Holt Capital Partners, L.P.

# Third Quarter Financial Market Commentary

## "Ninety Days in Ninety Seconds"

SEPTEMBER 30, 2013

## Rebounding Global Growth Is More Important Than The Political Gamesmanship In Washington

- While the media is transfixed on the political dog fighting in our nation's capitol, business activity is on an upswing. Broad-based acceleration in business investment, the renaissance of oil and gas production and a continuation of the housing recovery should help stimulate growth in gross domestic product (GDP) over the next several quarters. More favorable economic news from several emerging economies, including China and Brazil, should also stimulate domestic growth.

## The Conundrum Of Low Interest Rates And Economic Growth

- Low interest rates on government bonds typically have a favorable impact on loans to consumers and businesses. This stimulus generally reignites economic growth. Stock prices respond favorably to low rates because investors are willing to pay a higher P/E (price to earnings) ratio for a given level of earnings. This is largely what has happened over the past 15 months. S&P 500 earnings have grown modestly and P/E ratios have moved from 13x to 15x, which has propelled the index from 1,362 in June of last year to 1,681 at the end of September.

  What happens next? Over the next twelve to eighteen months the economy is likely to be slowly weaned off of life support as a result of the Federal Reserve adjusting their interest rate policies (a process that has become known as "tapering"). A stronger economy should be conducive to higher corporate profits. In this environment the P/E multiple may not change much, but if S&P 500 earnings rise from roughly $100 last year to $110 this year, followed by increases to $120 and $130 in 2014 and 2015, then stock prices have the potential to rise further driven by higher earnings, rather than higher valuation levels.

## Investors Should Be Careful What They Wish For

- Many commentators and politicians lament the slow rate of growth that has characterized this economic recovery. For investors, slow economic growth is not necessarily bad. Economic booms tend to be followed by economic busts. A slow growth "muddle through" scenario reduces the likelihood of excesses such as overleveraging by businesses and consumers, as well as limiting speculative bubbles. Technology continues to boost productivity and reduce labor costs. These are both important factors underlying the current record level of corporate profit margins. Investors in public companies have been the clear beneficiaries of these favorable slow growth characteristics.

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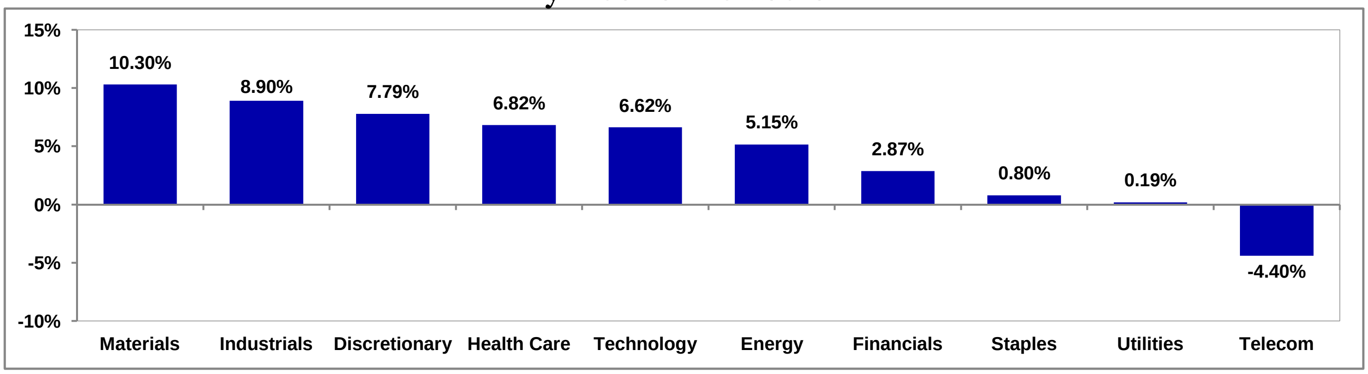
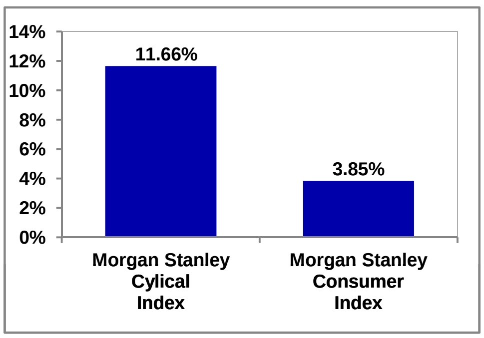
## Third Quarter Investment Performance (including income)

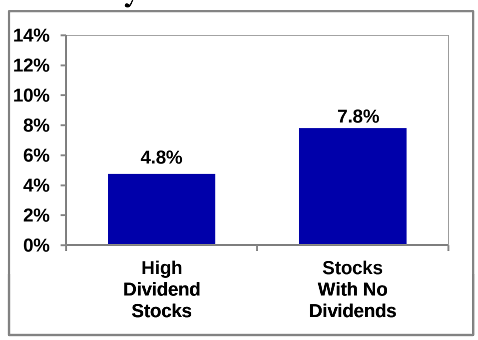
### By Economic Sector



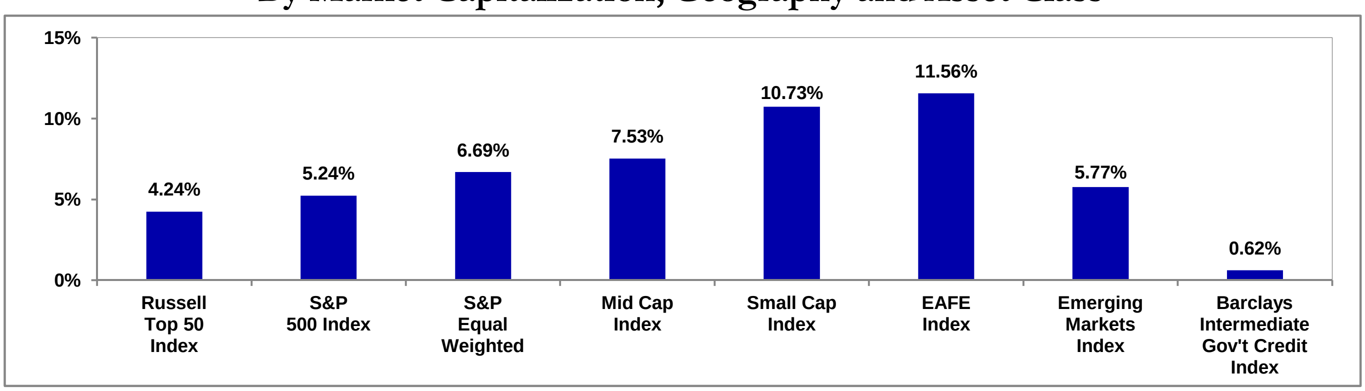

### By Economic Sensitivity




### By Dividend Yield




### By Market Capitalization, Geography and Asset Class



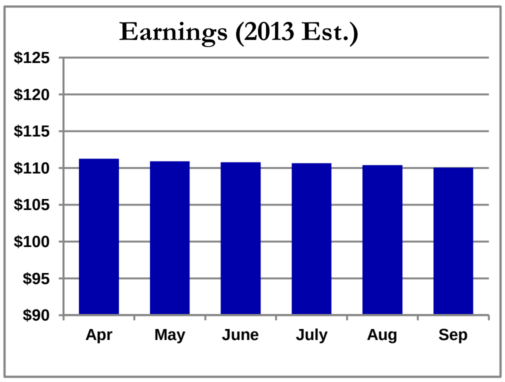

- The third quarter clearly favored companies whose growth prospects are more closely tied to the economic recovery. Cyclical sectors comprised the top three performers during the quarter, while the bottom three sectors had more defensive characteristics. This relationship can also be seen in the cyclical vs. consumer chart and the fact that non-dividend payers outperformed more established companies with high dividend yields.

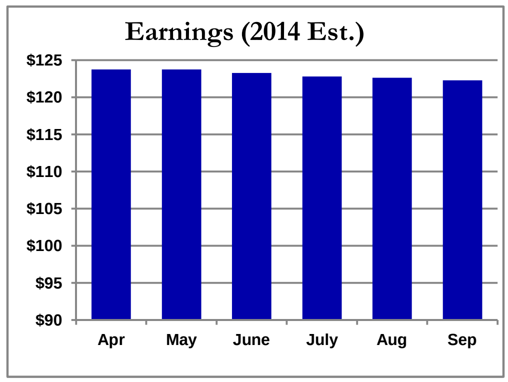
- Stocks outperformed bonds again in the third quarter, but this was the first time since 2012 that international stocks beat the S&P 500 Index. Consistent with the cyclical/growth bias of the quarter, small and mid cap stocks outperformed their large and mega cap peers.

## EARNINGS AND VALUATIONS

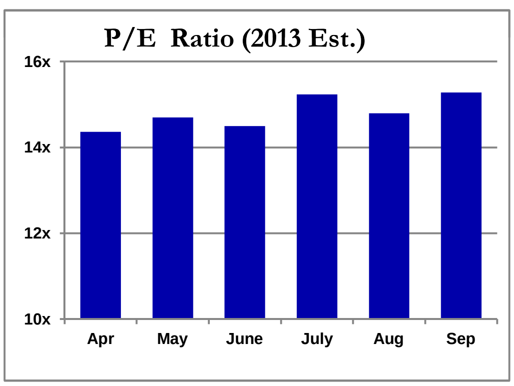
- S&P 500 earnings estimates for 2013 and 2014 have been relatively stable since the beginning of the year with expectations for 2013 hovering in the $110 to $112 range and 2014 estimates of $122 to $124. As the calendar marches relentlessly toward the new year, investors will increasingly focus on a 2014 P/E ratio that is historically inexpensive at 13.75x.

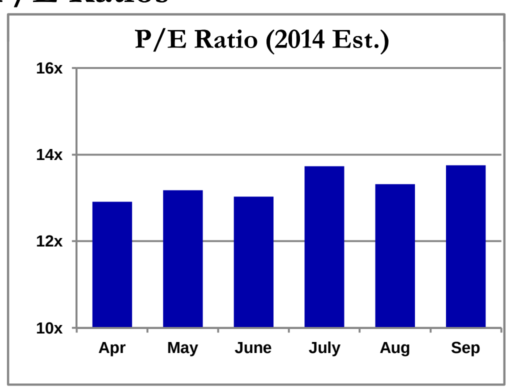
**S&P 500 Earnings Estimates**




**S&P 500 P/E Ratios**




## CONCLUSION

- Concerns regarding the shutdown of the federal government and dysfunctional leadership in Washington, D.C. are understandable. Financial market history is also clear that bear markets follow bull markets. However, I am not particularly concerned about the shutdown from a financial market point of view because it is a short term man-made problem and a solution will undoubtedly be reached after much political hand wringing and rhetoric.

- For stock market investors, the important fundamental aspects of the domestic economy are: 1) a continuation of easy credit conditions by the Fed, 2) better economic news from emerging markets, 3) an acceleration in domestic economic growth, 4) substantial cash positions on the part of investors as well as corporations, and 5) reasonable valuations.