Holt Capital
Partners, L.P.

Third Quarter Financial Market Commentary

"Ninety Days in Ninety Seconds"

September 30, 2016

Federal Reserve: Interest Rates and Economic Growth

- At their September meeting, the Federal Open Market Committee voted to leave short term interest rates unchanged, but indicated that a rate hike was likely before year end. As a regular part of its news release, the FOMC discloses a graphic representation of future interest rate forecasts by members of the board. This so-called "dot plot" indicated that most voting members now expect rates to stay lower for longer, compared to previous expectations. These forecasts imply that Federal Reserve policy is likely to remain accommodative for an extended period of time.

- Economic growth has accelerated recently and those gains are anticipated to continue into the fourth quarter. We expect corporate earnings growth to extend its slow rebound from the energy and commodity bust of 2014 and 2015. Additionally, employment gains should drive an increase in consumer spending. The combination of these factors should allow GDP growth to accelerate from 1% in the first half of the year to around 3% in the third quarter. This stronger set of economic data is likely to be supportive of a December interest rate hike by the Federal Reserve.

Are You Better Off Than You Were Last Year?

- Paraphrasing Ronald Reagan's memorable presidential quote from 1980, recent data would imply that the answer is "yes" for most Americans. This may seem contrary to many of the more negative headlines, but the Conference Board's consumer confidence survey hit a nine year high in September. In addition, the Census Bureau recently reported that real (inflation-adjusted) median household income increased by 5.2% in 2015, while the poverty rate decreased 1.2 percentage points. This is the first annual increase in median household income since 2007. Lastly, nonfarm payrolls have increased by almost 1.5 million workers during the first eight months of this year. Despite the negative political and media rhetoric, both Main Street and Wall Street are benefiting from an economy that continues to march slowly forward.

Is The Federal Government Legislating Wage Inflation?

- Changes to the so-called "white collar" overtime exemptions under the Fair Labor Standards Act will go into effect December 1, 2016. This law increases the minimum annual salary for exempt employees from $23,660 to $47,476. For a number of business this will have the impact of mandating significant wage increases for lower level management. While this law may have a positive social impact, higher wages that are not accompanied by higher productivity is the classic definition of wage inflation.

The Presidential Election

- Given the high unfavorable ratings of both candidates, this year's presidential election appears to be more about who people will be most inclined to vote against, rather than who they will support. The same populist sentiment that was prevalent in the Brexit vote in the UK is also evident in our presidential race. Anti-trade rhetoric is a risk to stock prices and could act to slow the globalization of trade that has characterized economic growth since shortly after World War II.

- Short term volatility around the election would not be unusual, especially if the polls continue to indicate a tight race. However, the longer term impact is more likely to be seen at the sector and industry level. A Clinton victory would be perceived as a negative for the pharmaceutical and biotechnology industries, while a Trump victory would probably be bullish for defense stocks and financials. Both candidates have been supportive of infrastructure spending and those proposals could drive multi-year growth for a number of industrial and material companies.

- The more extreme positions of each candidate are likely to be relegated to the back burner, as gridlock in Washington provides an effective mechanism to maintain most existing policies. Although many voters and investors might agitate for a change in the way Washington operates, the devil that we know might be preferable to the alternatives of either candidate. Our bottom line is that equities represent ownership in companies, rather than countries, and companies are the better managed of the two entities.

Conclusion

- Global economic growth appears to be accelerating after several years of sub-par results. Political uncertainty from the Brexit vote was expected to result in cyclical weakness, but those risks have failed to materialize. Commodity prices have stabilized and this has had a positive impact on a number of emerging economies and oil producing regions. Second half economic growth rates should exceed the weak pace of the first and second quarters and that strength is expected to carry over into 2017.

- Corporate earnings are steadily, albeit slowly, rebounding. Merger and acquisition activity is also seeing a resurgence as highlighted by the recent announcement of Bayer's bid for Monsanto and reports of Qualcomm's interest in NXP Semiconductor.

- Any election-related volatility is likely to be short-lived. Earnings growth is poised to accelerate and valuations continue to look reasonable. Interest rates remain near historic lows, which makes the outlook for fixed income investments uninspiring. Ownership of shares of productive businesses should continue to be the best long term route to enhance purchasing power and build value in a portfolio.

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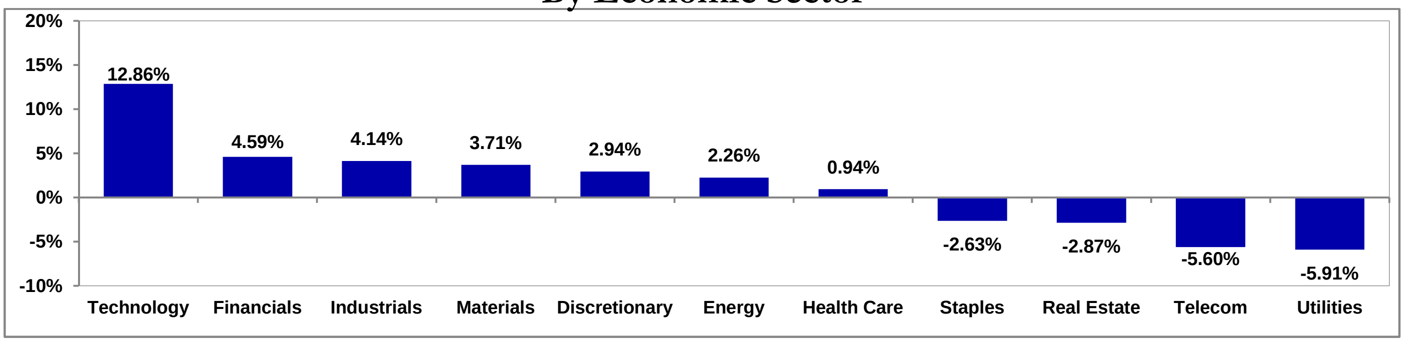
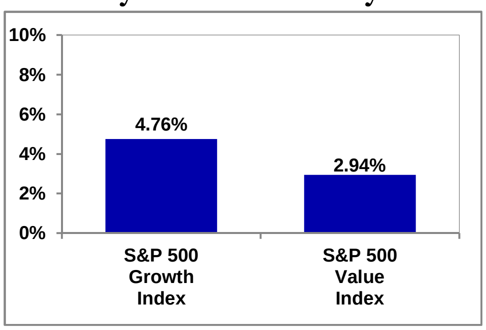
Third Quarter Investment Performance (including income)

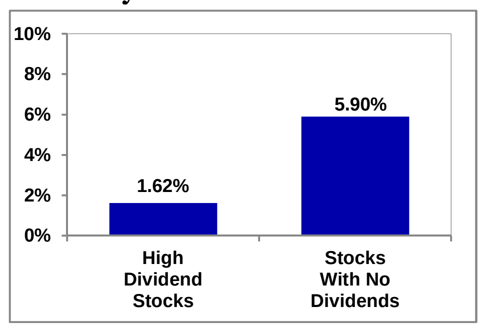
By Economic Sector



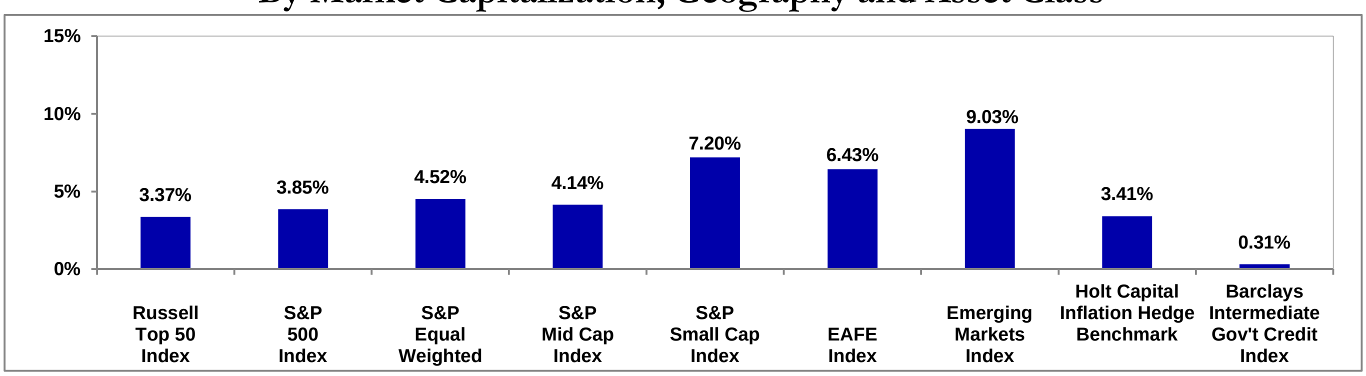
By Investment Style



By Dividend Yield



By Market Capitalization, Geography and Asset Class



- The bulk of the third quarter gain occurred during the first half of July, as stocks responded positively to reduced anxiety about Brexit, stronger domestic economic data, and better than expected corporate earnings.
- Economic sectors that are characterized by stable fundamentals and above-average dividend yields, such as telecommunications, utilities, and consumer staples underperformed as investors rotated into more economically sensitive sectors like technology, industrials, and materials.
- Interest rates rose slightly across all maturities as investors began to anticipate a rate hike in December. Higher rates are generally good for the profitability of financial stocks, especially banks, and the shift in sentiment around interest rates drove the financial sector higher.
- Small cap and emerging market stocks were the clear winners during the quarter. This was a classic reaction on the part of investors as smaller, more volatile stocks tend to outperform during periods of rising stock prices.