FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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U.S. stock markets surged following the November 8th presidential election and closed 2016 at near record levels. Despite the surprising election outcome here and the Brexit vote in Great Britain, stocks performed very well. For the year, the S&P 500 returned a very respectable 12%. In general, value strategies performed better than growth, small companies outperformed large ones, and domestic returns were better than international. Bonds were mostly negative for the quarter but generated low single-digit returns for the twelve month period. FBP equity results were generally ahead of the benchmarks for both the quarter and the full year.

Many analysts speculated that equities would suffer if Donald Trump won the U.S. presidential election, believing that Trump's political inexperience and unpredictable personality would raise investor fears. A Clinton administration was considered the more certain outcome. Investor expectations, however, can sometimes be difficult to forecast. Contrary to analysts' views, within hours after the election, stocks were moving higher. Investors quickly focused on the potential for pro-economic growth policies under the new administration. A business approach to running the government, coupled with the positive aspects of lower tax rates, faster economic growth, less regulation, repatriation of corporate cash and stronger earnings overwhelmed the uncertainty that seemed to accompany any discussion of a Trump victory. While we do not know the specifics of the policies that will be implemented, we do expect some of the pro-growth agenda will be enacted. Therefore, we believe that it is likely the economy will see a boost from new fiscal policies in the coming quarters and years.

GDP continued to advance moderately during 2016. With upticks in consumer confidence and domestic manufacturing, the Federal Reserve's Open Market Committee (FOMC) followed through on its widely telegraphed pledge to raise short-term interest rates in December. The prospect of marginally stronger economic growth next year made its decision even easier. The committee also re-affirmed its intentions to implement multiple rate hikes in the coming year, if economic conditions warrant. In light of the potential for stronger GDP and multiple interest rate hikes by the Fed next year, rates moved up sharply during the fourth quarter. The 10-year U.S. Treasury bond yield spiked from 1.6% on September 30th to near 2.5% at year end, resulting in negative bond market returns for the quarter as noted above. We believe rates will continue to trend higher in 2017.

With strong returns in 2016 and valuation levels somewhat elevated, a natural question is can equity markets continue to advance. The fourth quarter move in equities certainly indicates heightened expectations as we enter the New Year. Therefore, we would not be surprised to see some near-term market weakness; but over the long term, valuation levels and earnings growth are the main drivers of equity returns. Valuations are somewhat elevated with an approximate 17 times forward looking price/earnings ratio, but that ratio is not excessive and reflects positive expectations about future earnings growth. Earnings for the S&P 500 for the third quarter rose 3.1%, entering positive territory for the first time since the first quarter of 2015. Currently, analyst expectations are for a similar advance in the fourth quarter and for mid-single-digit growth for the full year 2017. Should the new administration's pro-growth policies take hold, actual results could be significantly better than those expectations. Lower corporate taxes,

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increased capital spending, better consumer confidence and less regulation indicate that earnings growth could continue for the foreseeable future.

Even though stocks performed well during the fourth quarter, there were pockets of weakness. For example, the Health Care and Real Estate sectors within the S&P 500 each lost more than 4%. Given this weakness, we selectively added new positions in Amgen, Eli Lilly, CVS Health and Public Storage in your Equity & Dividend Plus portfolio. We also initiated a new holding in LyondellBasell Industries, a petrochemical company that produces chemical building blocks for plastics production. Additionally, we were active with the covered call writing aspect of the portfolio due to the strength in the equity market near year end; therefore, the strategy modestly exceeded its annual target for cash flow generation. In your Large-Cap Value portfolio, we initiated a new position in Eli Lilly. The company announced in November that it was halting a late phase trial of a promising Alzheimer's drug which resulted in a sharp selloff in the stock. We believe Lilly is a very well-managed pharmaceutical company with a strong product pipeline that should produce above-average earnings growth over the next several years.

For additional firm wide information please visit our website at www.fbpinc.com or call us at 1-800-851-3804. As always we appreciate your continued interest in our firm.

