FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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The second quarter of 2018 saw equity markets stabilize and then move modestly higher. This followed a tumultuous first quarter that produced a sharp spike in volatility and the first market correction in more than two years. While there are macro concerns, which we discuss more fully below, continuing improvement in fundamentals helped propel stock prices higher. The S&P 500 advanced 3.4%, while the Russell 1000 Value was up 1.2%. Year to date, our results are positive, though returns for the value benchmark remain in negative territory. With large-cap technology stocks leading the market, the value style continues to lag growth.

After the 2016 election, most expected an unusual presidency. Many Americans were drawn to the idea that a successful businessman and Washington-outsider would shake things up and be good for the country. Eighteen months later, it is safe to say that times have been even more unusual than imagined. There have been several significant achievements by the Trump administration, including the summit with North Korea and the rollback of government regulations, but we believe the tax legislation passed in December is very significant and may prove to be the highlight of the Trump presidency. A major feature of the comprehensive bill is a lower corporate tax rate which has translated into strong bottom-line earnings growth for most U.S. companies. The direct benefits will continue into next year with earnings projected to increase at a high single-digit rate, which is impressive coming off the near 20% growth rate in 2018. Unemployment is near all-time low levels, and GDP continues to increase. These factors point to a favorable environment for stock prices.

As always, there are potential headwinds on the horizon. We had hoped that aggressive soundbites from the administration about trade would prove to be merely tactical posturing meant to strengthen the U.S. position during negotiations. But tariffs on steel and aluminum from Europe, Mexico and Canada went into effect on June 1, indicating that the administration is willing to act and not just talk. Trade seems to be the one factor that moves markets on a daily basis. We continue to believe that calmer heads will prevail and that a full-on trade war will be averted.

Somewhat paradoxically, the improving economy could also prove to be a concern as we head into 2019. The Federal Reserve FOMC has already increased interest rates multiple times since the election. Rates are still relatively low by historical standards, but higher rates could put a damper on the construction and housing markets, which could slow GDP growth. Oil prices have also spiked, up about 30% so far in 2018. With OPEC members agreeing to increase output and U.S. shale producers ramping up production, we would expect oil prices to level out near

current elevated prices. Higher oil and gasoline prices create headwinds for consumer spending and GDP. Additionally, one can never overlook new geo-political risks. In summary, we continue to believe that the economy is on solid footing and expect GDP to advance for the foreseeable future. Given the risks noted above, however, the pace of growth in 2019 could moderate somewhat.

Both our large-cap value portfolio and our dividend income portfolio produced solid results for the quarter. Longer-term returns for the strategies are competitive compared to the S&P and Russell, with sizable outperformance of the value index noted for the one-, two- and three-year rolling time frames. For our large-cap portfolio, the Energy sector was the strongest contributor to performance during the quarter. Surging oil prices led to significant stock price moves for several of our energy holdings. Due to double-digit performance from CenturyLink, the Telecommunications sector also generated positive results. For our dividend portfolio, the Consumer Discretionary and Energy sectors performed especially well. During the period, we sold shares of Intel and LyondellBasell through covered call option exercises. Both stocks performed well for our holding period. We added new positions in Hershey Company and Dominion Energy after both stocks experienced price weakness. The dividend yield from the equities in our portfolio is currently 3.6% versus 1.9% for the S&P 500. Dividend growth continues to be strong as corporate profits have increased. Additionally, portfolio trade activity and covered call option selling have enhanced cash flow generation in our portfolio. We believe that dividend growth will continue to be an important driver of equity total returns going forward.

For both strategies, we will continue to search for stocks that appear undervalued compared to their historical averages. The combination of attractive valuation and high cash flow generation should produce positive total returns as we go forward.

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.