FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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The third quarter ended with the S&P 500, the Dow Jones Industrial Average and the Nasdaq Composite all at record-high levels. It marked the eighth consecutive quarterly gain for the S&P, which has only experienced one down quarter since the end of 2012. Solid earnings and steady economic growth provided fuel for the strong equity returns. During the advance, markets seemed to shrug off escalating tensions over North Korea's nuclear tests and to look beyond the economic impact of a series of major hurricanes that hit the U.S. mainland and Puerto Rico. Additionally, markets appeared unfazed as the pro-growth agenda championed by the Trump Administration hit some speed bumps. Despite these issues, investors remain favorably disposed toward stocks as global economic conditions steadily improve.

Real GDP for the second quarter was reported at a 3% annual rate, a significant uptick from the first quarter's 1.2% rate. We will not know for a few weeks how the economy performed in the third quarter, but we would expect something lower than 3% given the impact of Hurricanes Harvey and Irma. Having said that, it should be mentioned that we believe the financial markets will give little credence to reported GDP for the quarter, since the unfavorable weather should prove to be only a temporary disruption. Consumer spending and manufacturing data for August were spotty, but business sentiment remained quite high.

In a statement following its September meeting, the Federal Open Market Committee (the Fed) announced it would begin to reduce fixed income security holdings on its balance sheet that were acquired in an attempt to stimulate the economy after the 2008-2009 recession. Removing this so-called "quantitative easing" stimulus has long been discussed but is now happening. Further increases to the fed funds rate are also possible in the coming quarters. The Fed believes these steps are necessary to return to a more normal interest rate environment (i.e. higher than current levels), but we expect further actions will be dependent on whether the economy continues to advance at a reasonable pace.

So far in 2017, market leadership has been concentrated in a small number of very large, mostly technology-related stocks, and these stocks continued to lead the way during the third quarter. Returns for the three months ending September 30 showed signs of broadening with ten of the eleven sectors generating positive numbers for the period. The Energy, Telecom and Materials sectors joined Technology among the best performing groups. Our portfolio performance compared favorably to both the S&P 500 and the Russell 1000 Value benchmarks this quarter. Energy and Materials stocks were the strongest performing sectors for the portfolio, each up more than 10%. For the year-to-date period, results are in line with the value benchmark but lag the growth-oriented S&P 500 index.

Stocks have been in a strong uptrend since before the election, continuing the bull market that started over eight years ago. Slow but steady economic growth in the U.S. and around the world, coupled with very low interest rates, provided the broad support to sustain and extend the market. Valuation seems elevated with the market trading at nearly18 times estimated earnings.

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These valuations can be justified, however, given the current environment of very low interest rates and consistently growing corporate earnings. At some point, we would expect a modest stock market correction, which would be viewed as a normal and healthy part of a long-term bull market. Both the timing and depth of the pullback are extremely difficult to predict, but we believe it would create attractive investment opportunities.

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.