FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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Equity markets heated up during the summer, carrying that momentum through quarter end. Broad stock market indexes, including the Dow Jones Industrials Average and the S&P 500, set record high closing levels during the third quarter. Stocks continue to move in synch with improving GDP growth and, in particular, earnings growth, which accelerated significantly following last year's tax cut.

Economically, many of the trends visible all year continued through September. Lower corporate and individual tax rates along with reduced government regulations have combined to spur consumer and business confidence, helping to propel GDP growth to higher levels. Employment numbers are strong, and consumer spending has been robust. Most economists have pointed to trade issues and a generally toxic political environment as the biggest ongoing risks to the economy.

Looking forward, we continue to see a very positive economic environment but there are some headwinds that bear monitoring building on the horizon. Inflation, while not showing up significantly in reported numbers just yet, is a potential negative. Higher input costs due to the imposition of new tariffs may work their way into prices in the coming quarters. Unemployment remains very low, near all-time low levels at under 4%. While this number could be understated due to anomalies with the labor participation rate, it is certainly indicative of a tightening labor market. Typically, one would expect to see noticeable inflationary wage gains with unemployment so low, but wage growth numbers remain rather modest. Monetary policy is becoming less accommodative. The Federal Reserve's Open Market Committee moved to increase the fed funds rate to an effective rate of 2.25% at its September meeting. The statement released following the meeting indicated that more increases are planned through 2019, assuming economic conditions remain strong. Although not problematic currently, the economy and markets will be affected as short-term rates keep rising. In the first few days of October, yields on longer-dated U.S. Treasury bonds spiked about 20 basis points, enforcing the notion that higher rates are likely coming. Higher oil prices, something we have anticipated since 2016, are also a potential headwind. Crude oil has moved up as demand continues to be strong and supplies have tightened due to Iranian sanctions, bottlenecks in West Texas and the reduction of capital spending by major oil companies following the 2015 oil price collapse. Consumer spending could be impacted this winter due to higher prices for gasoline and home heating.

Factoring in all of the above, we are likely in the later stages of the economic cycle. The difficulty is knowing how long this cycle will last. GDP growth is still very strong. Companies are doing a nice job managing their businesses in this environment, giving us confidence that they will continue to generate earnings growth, albeit at a slower pace than witnessed last year. Valuations are reasonable given current growth rates and the level of interest rates. We expect equity returns to remain positive but with more volatility and perhaps even a market correction at some point. We would view a correction as an opportunity to add some attractively valued companies to the portfolio.

Performance for our Equity & Dividend Plus portfolio for the quarter was broad-based with Health Care particularly strong. During the quarter, we sold remaining positions in Rio Tinto primarily through options exercises, and we added new holdings in DowDuPont and Broadcom. Dow and Dupont merged in 2017 with plans to combine, restructure and ultimately separate into three companies that should be stronger, more focused global competitors. We believe the result will be attractive total returns for investors. DowDuPont pays an above-market dividend yield that provides good cash flow while we wait for the split. We took advantage of market weakness to add Broadcom to the portfolio following the announcement of its acquisition of Computer Associates. Broadcom has a very attractive dividend yield, and we believe the company's strong free cash flow will allow it to grow its dividend going forward. The dividend yield from the equities in our portfolio was 3.4% at quarter end, which compares favorably to 1.9% for the S&P 500 and 2.4% for the Russell 1000 Value indexes. Portfolio income growth has been strong in 2018 as companies have raised dividends, and our portfolio actions have enhanced cash flow generation. The next twelve-month projected dividend income from the equities in our portfolio is approximately 15% higher than last year. We believe dividend growth will remain an important driver of equity returns, and we will continue to search for undervalued companies that have the potential to grow their dividend.

Strong performance from Health Care and Information Technology helped drive performance for our Large-Cap Value portfolio for the quarter. Portfolio activity included establishing a new position in Compass Minerals, a global leader in the mining of road salt. We expect company earnings to rebound from below normal levels as the company recovers from output disruptions and commodity price weakness. We sold the small remaining shares of Noble Corporation and also eliminated our Rio Tinto holdings during the quarter. In addition to the solid quarterly results, returns over one-, two- and three-year periods are well above the value benchmark and are quite competitive with the S&P 500, even with the strong outperformance of growth over value in this time frame.

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.