EUBEL BRADY & SUTTMAN
ASSET MANAGEMENT

MARKET REPORT
THIRD QUARTER 2016

"But quarter to quarter, it is not always easy to find new things to say." This statement was made earlier in the year by the CEO of Walgreens Boots Alliance Inc. We currently identify with this thought because the third quarter was in many respects a repeat of what has transpired over the last several years: unappetizing asset valuations amidst sluggish corporate profits in a world with significant uncertainties, political upheaval and slow growth, even though there has been extraordinary help from central banks. We will touch on central bank actions and regulations in this letter; however, we will discuss equities, fixed income and commodities first.

Equities

The S&P 500 appreciated 3.9% during the quarter (including dividends), bringing gains for the year to 7.8%.

Total Return as of September 30, 2016						
			Annualized			
	QTD	**YTD**	**1 Yr.**	**3 Yr.**	**5 Yr.**	**10 Yr.**
S&P 500	3.9%	7.8%	15.4%	11.2%	16.4%	7.2%
NASDAQ	10.0%	7.1%	16.5%	13.5%	18.6%	10.2%
Russell 3000						
Index	4.4%	8.2%	15.0%	10.4%	16.4%	7.4%
Value	3.9%	10.4%	16.4%	9.5%	16.1%	5.8%
Growth	4.9%	6.1%	13.6%	11.4%	16.6%	8.8%
Russell Mid Cap						
Index	4.5%	10.3%	14.3%	9.7%	16.7%	8.3%
Value	4.5%	13.7%	17.3%	10.5%	17.4%	7.9%
Growth	4.6%	6.8%	11.2%	8.9%	15.9%	8.5%
Russell 2000 (Small Cap)						
Index	9.1%	11.5%	15.5%	6.7%	15.8%	7.1%
Value	8.9%	15.5%	18.8%	6.8%	15.5%	5.8%
Growth	9.2%	7.5%	12.1%	6.6%	16.2%	8.3%

The technology sector was the best performer and utilities and telecommunications sectors declined the most. Greater expectations for additional increases in short term U.S. interest rates seemingly have had a negative impact on sectors with companies considered "bond alternatives" due to their dividend yields (e.g., the dividend yields of companies within the utilities and Telecommunications sectors look less attractive when yields offered on fixed income securities are higher, all else equal). The prospect of higher interest rates may also have boosted sectors that could benefit from higher interest rates (e.g., companies in the financial sector) or that could have been shunned due to their companies' emphasis on capital appreciation over dividends (as is the case with many companies in the technology sector).

Growth stocks outperformed value stocks during the quarter, but value stocks have handily outperformed growth stocks year-to-date. Small-caps outperformed large-caps for the quarter and year-to-date.

Fixed Income and Commodities

Corporate bonds, as measured by the BofA ML 1-10 year index, increased by 1.0%, bringing returns for the year to 6.2%. U.S. Treasuries and Agencies, as measured by a similar index, decreased 0.2% for the quarter but are still up 3.3% for the year. The 10-Year Treasury bond's yield increased to 1.6%, up from 1.5% at the end of last quarter and down from 2.3% at the beginning of the year. It is worth noting that during the quarter the 10-Year Treasury yield touched 1.36%, which is thought to be the lowest on record! Many foreign investors still covet these bonds, in spite of the ultra-low yields, because their governments' bonds have even lower (sometimes negative) yields. This is an odd market.

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Commodities (as measured by the Bloomberg Commodity Index) declined 3.9% in the quarter but are still up 8.9% for the year. Crude oil prices ended this quarter flat, but are up strongly for the year. At the end of the quarter, a collection of countries that control a large amount of the world's oil supply, Organization of Petroleum Exporting Countries (OPEC), agreed to come to an agreement (you read that right) later this year to limit output. Details are limited, political and economic interests may derail this potential deal, and OPEC has had difficulty making these kinds of agreements stick in the past. So, we will see how this unfolds.

Central Bank Actions

We do not typically spend much time writing about the actions of central banks, especially whether they will raise interest rates in the short-term a fraction of a percent here or there. We believe that investing primarily based on such analysis is not fruitful. However, in light of the current environment we believe a few comments are worthwhile.

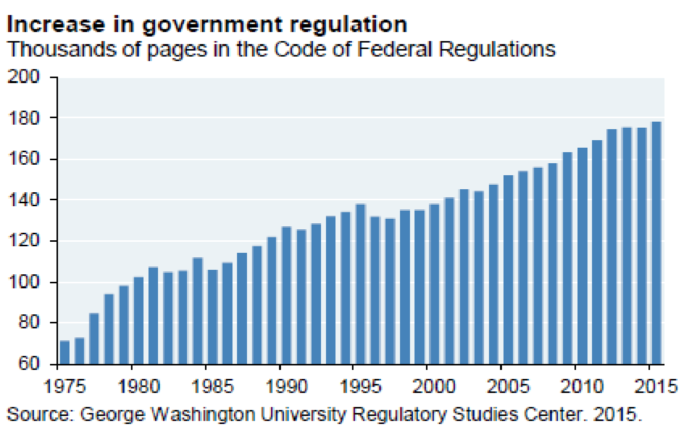
Global central banks have moved on from tools they used pre-financial crisis to new tools, including buying huge amounts of assets in the hopes of improving economies. This incredible central bank assistance has gone on for so long that the atypical and unthinkable now seem more typical and commonplace. Examples:

- According to a JP Morgan report, "Central banks now own almost half of the $43 trillion in developed world **government** bonds."
- Additionally, The European Central Bank is going out further on the risk curve by purchasing **corporate bonds**.
- The Bank of Japan is taking more extreme measures by purchasing **stocks** via ETFs.
- A prominent U.S. economist has recently suggested that other central banks examine purchasing stocks as well.

Despite the significant use of this financial medicine, Federal Reserve Vice Chairman Stanley Fischer recently stated, "We could be stuck in a new longer-run equilibrium characterized by sluggish growth." Regardless of whether you feel central bank actions are the correct thing to do or not, we do not think these are ingredients that *should* have led to higher asset valuations. However, we believe monetary policies have contributed significantly to the very low interest rates and unattractive valuation environment. We do not know where this ends (be wary of anybody who says he/she does), and the ultimate outcomes and consequences of these actions are unknown. As such, we believe our portfolios remain defensively positioned.

Regulations

As you can see in the table below, U.S. regulations have been on a seemingly unstoppable rise. We believe many of the regulations are well-intended, but ultimately can be time-consuming, expensive, and counterproductive for many firms. At some point, consumers are likely to share in the cost of the many new regulations through higher prices for goods and services.



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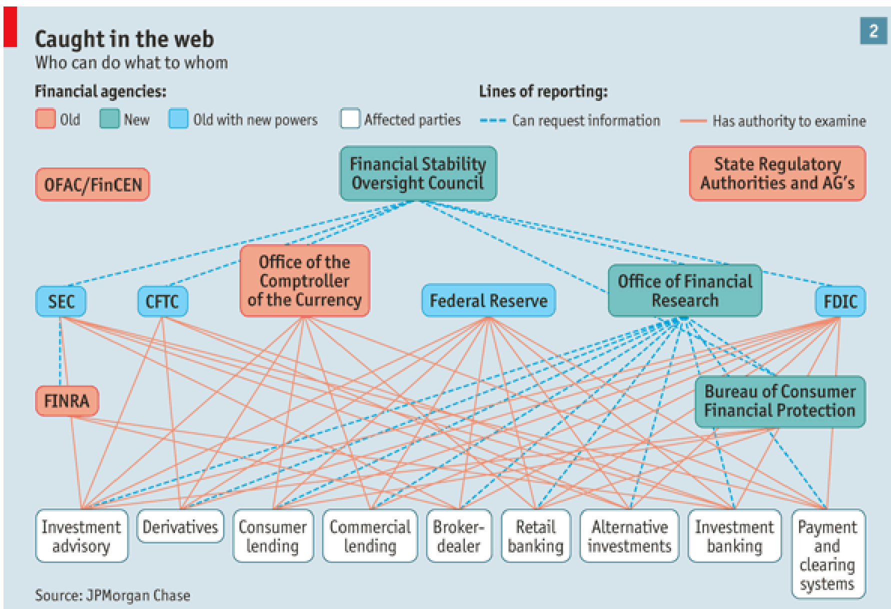
The National Federation of Independent Business (NFIB) creates a publication every four years that includes feedback from small businesses regarding their biggest issues. In this year's version, the publication states:

> "Unreasonable Government Regulations" moved up in importance from ranking fifth in 2012 to its current second place ranking. Small-business owners are increasingly burdened by government regulations as the Administration added record numbers of pages and regulations to the Congressional Register. The Environmental Protection Agency (EPA) has been particularly active, posting regulations covering a wide range of business activities and property ownership issues without a cost-benefit analysis, imposing huge daily fines to force compliance. NFIB's survey Regulations showed that 72 percent of small employers characterized government regulations as a serious problem, 45 percent "very serious". Twenty-five percent said the extra paper work was the single greatest compliance problem, 22 percent cited the actual cost of compliance. The third most cited problem was the difficulty in understanding what had to be done for compliance. Wasting the entrepreneurs' time is a significant growth impediment.

The financial industry is not immune to these regulations. For example, below is a chart from The Economist in 2012 (we do not believe much has improved):



We think the pendulum has swung too far in the direction of increased regulation. While we certainly do not believe all regulation is bad, we do not believe more and more regulations make outcomes better and better. What matters most is the sensibility and effectiveness of regulations, in our view.

Summary

- World economies experienced more of the same during the quarter as U.S. equities moved higher, U.S. bonds were more mixed, and commodities declined. A legitimate deal amongst oil suppliers may (or may not) be in the making.
- Atypical central banking actions have been occurring for awhile and have become more extreme in recent years. We believe this has helped contribute to very low interest rates, unattractive asset prices, and a certain numbness to the extraordinary monetary policies being taken.
- Regulatory burdens for businesses have continued to increase. They may not slow over time, but an emphasis on effectiveness of regulation (rather than amount of regulation) could help innovation and result in additional economic growth.

Past performance is not indicative of future results. Market and economic data has been provided by third party sources. This data, while believed to be reliable, has not been independently verified by EBS.