FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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Equity markets continued to generate positive returns during the second quarter. The S&P 500 moved up 3%, marking its seventh quarterly advance in a row. In the first six months of the year, the S&P achieved a new record-high close 24 times. The S&P has only experienced two negative quarters in the last five years. That is remarkably consistent performance, especially considering the modest pace of economic growth and domestic political uncertainties. Measures of stock market fear are at multi-year lows indicating that, at the moment, investors are feeling confident.

On the positive side of the equation, the U.S. economy continues to grow, albeit at a relatively slow pace. First quarter 2017 GDP was revised upward to 1.2% in May; while better than the originally reported number of 0.7%, it is less than stellar. Economic conditions were strong enough, however, to warrant another fed funds hike by the Federal Reserve in June, its second move this year. Corporate profits have been quite strong with first quarter annualized earnings growth of almost 15%. An uptick in global economic activity has been a significant driver of these earnings gains, which were more the result of revenue growth than margin improvement. If the Trump administration and Congress can push through some of the pro-growth policies that have been proposed, we could see an acceleration in domestic economic activity. However, diminished hopes for progress on this front in 2017 have led to a reversal in the post election rally in cyclical stocks.

Market performance this year is demonstrating a pattern of narrowness that is somewhat concerning and bears monitoring. Narrow markets occur when a small number of stocks perform very well, while the vast majority of stocks only tread water. This type of market can give the appearance of strength as these few strong stocks boost the return for the index. This year, similar to 2015, market leadership has been concentrated in a small number of very large-cap, mostly technology related stocks. Should GDP accelerate in the coming quarters, earnings growth will likely broaden across economic sectors allowing market leadership to expand and possibly rotate away from these mega-cap companies. We believe that would be a favorable development in that it would indicate a healthier environment for the overall market.

As one might expect in the market climate this year, the Nasdaq 100 composite has been sizzling, up more than 16% in 2017. In contrast, the Russell 1000 Value index, much more representative of our approach to investing, is up only 4.7%. Our results came in modestly below the Russell index for the quarter and year-to-date periods, though year-over-year results are more favorable compared to the indexes given an especially strong 2016.

During the quarter, we reduced our weightings in Microsoft and Royal Philips through exercised call options. Both stocks had performed well following favorable earnings reports. The energy sector, on the other hand, saw weakness in the quarter. This provided us the opportunity to make an initial investment in Schlumberger, the world’s largest and most

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diversified energy services company. Schlumberger has a 3% dividend yield, and we believe it offers attractive long-term total return potential at its currently depressed stock price. We also took advantage of share price weakness to add to holdings in AT&T, LyondellBasell Industries, UPS and Nordstrom.

The dividend yield of the equities in our portfolio was 3.5% at quarter end, which compares favorably to the 2% yield of the S&P 500. We also believe our portfolio is attractively valued as it trades at a discount compared to the S&P on other valuation metrics, providing the opportunity for potential price appreciation. After the first half of the year, we are on pace to meet our cash flow objectives for the portfolio, both from dividend income and premium income from selling covered call options.

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.