Holt Capital
Partners, L.P.

Fourth Quarter Financial Market Commentary

"Ninety Days in Ninety Seconds"

December 31, 2016

Stocks Respond Positively To A Shift In Fiscal Policy

- The election results have generated hope among investors that with Republican control of the White House, as well as the House and the Senate, gridlock may be ending and that policy visibility may be emerging. It also produced a sea change in the outlook for economic growth as investors embraced political promises of fiscal stimulus, tax reform, and deregulation. Trump's Cabinet-level nominees and economic proposals have inspired a broad-based rally in the stock market, as well as renewed optimism on Main Street. As the new year unfolds, politicians in Washington will need to be focused on execution and turning hope into reality.

- The breadth of the change in sentiment is rather remarkable. Fiscal stimulus, tax reform, economically sensitive stocks, immigration reform, populism, and renegotiating trade agreements are now in vogue. Conversely, fiscal spending constraints, tax increases, stocks with high dividend yields, open borders, political elites, and offshoring are now out of favor.

Risks to The Optimistic Consensus View

- Conventional wisdom among investors is that the earnings recession of the past six quarters is ending and that fiscal stimulus will reinvigorate economic and profit growth. As is typical during major shifts in investor sentiment, stocks have moved ahead of fundamentals, thereby pushing up valuations and making the market more vulnerable to any short-term disappointment. We would view any unanticipated speed bumps as a part of normal market volatility, rather than a cause for concern.

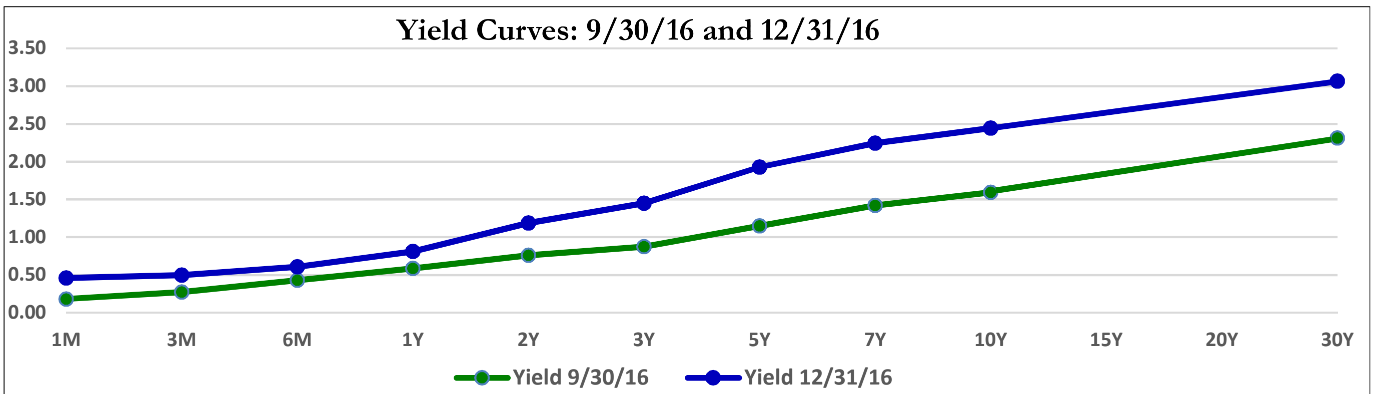
- The incoming administration will have the benefit of Republican majorities in the House and Senate, but the Democrats have not lost their political voice and both parties are characterized by internal fractures. Senate confirmation of Trump's Cabinet nominees, his promise to repeal ObamaCare, and his policy toward Russia are all potential political powder kegs that could pose risks to the early months of his presidency.

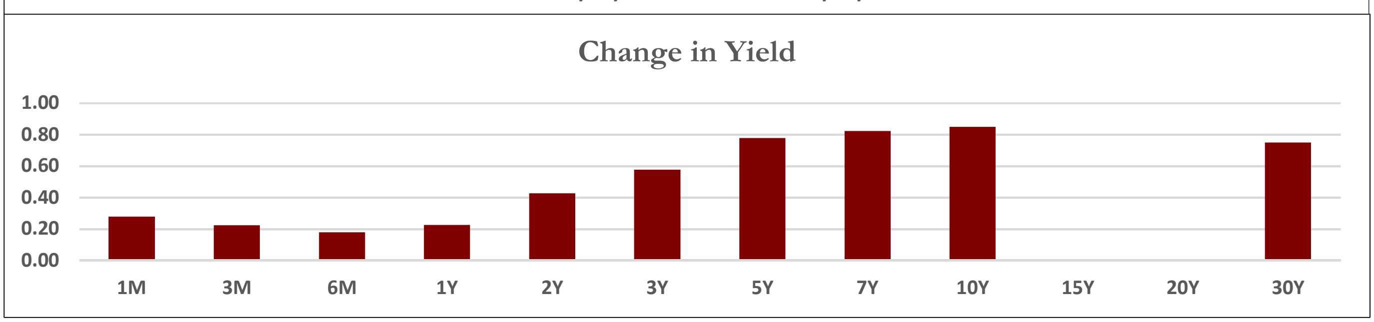
- Investors have focused on the pro-business comments of the Trump transition team, and have largely forgotten some of the candidate's more controversial positions. In addition, the tendency for the President-elect to jawbone individual companies has become a disconcerting characteristic for the future leader of the free world. If anti-trade rhetoric returns in a meaningful way or if "building a wall" appears to be a serious topic rather than a euphemism for tighter immigration standards, then the Trump rally could fade.

INTEREST RATES AND THE FEDERAL RESERVE

- The Federal Reserve has clearly reached an inflection point in monetary policy. As they reiterated in their December statement, interest rate levels are expected to normalize at a more rapid pace in 2017. Pronouncements from the Trump transition team point to a policy that will favor fiscal stimulus, tax reform, and higher budget deficits. These two factors have driven bond yields much higher over the past three months.

- The Federal Reserve is facing a new world in the post-election environment. Asset values and industrial commodity prices have risen sharply and the job market has tightened. Interest rates on two year government bonds recently hit their highest level in over six years. Although the Federal Reserve raised short term interest rates by one quarter of a percent in December, two year note yields have risen by twice that amount. The challenge for the Fed is to avoid being seen as falling behind the markets in recognizing an acceleration in economic growth.





DOW JONES: 20,000 IS JUST A NUMBER

- The media has recently focused investor attention on the fact that the Dow Jones Industrial Average is approaching 20,000. For long term investors, it is important to remember that this is just a number and it has no real meaning in terms of valuation, nor is it predictive of the future direction of stock prices. This is similar to Roger Bannister running a mile in under four minutes or Bob Hayes breaking the ten second barrier in the 100 meter sprint. All were historically significant events, but after the initial euphoria, life returned to normal.

Historical Precedents For The Surge In Investor Sentiment

- Comparisons have been made between the Reagan revolution in the 1980's and the election of Donald Trump. The economic and interest rate environment of 1980 was much different than today's situation, but the desire for less government regulation and lower tax rates link the two leaders.

- From a stock market perspective, the sector rotation since the election has been rather extreme (*see graphs on Page 4*). Top performing sectors from the past several years have slipped to the bottom of post-election rankings and prior laggards have become the new winners. Somewhat surprisingly, the current environment appears to have some similarities to the dot com era. During the five years prior to the dot com bust, the technology and telecommunications sectors were market darlings. During this same time period consumer staples and materials were the two worst performing sectors. As the bubble began to burst and investors refocused on valuations and earnings, the next five years proved to be radically different. Staples and materials were among the best performing sectors, while technology and telecommunications were bottom dwellers. Comparing the current environment with past market history can be instructive and offer insights about emerging trends.

Conclusion

- Investor sentiment regarding economic growth has brightened over the past couple of months. We expect this bullish long term trend to continue into the new year, but it is almost certain to be accompanied by unexpected short term volatility.

- Interest rates have been in a secular decline for 35 years and the bottom of this cycle probably occurred in this past summer. As rates begin a sustained rise, it could lead to a reversal in equity market return patterns that have dominated the past several decades.

- Determining the extent to which the long term winners and losers in the financial world have changed as a result of the election will be one of the biggest investment challenges of the new year.

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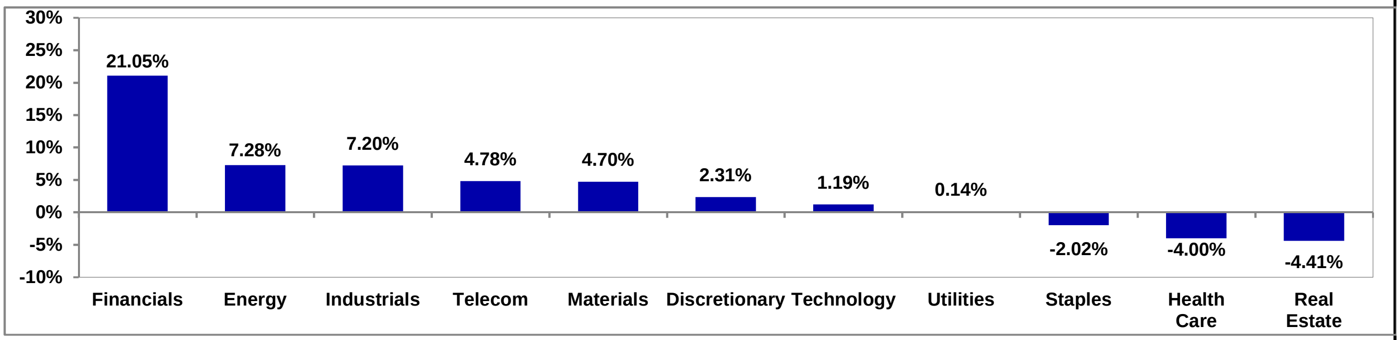
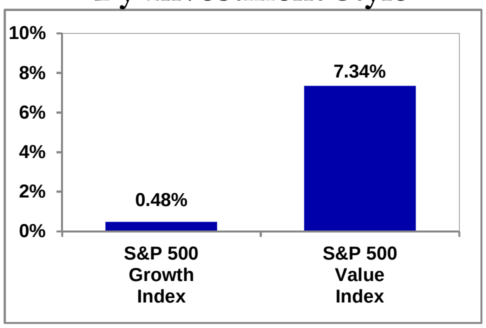
Fourth Quarter Investment Performance (including income)

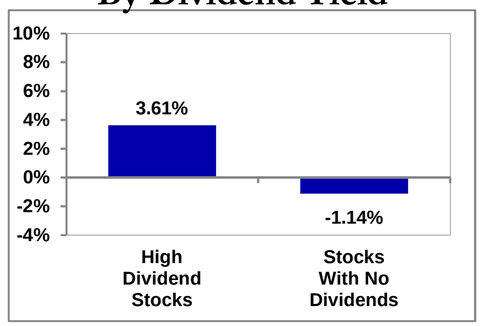
By Economic Sector



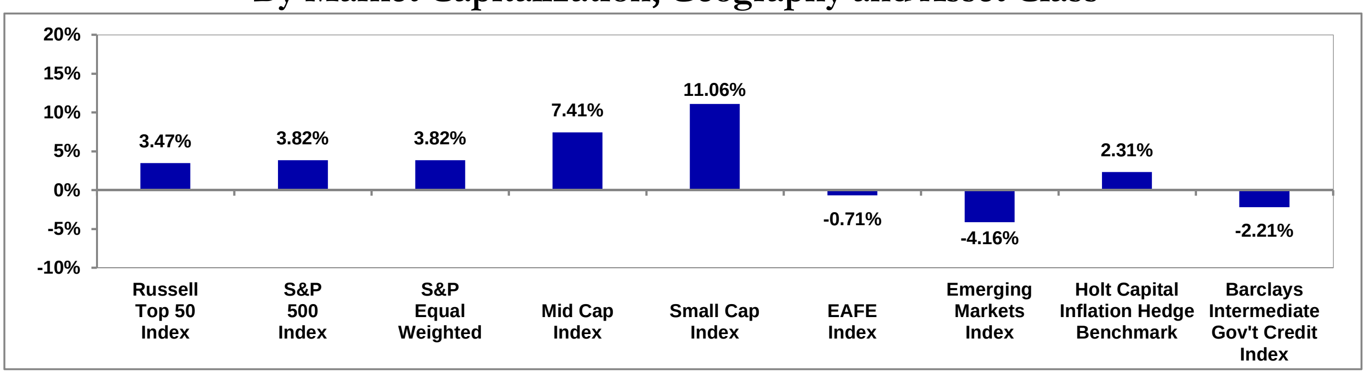
By Investment Style



By Dividend Yield



By Market Capitalization, Geography and Asset Class



- The shift toward economic policies that embrace fiscal stimulus, tax reform, and deregulation has boosted the more cyclical sectors of the stock market.
- As interest rates have increased in the bond market, defensive sectors and stocks with high dividend yields have lagged.
- The financial sector was characterized by low valuations prior to the election. This set the stage for a rally that was turbocharged by the view that Trump's policies will drive economic activity and interest rates higher, thereby positively impacting earnings for bank and insurance companies.
- Technology stocks have struggled amid concerns about the impact of Trump's policies on global trade and immigration.

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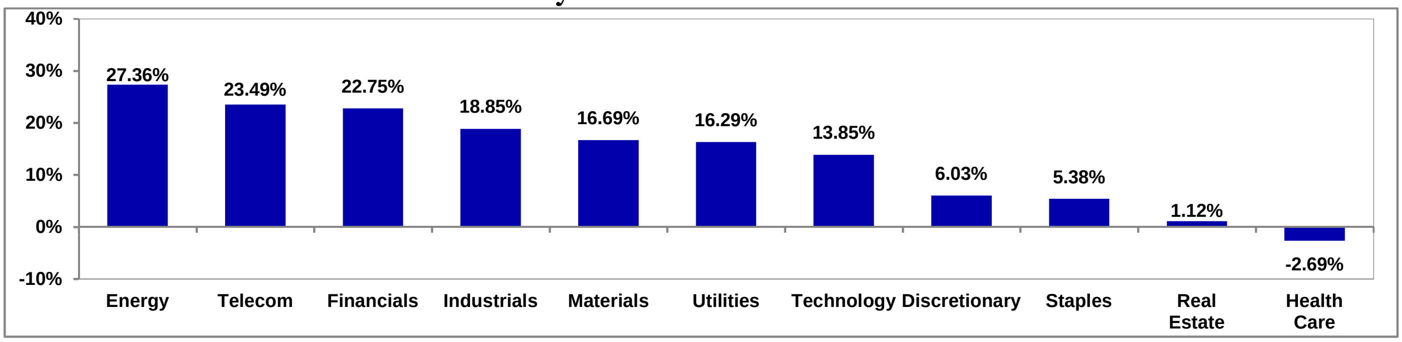
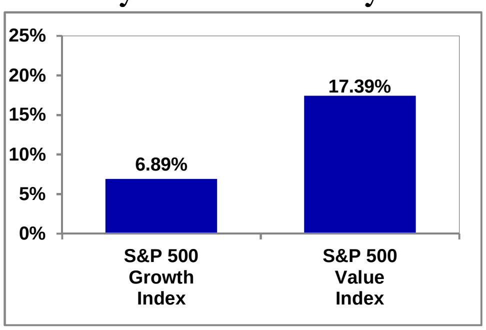
2016 Investment Performance (including income)

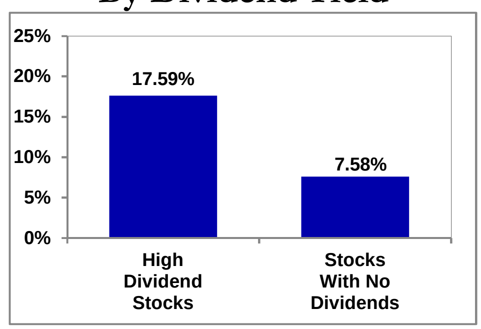
By Economic Sector



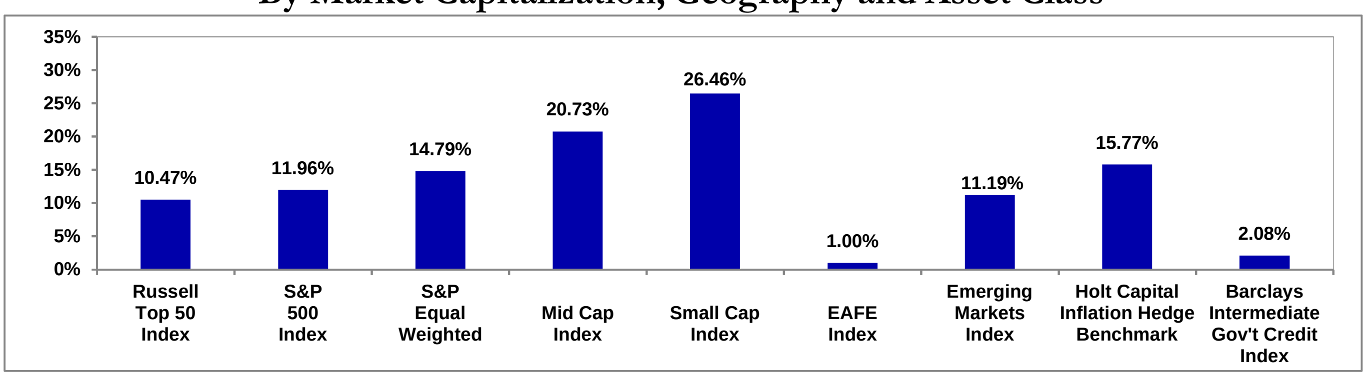
By Investment Style



By Dividend Yield



By Market Capitalization, Geography and Asset Class



- The strong post-election rally in the stock market helped to produce double digit returns across all domestic market capitalizations for the calendar year.
- The highest returns for the year were generated by the energy and financial sectors. These sectors have exhibited the greatest price volatility, i.e. risk, over the past several years. The same risk relationship held true at the market capitalization level as well, with the traditionally more volatile mid cap and small cap stocks leading the performance parade.
- International stock returns were hurt by the strength of the dollar, as well as sluggish economies in many geographic regions.