Stegent Equity Advisors Investment Letter

Stegent Equity Advisors, Inc. **October 2016**

Third Quarter 2016 *Key Takeaways*

Despite numerous uncertainties, including a U.S. presidential campaign that continues to unfold as the most unconventional in recent memory, the Vanguard 500 Index rose by nearly 4% in the third quarter. Stock market volatility remained at extremely low levels through July and August.

September seemed to usher in a change in tone. During the month, stock investors registered high anxiety, with markets rising and falling sharply in response to any oil-related headlines and any suggestion of interest rate hikes by central banks.

European stocks outperformed the Vanguard 500 after the Brexit low and for the third quarter. They still trail U.S. stocks for the year (both in dollar-hedged and unhedged currency terms). We continue to believe European stocks are cheap relative to U.S. stocks, based on normalized earnings power, and offer attractive relative returns.

September Benchmark Returns (Preliminary)

Large Cap Benchmarks	Sept	3Q	YTD
Vanguard 500 Index	0.0%	3.8%	7.7%
iShares Russell 1000	0.1%	4.0%	7.9%
iShares Russell 1000 Growth	0.3%	4.5%	5.8%
iShares Russell 1000 Value	-0.2%	3.4%	9.8%
Mid-Cap Benchmarks			
iShares Russell Mid-Cap	0.2%	4.4%	10.2%
iShares Russell Mid-Cap Growth	0.0%	4.5%	6.8%
iShares Russell Mid-Cap Value	0.4%	4.3%	13.5%
Small-Cap Benchmarks			
iShares Russell 2000	1.1%	8.9%	11.5%
iShares Russell 2000 Growth	1.4%	9.1%	7.7%
iShares Russell 2000 Value	0.7%	8.7%	15.5%
Other Benchmarks			
Vanguard FTSE Developed Markets ETF	1.6%	6.3%	4.3%
MSCI World ex USA Index	1.3%	6.4%	3.6%
Vanguard FTSE Europe ETF	0.8%	5.0%	0.8%
Vanguard FTSE Emerging Markets ETF	2.1%	8.1%	17.4%
Vanguard REIT Index	-1.8%	-1.5%	11.7%
Vanguard Total Bond Mkt Index	-0.1%	0.4%	5.9%
BofA Merrill Lynch U.S. High Yield Cash Pay	0.6%	5.5%	15.3%
Vanguard Intermediate-Term Tax-Exempt	-0.4%	-0.3%	3.5%
S&P/LSTA Leveraged Loan Index	0.9%	3.1%	7.7%
Citigroup World Govt. Bond Index	0.7%	0.3%	11.1%

Emerging-market stock returns have been particularly striking, building upon their sharp rebound and outperformance versus other markets that began in late January. Emerging-market stocks are now up 17% for the year.

Yields on U.S. 10-year Treasury bonds rose to as high as 1.75% during the quarter on worries over central bank policies, but the Federal Reserve's decision not to raise interest rates in September soothed markets. Yields ended the quarter at 1.56%, still up from 1.44% on July 1. A December rate rise is potentially still on the table, and financial markets remain keenly attuned to this possibility. The core bond index gained just 0.4% for the quarter.

Rising rates pose a significant risk to core bond returns, which is one of the justifications behind our tactical positions in flexible fixed-income funds and floating-rate loans. Our portfolios benefited last quarter from both positions, as they contributed strong absolute and relative performance compared to core bonds.

Third Quarter 2016 Investment Commentary

As we look back on the last three months, what stands out is how quiet financial markets were during the summer, and yet, as September rolled around and market fluctuations picked up, how much it paid to be diversified. We are pleased with our overall results and by how our positions and active managers performed, in spite of building a defensive position leading up to the election.

Central bank actions and inaction, as well as fears surrounding either, drove financial market swings during the most recent quarter. Against a backdrop of soft economic growth and weak corporate earnings, extremely low interest rates have driven investors to bid up the prices of financial assets, distorting markets in the process. Investors are now dependent on low rates continuing to bolster rising asset prices. Any sign this "easy money" interlude is nearing an end has triggered gyrations in stocks and bond markets.

In viewing recent market performance, we keep coming back to one of our fundamental principles, that successful long-term investing is a marathon, not a succession of sprints. Focusing on how all the pieces of your portfolio together contribute to performance and less on what a specific investment is doing in any given quarter is the best way to avoid overreacting to temporary market declines. Investors should be extra cognizant of this as the U.S. presidential election draws closer. We are prepared for more financial market fluctuations going into the race's final weeks by building cash positions to a higher than normal level in our portfolios, but we are not making wholesale changes. Maintaining diversified portfolios, managing risk, and riding out periods of uncertainty, however uncomfortable, are key to successful investing.

As we focus on this bigger picture, we acknowledge shorter-term successes and challenges. During the past quarter, our emerging-market position performed well, continuing a turnaround that began during the second quarter of this year. Its year-to-date double-digit gains outpaced those of nearly every other investment category. Additionally, other areas of the portfolio such as international stocks, flexible bond funds, floating-rate loans and alternative strategies added value. While performance was mixed for our natural resources during the quarter, the investments we hold in this category are fulfilling their longer-term role as portfolio diversifiers, namely by reducing inflation risk. Overall, positive contributors outweighed negative ones across our portfolios.

Given a current investment environment that features high uncertainty, and one that appears to offer lower overall return prospects compared with those of the past two decades, your diversified portfolios are both resilient and well-positioned for long-term outperformance on a risk-adjusted-return basis.

And as always, we are grateful for the opportunity to continue to serve as your trusted advisor.

Loyd J. Stegent, President
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