To: Aequitas Client

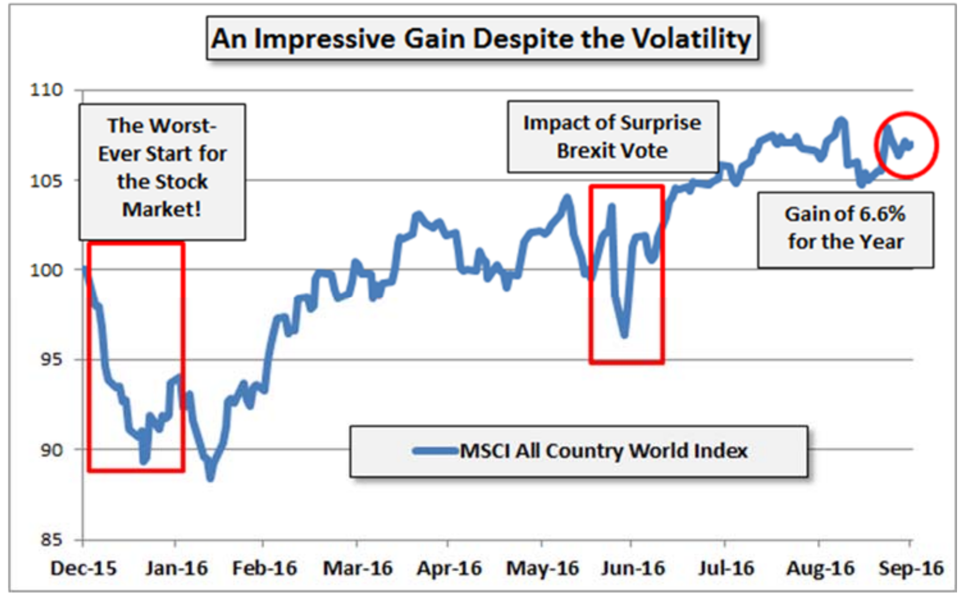
From: Aequitas Investment Advisors

Subject: Focusing on Fundamentals and Investing for the Future

---

Dear Client,

For the year-to-date through September 30th, the Global Stock Market (i.e., the MSCI All Country World Index) posted a surprisingly strong gain of close to 7%, despite the raft of uncertainties around the globe. The year began on an ominous note with the stock market plunging more than 10% over the first three weeks of January - the worst start to a year since William McKinley was President in 1897 (an interesting fact is that McKinley introduced tariffs to protect US industry). The stock market's woes continued into early February, but as positive economic reports began trickling in, the market regained its footing only to be knocked back into negative territory by England's surprise Brexit vote in late June. Brexit fears, however, proved short lived once it became clear the process of exiting from the European Union would take many years of back and forth negotiations. The market bounced back given favorable economic developments, including strong job growth numbers in the US and a modest pick-up in economic activity around the globe. Investors were also reassured by accommodating words from the Federal Reserve (i.e., no rush to raise interest rates). All in all, the stock market has continued to climb the *wall of worry*.

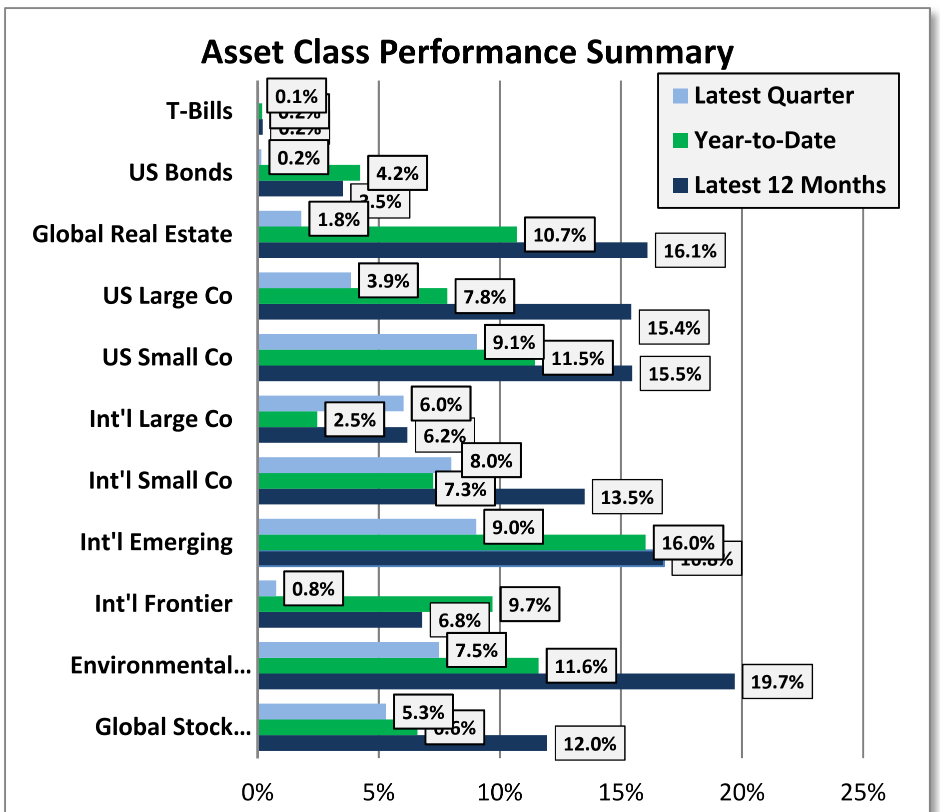


As we are all acutely and painfully aware, the presidential election of 2016 has evolved into a bizarre spectacle seemingly focused more on personalities, character flaws and fear rather than substance and a rational discussion of the issues. For investors, of course, what matters is how each candidate's economic proposals would impact the economy and our future financial wellbeing. We've posted several comparative summaries of the candidates' platforms on our website's Chart Room (aequitas-inv.com/chart-room), but in a nutshell, most economists believe there would be less uncertainty with a Clinton victory and significantly greater uncertainty with a Trump victory. On the one hand, should Hillary Clinton win in November, most economists see little economic turmoil as her election would probably sustain the "status quo" given the likelihood of continued gridlock in Washington (assuming Congress remains under Republican control). On the other hand, while Trump's proposed tax cuts and infrastructure spending would arguably create positive fiscal stimulus for the economy in the short-term at least, his controversial positions on immigration and foreign trade could prove to be counterproductive. For example, should Trump follow through on his threat to impose tariffs on imports from China and Mexico, we might find ourselves embroiled in trade wars which could lead to higher prices for US consumers as well as reduced demand for our exports.

As of this writing, the forecasting model of renowned statistician Nate Silver (www.fivethirtyeight.com) indicates a greater than 80% probability of a Clinton victory in November based upon the current electoral college map (her probability of winning was 55% in late September). The "odds", therefore, are that the status quo will be maintained, for better or worse, which is what the financial markets are expecting. However, the polls do not necessarily reflect actual voter turnout (remember Brexit's surprise outcome?) and a lot can happen over the next few weeks. Should the unexpected occur, we would anticipate a stock market shock, probably worse than Brexit, but we would also expect the markets to gradually stabilize as a new set of facts and assumptions are absorbed. The markets would probably look favorably upon lower personal and corporate tax rates, as well as increased infrastructure spending, but uncertainty would be greatly heightened until details emerged regarding Trump's immigration and foreign trade positions. From a practical standpoint, most of his proposals would require Congressional approval. While there would be support for tax reform from a GOP Congress, Trump's more controversial proposals would likely be met with resistance. I'll offer a closing remark on the election later, but for now, let's move on to more positive news such as the latest investment returns.

Asset Class Performance Review

For the quarter, most of the asset classes posted healthy gains with the largest coming from US Small Co's (+9.1%), Emerging Markets (+9.0%) and International Small Co's (+8.0%). Next were the Environmental Markets (+7.5%), which I will elaborate on below, followed by Int'l Large Co's (+6.0%) the Global Stock Market (+5.3%), i.e., the MSCI All Country World Index, US Large Co's (3.9%) and Global Real Estate (+1.8%). The laggards were the Frontier Markets (+0.8%), US Bonds (+0.2%) and US T-Bills (+0.1%).



The trailing 12-month returns were robust with many asset classes posting well-above historic average returns (for a change!). The double digit leaders were Environmental Markets (+19.7%), Emerging Markets (+16.8%), Global Real Estate (+16.1%), US Small Co's (+15.5%), US Large Co's (+15.4%), Int'l Small Co's (+13.5%) and the all-inclusive Global Stock Market (+12.0%). The Frontier Markets (+6.8%) and Int'l Large Co's (+6.2%) were next in line with US Bonds (+3.5%) and US T-Bills (+0.2%) bringing up the rear. Clearly, there was a "risk-on" appetite for stocks over the past twelve months.

The year-to-date returns (green bars) were generally in alignment with those of the trailing quarter and twelve-months. The Global Stock Market gained 6.6% with the highest return coming from the Emerging Markets (+16.0%) and the lowest from Int'l Large Co's (+2.5%). Of note, some of the strongest performance came from asset classes which were the biggest losers in 2015, notably Emerging Markets, US Small Co's and Frontier Markets.

Sound Investment Principles Designed to Deal with Uncertainty

Utilizing sound investment principles in managing a portfolio will help improve the chances for a successful long-term investment experience through all investment cycles, including uncertain times such as we face today. While perhaps sounding like a broken record, some of the key principles we integrate into our recommended portfolio structures include:

- Establish an appropriate mix of safe haven investments (high quality bonds) and growth investments (diversified portfolio of stocks). The most important decision for investors is to establish a bond and stock mix which matches personal risk tolerance and time horizon as well as long-term rate of return requirements.
- Allocate a sufficient portion of the portfolio to safe haven assets in order to meet one's financial requirements regardless of what the stock market is doing in the short-term. We generally recommend allocating 7-10 years' worth of future cash flow requirements to high quality bonds in order to avoid having to sell stocks when prices are down.
- Utilize portfolio rebalancing to trim higher priced asset classes in favor those with lower prices (i.e., sell high and buy low). Also, having a substantial allocation to safe haven investments provides a source to buy stocks when prices are depressed. (If we experience a market shock following the election, we might be presented with a great opportunity for rebalancing).
- Diversify the portfolio across an array of asset classes with different performance characteristics to achieve a desirable risk-adjusted return.

- Minimize investment management expenses by constructing the portfolio with low-cost funds.

Regardless of Who Wins in November, We'll Need More Water

Given the speed at which the global economy is depleting our earth's natural resources, we believe there is an opportunity to participate in the growth of companies involved in four primary areas of resource efficiency, including: (1) water infrastructure and related technologies, (2) efficient energy, (3) sustainable agriculture and (4) waste management. In regard to water, for example, consider the following facts which were provided by Impax Asset Management (the manager of the Pax Global Environmental Markets Fund):

- Almost all of the water on earth is salt water with only about 2.5% considered fresh. Of this, less than 1% is accessible surface water. In many areas, the water is polluted, exacerbating the supply constraint. Additionally, while fresh water supplies are relatively static, global populations are expected to increase from less than 7 billion to 9 billion by 2050 and much of this population growth is occurring in developing economies where access to fresh water is much more limited. Under a current business as usual scenario, by 2030 water demand will outstrip supply by 40%.
- In developed markets, substantial investment is needed to upgrade aging infrastructure (think of Flint, Michigan), and the costs of doing so are rising steeply. Cumulative water infrastructure spending requirements are expected to exceed $23 trillion by 2030.

Impax Asset Management has identified three types of companies for investing in the global water market:

- Water infrastructure companies, including those manufacturing pumps, pipes, valves and irrigation equipment.
- Water treatment companies, including those involved in desalinization and waste water re-use.
- Water utilities which generally offer stable cash flows.

Water resource management is just one of the primary components of the Environmental Markets; the recommended Pax Global Environmental Markets Fund invests in all four of the primary areas of resource optimization. Beginning with this quarter's performance review, we will include the returns of the *FTSE Environmental Opportunities Index* which is designed to track global companies with a significant commitment to environmental business activities. Over the past five years, the FTSE Index has gained 12.4% annually compared to 10.6% for the MSCI All Country World Index (i.e., the Global Stock Market). For the latest twelve months, the FTSE Environment Markets Index landed at the top of our asset class performance chart with a return of 19.7%.

Closing Thoughts

The rise of Donald Trump and Bernie Sanders are clear signs that the "system" is not working for everyone. Most of the benefits of globalization and economic growth since 1999 have accrued to the upper fifth of the population. Median household income, *when adjusted for inflation*, peaked in 1999 and has fallen ever since. Median real incomes in the bottom fifth of the population have fallen by more than 17% since 1999. At the other end of the spectrum, real incomes for the top fifth have grown modestly, but incomes of the top 1% have skyrocketed to the point where the wealth gap is the highest it's been since 1928. While Trump and Sanders presented diametrically opposed solutions to address populist discontent, their impact has shaped this election and will serve to impact politics for years to come. In a New York Times article published last March (*How Can Donald Trump and Bernie Sanders Both be 'Populist'?*), American historian and Georgetown professor Michael Kazin wrote:

> In their own fashion, Sanders and Trump are protesting inequalities and the corruption of public life without calling the entire system into question. (Sanders may speak of "revolution," but he still chose to run for president within the two-party system.) You may love such upheavals or loathe them. Trump's hostility toward undocumented immigrants and Muslims is certainly reprehensible. But every major "populist" insurgency is a warning about serious problems festering in our politics.

While the status quo might be positive for the markets in the short-term, what voters from all walks are crying out for is change in government and new solutions. Hopefully, all of this political energy will create a greater sense of urgency in Washington so that our representatives can reach constructive agreement to get some things done *for a change*.

To conclude, while we lament over the sad state of our political affairs, let us consider Winston Churchill's words, "Many forms of government have been tried and will be tried in this world of sin and woe. No one pretends that democracy is perfect or all wise. Indeed, it has been said that democracy is the worst form of government, except for all the others that have been tried from time to time." Amen.