive months of declining manufacturing output. Clearly, the world's bond market is seeing this and is worried, even if stock markets are not. Conventional market wisdom says when bonds and equities disagree like this, it is usually more profitable to believe the bond market.

Chart 4

Recession Probability Rising Fast

NY Fed Recession Probability Model



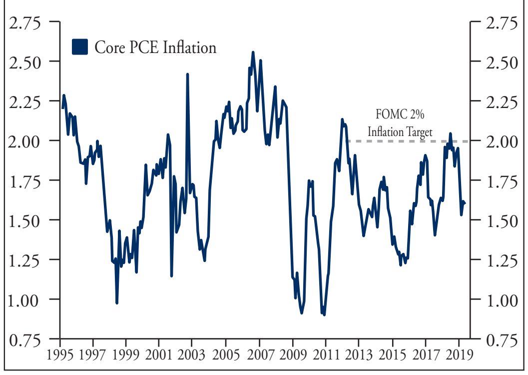
Source: NY Fed, Real Investment Advice

Given the sharp decline in both manufacturing activity and bond yields, it will come as no surprise that measures of recession risk are now signaling an increased probability of a recession within the next year. Chart 4 highlights a recession prediction model constructed by the New York Federal Reserve Bank which portrays a significant jump in the risk of a recession in recent months. Indeed, this model now has the risk of a recession in the US at roughly the same levels it reached in July of 2007, about 5 months before the Great Recession began. Once the risk of recession has attained its current level, a recession has almost always followed in the not too distant future. Clearly, the Fed is worried as it has made a fairly rapid reversal in its approach to monetary policy by indicating its concerns and signaling a rate cut later this month.

Chart 5

Inflation Remains Persistently Weaker than Expected

Core PCE Inflation Annual Percent Change

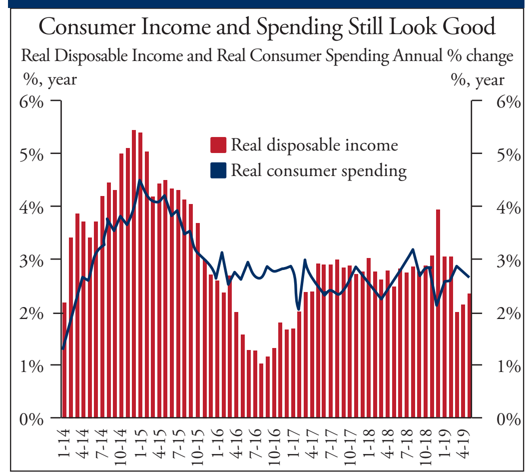


Source: Goldman Sachs

Another foreboding indicator is the still low level of inflation. Ever since the Great Recession, central bankers have been fighting deflationary tendencies, rather than inflation. The Fed recently expressed its dismay at its inability to return inflation to its long term goal of 2% (Chart 5) and used that as a reason for turning so quickly to a more accommodative monetary policy approach. Again, it is quite unusual to have a situation where the stock market is at a new high, the economic expansion is setting new records for longevity, the economy is at full employment, wage growth is rising, the Federal deficit is quite high and yet inflation still remains subdued. Such a weird combination of factors suggests many long held economic theories are in need of a revision. Even the Fed remains a bit confused by this as some members are not convinced rate cuts are the right prescription at the moment.

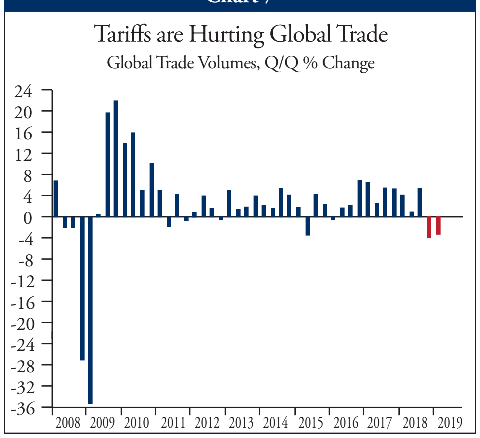
Whether the Fed cuts rates or not in July and beyond due to recession concerns, rates have already fallen quite a bit on their own providing stimulus to the economy. Most notably, 30 year mortgage rates have dropped significantly from the high near 5% reached in the second half of last year to the current level of close to 3.8%. With the latest decline in longer term interest rates, the yield curve has inverted, which is yet another potential indicator of an impending recession. The real yield on the US government's 10 year bond, which measures the yield after taking into account inflation, has recently fallen to zero. Meanwhile, as noted earlier, literally trillions of dollar of foreign government bonds currently have a negative yield even before inflation is taken into account. Even Switzerland's 30 year government bond recently moved to a negative yield! That is just remarkable and it reflects the growing concern many investors now have about receiving a return of their capital rather than a return on their capital. Meanwhile, one can also understand why some members of the Fed are hesitant to cut interest rates when there is full employment and the stock market is hitting new highs. Chart 6 highlights data regarding real consumer income growth and spending which, while slightly weaker in recent months, should hardly be setting off any alarm bells about an approaching recession. Since consumer spending accounts for roughly 70% of US economic activity, this data suggests a growth slowdown is about all that is likely to occur.

Chart 6



Source: Oxford Economics/Haver Analytics

Chart 7



Source: NBF Economics and Strategy

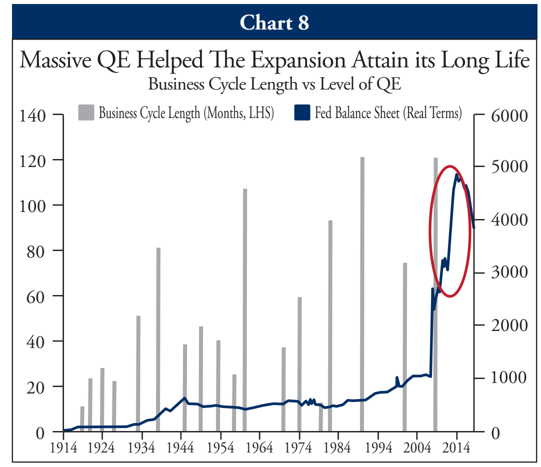
Still, the issue for the global economy is not so much poor US consumer spending. Rather, it reflects the trade war and its impact on global trade volumes as shown in Chart 7. Those weakening trade flows are clearly a big problem for the Chinese economy which was already slowing down under the weight of its enormous and still rising debts. While we have erred in predicting trouble for China's economy in the past, we suspect we are now getting much closer to the Chinese government losing control over its financial system and overall economic growth. This is the reason why President Trump's tariffs against China are likely to be very effective in getting China to make the changes President Trump is looking for to attain fairer trade between the two countries. Of course, should both Trump and/or President Xi miscalculate during their trade negotiations, China's economy could slip into a deep recession leading to significant economic disruptions around the world. The greatest economic pain would be reserved for China, but we suspect the plunging bond yields across the globe are already telling investors that a new deflationary wave emanating from China is close at hand. It may already be difficult to thwart, but it appears the Fed is going to try to do what it can to help.

Looking More Closely at the Longest and Strangest Expansion in US History

"You are bringing some strange ideas to our ears, and we would like to know what they mean." Acts 17:20

As we noted earlier, it is rather bizarre to have the Fed considering a rate cut during a period with such high employment and a stock market near all-time highs. Moreover, the Fed ended its rate hiking just last December, so the turn to a more accommodative policy has been unusually rapid as well. How is it possible this is happening in the midst of the longest US economic expansion in history? Surely, one would reasonably expect a higher level of inflation at this point, if nothing else, right? Remember, the Fed "printed" massive sums of money via its Quantitative Easing (QE) programs, which never ending commercials for gold assured us would lead to runaway inflation, the collapse of the US dollar and an economy left in ruins. Of course, none of that happened and, in fact, just the opposite is the current economic issues. The US economy has performed much better than most other countries since the Great Recession, it has not stopped growing, the inflation rate is too weak rather than too strong and the dollar has been reasonably strong as well. Clearly, Quantitative Easing was a much better policy approach than anyone, even the Fed could have imagined. Chart 8 shows how QE was a very distinctive element in this record setting recovery versus all previous cycles. While economic historians will be trying to understand how it achieved the superlative outcome it has for years to come, there can be no doubt about its positive impact on the economic outcome the US has enjoyed since 2009.

Chart 8



Source: Deutsche Bank, NBER, Haver, Bloomberg Finance LP

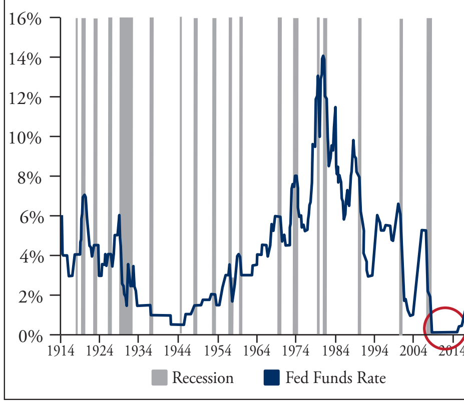
Of course QE was not the only oddity this extended economic cycle has seen. Another factor playing into its remarkably lengthy run has been the zero interest rate policy pursued by the Fed for such an extended period of time.

Chart 9 highlights this unusual Fed behavior, something most investment professionals never thought they would ever see. In retrospect, the Fed deserves a lot of credit for having the courage to pursue such policies as QE and ZIRP (Zero Interest Rate Policy). Both of these policies were well beyond a normal central bankers thinking and yet the US Fed found the courage not only to pursue these radical approaches, but to stick with them for an extended period of time, even in the face of substantial criticism from politicians, economists and investors alike. By adopting these policies early in the crisis and not altering them significantly for many years, the Fed helped propel the US economy on a slow but durable recovery. Somewhat shockingly, this lengthy recovery has also been well-balanced. With QE boosting financial asset prices and ultra-low interest rates stimulating growth, it has been remarkable the economy did not find its way into any of a variety of ways to create excesses which would have ultimately undermined its success.

Chart 9

ZIRP Policy Also Helped Lengthen the Cycle

Holding Rates at Zero to Help Preserve Economic Growth

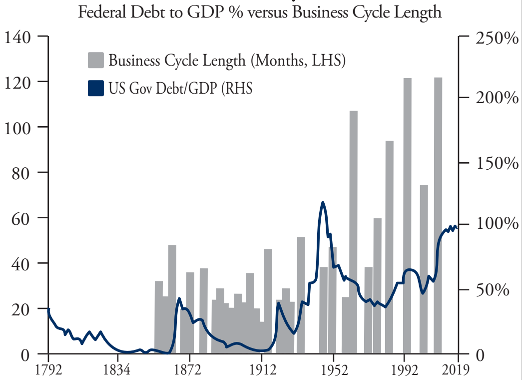


Source: Deutsche Bank, NBER, Haver

Chart 10

Huge Additions to the National Debt Also Boosted the Economy

Federal Debt to GDP % versus Business Cycle Length



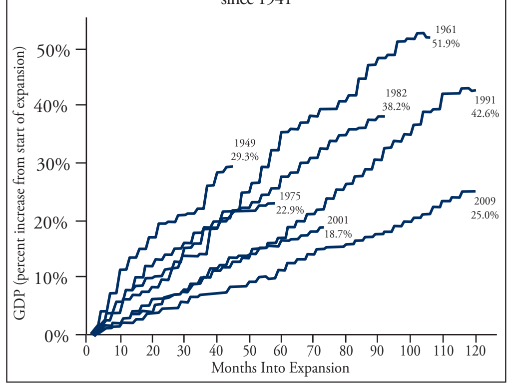
Source: Deutsche Bank

QE and ZIRP represented seriously strong monetary medicine for a very sick economy following the Great Recession. But most will also remember the overwhelming concern many had about the huge budget deficits the US government ran as the Obama administration utilized a heavy dose of fiscal stimulus to overcome the impact of the banking crisis on the US economy in 2009 and beyond. Deficits amounting to as much as 10% of GDP at the peak of the fiscal stimulus post the crisis led to a rapid jump in the US government debt to GDP ratio (Chart 10). Despite this huge fiscal stimulus, as well as the previously unheard of QE and ZIRP monetary policies, most observers would have thought the US economy would have started running very hot, very quickly.

Chart 11

This Upturn is the Longest But Hardly the Strongest

Cumulative GDP Growth over the Length of Economic Expansions since 1941



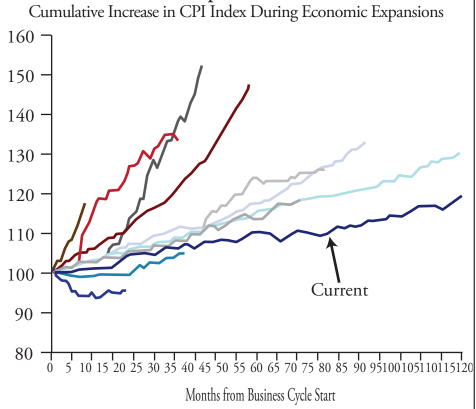
Source: St. Louis Federal Reserve

As it turned out, however, nothing could have been further from the truth. Despite the massive stimulus, the now longest ever economic recovery has been unusually weak. Indeed, as seen in Chart 11, the current recovery's total expansion has barely beaten out two other economic recoveries that were only about half as long and falls well behind those that were nearly as long. This tepid recovery in the face of such overwhelming stimulus highlights just how much damage the Great Recession had done. One significant reason for the lack of economic growth was the damaged banks were less than willing lenders to all but the best borrowers as they cautiously rebuilt their strength. Another reason was the regulatory burden on financial institutions, in particular, and business generally during the Obama administration was unusually heavy. As the Trump administration pursued both pro-growth taxation and regulatory policies, economic growth finally began to pick up speed.

Chart 12

Inflation Remarkably Subdued Versus Other Expansions

Cumulative Increase in CPI Index During Economic Expansions



Source: Deutsche Bank, GFD, NBER

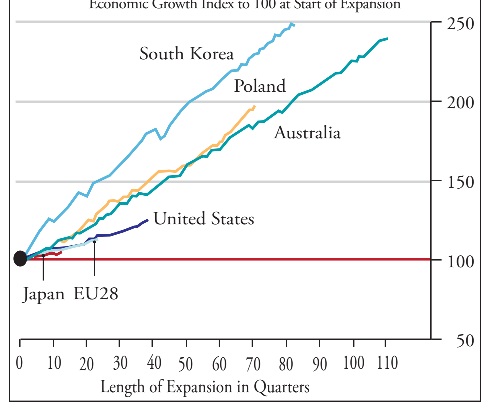
In part because the economy was growing only sluggishly until recently, inflation has hardly been an issue for the financial markets or the Fed. Rather, the Fed has been more concerned about inflation being too low. Chart 12 shows how remarkably subdued inflation has been in this extended economic cycle relative to other business cycles in history. Fortunately, the fiscal and monetary stimulus has been able to keep inflation growing at least slowly and deflation has been avoided.

Chart 13

Current US Expansion is Short By Australian Standards!

Longest Known Economic Expansions in Other Nations

Economic Growth Index to 100 at Start of Expansion



Source: N/A

While the current economic upturn has been both very long and very modest, it may also surprise investors by continuing for many more years. Chart 13 shows some countries economic expansions have lasted much, much longer than the current US cycle without incurring a recession. Australia has actually gone more than a quarter of a century without a recession! While we are growing concerned about the current threat of US recession, which would naturally have global ramifications, smart policies could extend this recovery for many more years. With the Fed being more responsive then normal to signs of economic weakness, however, it is not over until it is over. Nevertheless, a degree of caution now appears more appropriate regarding a potential recession.

Time to Get More Cautiously Positioned

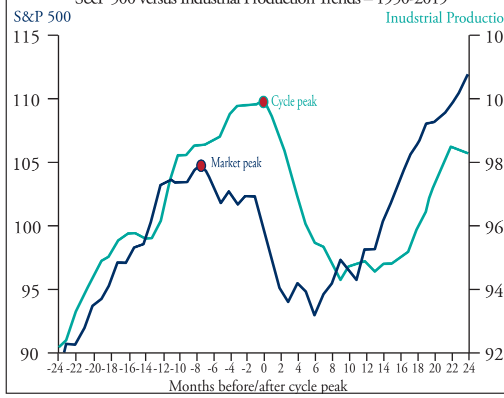
"Be sure you know the condition of your flocks, give careful attention to your herds" Proverbs 27:23

Naturally, it is very difficult to predict when a recession will actually begin. No one likely yet forgets how spectacularly wrong the market was when it effectively predicted a recession had already begun at the end of 2018. While we were correct at that time in saying there was no recession, it did not really matter for a few months as the market freaked out anyway. 2019's strong first half for investors, the best first half for equities since 1997, is largely the result of the market pretty quickly figuring out its recession fears were badly misplaced at the end of last year. Now, it is understandable that investors try to get a jump on predicting the start of a recession as the normal pattern is for the market to falter many months prior to a recession beginning (Chart 14). Indeed, one of the strongest arguments for a recession not being imminent is equities recently reached all-time highs. Another good reason to doubt the possibility of an impending fall in economic activity is the widespread belief the record economic expansion is on its last legs, as the consensus opinion is often wrong.

Chart 14

Stocks Typically Falter Months Before the Onset of Recession

S&P 500 versus Industrial Production Trends – 1950-2019



Source: Capital Group, Federal Reserve Board, Haver Analytics

Chart 15

Equity Valuations are Normal

12 Month Forward PE Ratio for the S&P 500

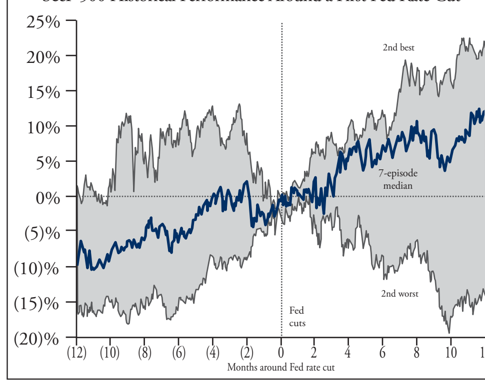
Source: FactSet

Moreover, the market as a whole is not massively overvalued nor are there widespread signs of speculative behavior in equities. The forward price-earnings ratio is not only below its recent peak but also well below the levels seen in the hyper-speculative atmosphere just prior to the crash of the internet bubble in 2000 (Chart 15). In fact, the current price earnings ratio is about as normal as it can get. But that is based on forecast earnings which would turn out to be too high should the economy begin to weaken as it already appears to be doing. Profit margins remain at higher than normal levels and any weakness in corporate profitability would rapidly alter the valuation landscape. Between the trade war, rising wages and the Trump tax cut stimulus beginning to wear off, it is not too hard to imagine a scenario where profits could prove to disappoint investor expectations in the coming year. During the second quarter, the number of company's warning investors profits will be lower than expected has been unusually high, indicating sales and/or profit margins are under pressure.

Chart 16

Stocks Normally Fall Before the first Rate Cut

S&P 500 Historical Performance Around a First Fed Rate Cut



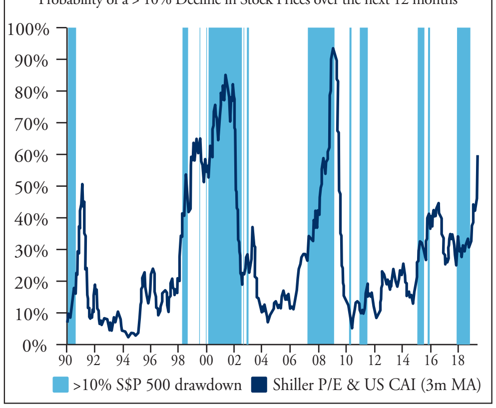
Source: N/A

Chart 17

Risk of a 10% Correction in Stocks Rising

Goldman Sachs Model Of Risk of Market Sell-off

Probability of a > 10% Decline in Stock Prices over the next 12 months



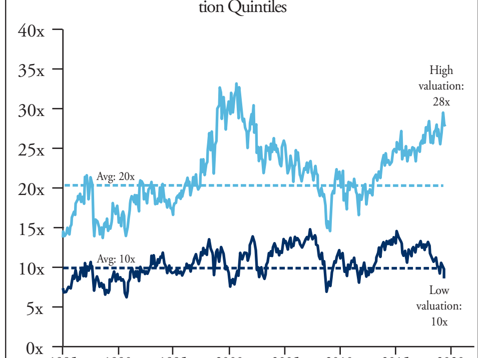
Source: Datastream, Goldman Sachs Global Investment Research

Given the Fed's brand new accommodative bias, it has obviously become concerned the economic cycle needs its help if the expansion is going to continue setting new records for length. The big question for both investors and the Fed is whether or not the signs of slower economic growth are transitory or something more dangerous. For many observers, it is not yet clear but the Fed's quick response to signs of weakness is welcome as the Fed is usually too late in getting started in combatting recessionary forces. Chart 16 highlights how the markets have typically behaved prior to and after the Fed's first rate cut, which we may see before the end of July. Normally stocks dip before the first Fed rate cut over increasing signs of weakness and do not recover much during the first 2-3 months after rates are reduced. So, while investors are celebrating the Fed's pronouncement of an easing bias, they may be reveling prematurely.

Chart 18

Expensive Stocks are Really Expensive

12 Month Forward PE Ratio for Top and Bottom S&P 500 Valuation Quintiles



Source: Refinitiv, Morgan Stanley Equity Research

Given the unusually strong first half returns in equities, the risk of at least a temporary setback in the market is likely higher than normal. Goldman Sachs has developed a model that predicts a greater than 10% fall in share prices and the odds of this happening have risen sharply lately (Chart 17). Moreover, it is hard not to be concerned about the huge gap in valuations that is a bit too reminiscent of the internet bubble seen in Chart 18. While the whole market is not overvalued, the technology stocks have once again gotten pretty pricey. Also, the very largest stocks have dominated the markets to an unusual extent recently. As a result, a more prudent investing approach seems like sensible at this time.

Share Prices Appear Due for at Least a Temporary Setback

"They will pass safely through the sea of distress" Zechariah 10:11

Following such a strong advance in stocks in the first half of 2019, it will be difficult for the market to continue to race ahead without a setback. The average decline during the course of a typical year is almost 14%, so it would not be unusual at all for the market to struggle at some point soon. Moreover, August and September are the seasonally weakest months of the year, which only heightens the risk of a market decline. Additionally, the recent strong June employment report has at least partly undermined the case for the Fed to cuts rates in late July. Given how the Fed's signaling it might lower rates triggered a sizable June rally, the prospect of the Fed taking a more patient approach to rate cuts could trigger some selling. On the trade front, China and the US are talking again but there is little evidence the two nations are much closer to reaching a meaningful trade deal that would remove tariffs and restore investor hopes in global growth. In Europe, Deutsche Bank is in the midst of a huge restructuring that is unerving investors as it brings back bad memories of the 2008 financial crisis. The financial markets currently seem to be at a key point, where if a recession can be avoided, the longest ever and second most profitable ever bull market (Table 2) can continue to move forward. While a decline of more than 20% would officially end this current record bull run, a meaningful decline less than that amount remains possible and would be at least temporarily be painful.

Table 3

Current Bull Market is Longest Ever Too

How Much Further Can it Go On?

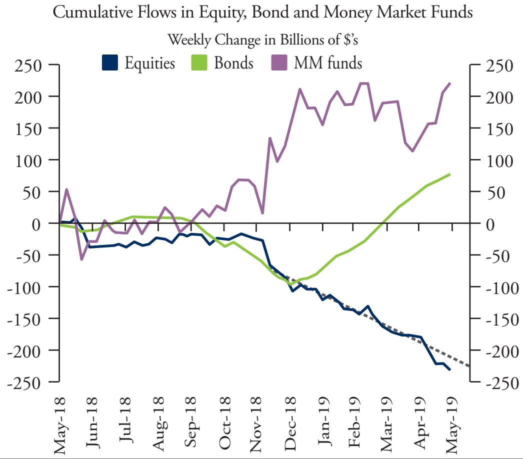
S&P 500 Start	S&P 500 End	Mos	Yrs	Cumulative % Change
3/9/2009	**4/29/2019**	**122**	**10.2**	**335.0%**
10/11/1990	3/24/2000	114	9.5	417.0%
6/13/1949	8/2/1956	86	7.2	266.3%
10/3/1974	11/28/1980	74	6.2	125.6%
8/12/1982	8/25/1987	61	5.1	228.8%
10/9/2002	10/9/2007	60	5.0	101.5%
10/22/1957	12/12/1961	50	4.2	86.4%
4/28/1942	5/29/1946	49	4.1	155.3%
6/26/1962	2/9/1966	44	3.6	79.8%
5/26/1970	1/11/1973	32	2.6	73.5%
12/4/1987	7/16/1990	32	2.6	64.8%
10/7/1966	11/29/1968	26	2.2	48.0%
	Average	**63**	**5.2**	**165.2%**

Source: Schwab Center for Financial Research

Chart 19

Investors Fled Stocks for Safety so Far in 2019

Cumulative Flows in Equity, Bond and Money Market Funds



Source: Deutsche Bank

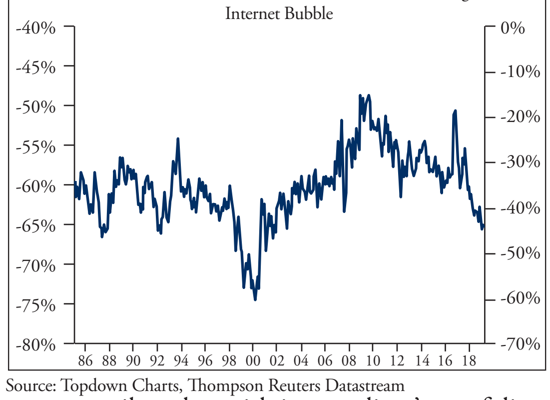
All during the sharp move higher this year, many investors have already been running for cover. Chart 19 depicts this move by investors towards the relative safety of both bonds and money market funds and away from the greater short term risk from equities. Once again, this is very odd investor behavior for a market hitting all-time highs and highlights the investor skepticism associated with this particular advance. Perhaps investors remained spooked by the nasty sell-off at the end of 2018 and were looking for any recovery in prices to exit. Or maybe the record length of both the economic recovery and the bull market has investors anxiously keeping their eyes on the exit believing the bull market has to end sometime soon. Whatever the cause, while there are some signs of speculation (such as the very high percentage of initial public offerings of companies that have no earnings), overall, risky investor behavior has been relatively subdued. This alone could be a signal the current bull market actually still has room to run.

One aspect of the latter part of this current bull market has been the notable outperformance of growth stocks versus value stocks. While not quite at the same level as in the internet bubble, the valuation differential between growth and value stocks has once again reached historically extreme levels (Chart 20). This largely reflects unusually intense investor focus on the largest and most successful technology stocks while lower valued financial and cyclical stocks have been largely ignored. It is never easy to know exactly when such overheated trends will reverse but we are likely getting close to that point. Accordingly, Stewardship Partners has raised cash by selling more growth than value stocks as we raise cash to take a more cautious stance on the market's prospects over the second half of 2019.

Chart 20

Growth Stocks Are Expensive, Value Stocks Cheap

Value Stocks Valuation Discount Relative to Growth Stocks Largest Since Internet Bubble



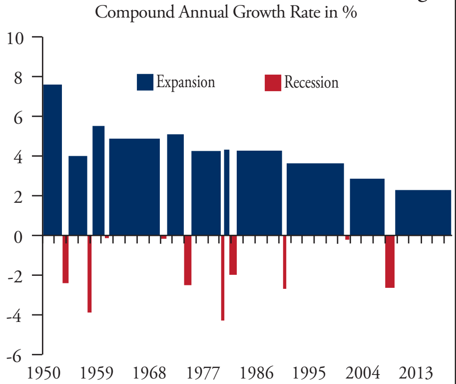
Source: Topdown Charts, Thompson Reuters Datastream

While we have already positioned our portfolios more cautiously, we may take further actions to reduce risk should the market continue to move higher or should a sell-off begin to materialize. Yet, even as we temporarily reduce risk in our client's portfolios, we acknowledge the market could continue to move higher. This is a risk we believe is worth taking given the current economic and investment environment. At the same time, we are very aware that recessions, while painful when they occur for investors, are normally quite short in duration (Chart 21). Should we determine a meaningful sell-off is not on the horizon, we will also quickly reinvest the cash we have raised. For the moment, however, we believe a more prudent approach is advisable.

Chart 21

Recessions are Short, Bull Markets are Long

Compound Annual Growth Rate in %



Source: Oxford Economics/Haver Analytics

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, Total System Services, and one we avoid, Nike. Total System Services is a holding in some Stewardship Partners portfolios while we actively avoid ownership in Nike 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 – Total System services – Commited to good works

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

Total System Services is one of the "cleanest" companies we screen. It is also among the largest electronic payment processors in the world. As such it helps companies, mostly financial institutions, move to a paperless means of doing business. Total System Services, often referred to by the acronym TSYS, serves other companies that issue bank, private label, prepaid and other types of credit and debit cards. TSYS offers products and services such as credit authorizations, payment processing, fraud monitoring and card issuance. Its NetSpend business segment provides general purpose, reloadable prepaid debit cards and payroll cards to people who do not normally use conventional banks. Headquartered in Columbus, GA it now employs nearly 13,000 people around the world. About 85% of its business is generated in the United States but its reach outside the US extends to 80 countries on five continents. TSYS processed over 32 billion credit card transactions in 2018. TSYS traces its founding all the way back to 1888 when a textile manager decided to open a bank to help an employee have a safe place to store her savings. That bank survived the depression and became one of the first banks in the state of Georgia to issue credit cards to its customers in 1959. Over time, the bank began to develop an expertise in credit cards and payment processing, so much so that it decided to spin out TSYS as an entirely separate business back in 1983. As financial technology rapidly evolved, TSYS kept pace with the times and built a substantial business helping its clients successfully navigate the rapidly modernizing world of electronic and internet-based finance. TSYS recently announced it was merging with Global Payments in a deal valued at $21.5 billion. The combined company will service roughly 1,300 financial institutions and more than 3.5 million small and medium sized merchants.

TSYS lists five corporate values which define the company and what it does. The first is integrity, wherein the company highlights its commitment to the highest possible ethical values. The second is relationships. TSYS acknowledges the worth of every individual and seeks to connect with its clients, team members and other stakeholders via cooperation, collaboration and service to achieve common goals. The third corporate value is excellence. TSYS seeks to deliver unparalleled service and quality with a sense of urgency, passion and intensity unmatched in their industry. The fourth corporate value is innovation as TSYS is committed to creatively helping their clients meet not only their current needs but also anticipate what their future requirements might be as well. The final corporate value is growth, whereby TSYS is committed to invest in technology, reward its team members and provide attractive returns to shareholders in a results-driven environment. TSYS also maintains a comprehensive ethics policy to help guide its employees as they seek to serve the interests of the company best. Included within this policy is the ability of any TSYS stakeholder to report a questionable situation anonymously via a 1-800 help line. There is also the ability to directly contact the company's board of directors via the company's website. The ethics guidelines also highlight the company's "no retaliation policy" regarding those who might report items of concern to management. Given the sensitive financial data the company deals with on a daily basis, it should come as no surprise the TSYS ethics guidelines include sections on confidentiality and data protection. TSYS clearly has achieved a good corporate reputation for integrity and has been named one of the World's Most Ethical Companies by the Ethisphere Institute in six out of the last seven years, including in 2018.
TSYS also does a notably good job of providing for its employees. The company states the following, "Our success as a company, and as a service provider to millions of people around the world, is dependent on our well-trained, competitively rewarded and greatly valued team members. Employing, developing and recognizing highly engaged team members are essential components of our overall approach

to Global Citizenship". TSYS backs up that sentiment in many different ways. The company shows how much it values its team members through its extensive benefits package. In addition to normal healthcare benefits, TSYS has in place many plans to assist employees with the rigors of life. Included among these are flexible work arrangements so employees can structure their day and where they work to fit into the ever more complicated schedules of a modern family. Discounted daycare is available for employees in need of child care as are employee assistance programs for those who are working their way through unique challenges in their lives. TSYS also has a program to assist employees with ride sharing and parking issues. TSYS simply wants to promote the general welfare of their employees and their loved ones. Accordingly, they offer tuition assistance and job development programs, discounted gym memberships or onsite gyms, financial counseling so employees can build their long term wealth and adoption assistance programs. TSYS is also a very veteran-friendly company, which is not surprising given the close proximity of the company's headquarters to Fort Benning. TSYS also will give employees time off so they can help local charities. In recognition of its exemplary efforts to be a blessing to its employees, TSYS has received a variety of awards including being recognized by the Dave Thomas Foundation for being one of the country's best adoption-friendly companies. Due to its support for veterans, TSYS has received the Military Times EDGE Magazine "Best for Vets" award. It has also been named one of the top veteran friendly companies by the US Veterans Magazine and has received many additional similar commendations for its extensive efforts to assist veterans.

TSYS also is a very charitable company, as are it employees. The list of charitable endeavors the company has been involved in over 2018 is far too long to catalogue in the small space we have here. A few of the highlights, however, are the company donating $3.1 million to 193 different charitable organizations, employees donating 100,000 bottles of water to the St. Vincent DePaul Society, a Catholic organization that provides for the poor, and a "Stuff the Bus" campaign that provided 3,452 backpacks filled with school supplies for young students in cities where TSYS has an office throughout the world. The company also partnered with the Disabled Veterans Foundation to provide nice new suits, shirts and shoes for financially challenged disabled veterans looking to transition to civilian life. Additionally, on Thanksgiving, the company sponsors a program whereby employees invite military personnel into their homes to share the holiday with their families. In 2018, roughly a quarter of the company's workforce volunteered their time at local charities and totaled nearly 74,000 hours of donated time to those organizations.

TSYS' numerous good works 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 corporation seeking to be a blessing to all. While no company, like no person, is perfect, this is clearly a company which seeks to benefit all those it comes into contact with and is an organization we can be proud to be part-owners of!

The Bad – Nike – Questionable Business Practices

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

Nike has recently made a habit of courting, and profiting from, cultural controversies. By embracing an ad campaign focused on former NFL quarterback Colin Kaepernick who gained notoriety by kneeling in protest of racism during the playing to the US national anthem at the beginning of NFL games, Nike's apparel sales jumped significantly. More recently, Nike had just launched a new sneaker with the Betsy Ross 13 colony American flag emblazoned on the shoe when Kaepernick asked the company to halt the sales of the shoe because the flag was a symbol of racism due to some of the founders of the United States being slaveholders. Nike complied with Kaepernick's request to remove the shoe, leaving many observers disappointed that such a seemingly dubious effort to highlight past racial issues would be received and acted upon by Nike. Moreover, Nike's on past of utilizing what many would argue was nearly slave labor in Asian sweatshops to produce their shoes and apparel would cause Kaepernick to walk away from his very lucrative contract with Nike. In 2000, Nike Chairman Phil Knight rescinded a proposed $30 million donation to the University of Oregon when the university joined with the Workers Rights Consortium (WRC), which Nike had refused access to their factories so the WRC could inspect them. The WRC actually had a campaign to organize university sports programs to boycott Nike equipment and endorsement money due to its use of sweatshops. Additionally, Nike is a financial supporter of the Population Council, an organization which supports abortion. Nike's donations are reportedly aimed at helping reduce the sexual exploitation of girls, but we would prefer they seek to achieve that worthy goal by funding groups that are not supportive of abortion. Nike's efforts to diminish patriotic symbols like the US flag, its past history with sweatshop labor and its involvement with groups like the Population Council mean we will not invest in its stock for our clients.

We seek to avoid investing in companies like Nike. 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 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 – Care Net – Saving Innocent Children from Abortion

"Children are a heritage from the Lord, offspring a reward from him." Psalm 127:3

Founded in 1975 as the Christian Action Council by pro-life leader Dr. Harold O.J. Brown shortly after the Supreme Court decision to legalize abortion in the United States, this ministry changed its name to Care Net in 1995. It is a Christian ministry that supports one of the largest networks of pregnancy centers in North America and runs the only real-time call center providing pregnancy decision coaching in the United States. It states its very worthy vision in this manner, "Care Net envisions a culture where women and men faced with pregnancy decisions are transformed by the gospel of Jesus Christ and empowered to choose life for their unborn children and abundant life for their families". One can easily see this ministry is trying its best to transcend the language historically used by pro-life groups in this vision statement and to be inclusive of all the men, women and other family members affected by abortion. Care Net goes on to put forth this as their mission statement, "Acknowledging that every human life begins at conception and is worthy of protection, Care Net offers compassion, hope, and help to anyone considering abortion by presenting them with realistic alternatives and Christ-centered support through our life-affirming network of pregnancy centers, churches, organizations, and individuals". This holistic mission statement is refreshing and Care Net effectively carries out its message via its roughly 1,100 affiliated pregnancy centers throughout North America which are staffed by 30,000 volunteers fully dedicated to helping save the lives of innocent children.

As the oldest active pro-life ministry, Care Net has had many years to improve its methods and achieve greater success in this all important work of preserving children's lives. Based on Care Net's own measures, this ministry has allowed 677,248 precious children to be born that otherwise might have been aborted. In 2018 alone, the number was estimated at over 77,000. Eight out of 10 women who are considering abortion which visit a Care Net pregnancy center choose life for their child. Ultrasound technology has proven to be key components in saving children's lives as expectant mothers better understand the humanity of their child after seeing it more clearly via an ultrasound of their womb. Care Net has been able to perform over 1 million free ultrasounds in the last ten years and the number of their facilities equipped with ultrasound technology has grown by 20% over that time period. Care Net has also provided 2.8 million free pregnancy tests over the last decade. But Care Net's work extends well beyond ultrasounds and pregnancy tests. More than 1.6 million visitors to their pregnancy centers heard the gospel message since 2009 and roughly the same number have received practical help such as free diapers and car seats. Another 1 million have received parenting support and education. Care Net also operates the Pregnancy Decision Line (PDL) 800 phone line and website. This is the only pro-life national call center available to women at risk of pursuing an abortion and it provides immediate counseling, information and referrals. Over 326,000 women have utilized the PDL website. Clearly, Care Net is saving innocent lives and providing for the needs of women who choose life over abortion for their babies.

Care Net is an effective and inspiring Christian ministry which has enjoyed considerable and growing success at saving the lives of innocent unborn children. It has persevered over many decades and challenges in the fight to preserve the lives of those created in the image of our Lord. It has strived to transcend the normal talking points regarding abortion and focus on a loving, caring message founded firmly in the gospel. Care Net is also very transparent about its finances and is worthy of consideration for your financial support. Care Net currently earns a Three Star Financial Efficiency Rating from MinsitryWatch.com.

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 – The Signatry

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

The Signatry is global Christian foundation established in 2000. As a foundation, the Signatry administers the accounts through which people give, and orchestrates the tools to simplify all aspects of giving. We are a global movement that equips donors, advisors, and ministries to fulfill their unique roles in expanding Kingdom impact. Since its founding, The Signatry has facilitated sending more than $2 billion to ministries and organizations throughout the globe. Bill High has been with The Signatry since its inception when it was known as the Christian Community Foundation of Kansas City. Several years after its founding, the foundation became an affiliate of the National Christian Foundation (NCF), the largest Christian foundation in the United States. In 2017, it separated from NCF and became The Signatry. One of the many distinctive aspects of The Signatry that we at Stewardship Partners admire is its embrace of Biblically Responsible Investing (BRI) in its donor investment pools, something other Christian foundations surprisingly generally do not employ. Another distinctive of The Signatry is its commitment to transparency – the foundation makes its fees for its services very clear and straightforward for its donors.

The Signatry states that its mission is "to inspire and facilitate radical biblical generosity". Its vision is "to write the last check to the last missionary to be sent out to the last unreached people group so the last person can hear the gospel". The Signatry also adheres to a set of five values, with the first being "Family". The Signatry believes the family is the first place for training the next generation biblical values. Its second value is Creativity and Innovation which are essential for helping to solve the world's greatest problems. The third Signatry value is teaching generosity as a way of life. Its fourth value is Integrity and Transparency as their code of conduct. The fifth value is collaboration as The Signatry believes partnerships are needed to accomplish great goals.

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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