FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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In the first quarter of 2019, the stock market rebounded from the sharp correction experienced late last year. The S&P 500 produced its strongest quarterly return since 2009 and its best first quarter return in twenty years. Recession, trade and interest rate fears, which were rampant in the fourth quarter, seemed to fade away as investor sentiment improved markedly. Simply put, we believe there was emotional selling of stocks in the fourth quarter of last year, which was exacerbated by lack of liquidity in late December. As we often see with equity markets, the sell-off proved to be short-lived.

Corporate earnings surged more than 20% last year, in large part due to the 2017 corporate tax rate cut and regulatory reform. With earnings up and stock prices down for the year, the price to forward earnings ratio for the S&P 500, at 14.4 times, looked more attractive at the end of 2018 than it had in more than five years. We believe the significantly more attractive valuation played a major role in moving stocks higher. Additionally, many of the concerns listed above were mitigated after the Fed backed off its hawkish posture, trade negotiations with China seemed to be progressing, and GDP, while slowing, continued to show steady growth. The stage was set for positive stock market performance.

March 2019 marked the ten-year anniversary of the bottom of the bear market experienced during the last recession. After ten years of economic growth, it is natural to be concerned about the next recession and the timing of when it may happen. Recessions normally occur when excesses build up in the economy, and the Fed is forced to raise interest rates to slow growth and control inflation. We are far from that situation today. While the cycle is long at ten years, the current expansion has been characterized by slower growth than prior cycles. Inflation appears under control, interest rates remain low, and very few capacity constraints are visible.

An inverted yield curve, where short-term interest rates for U.S. Treasuries are higher than long-term rates, is getting a lot of attention and concern by investors. Historically, an inverted curve is a reliable leading indicator of recession, but with an 18- to 24-month lag. At the very short end, the Treasury curve is inverted, but the curve is positively sloped past the three-year maturity bond. While it bears monitoring, we do not believe the current slope of the curve is indicative of a looming recession. Instead of indicating an overly restrictive Fed policy, it says much more about the low level of interest rates around the world as well as the safety and attractiveness of U.S. Treasury bonds.

With the strong market so far in 2019, valuations have moved higher to about 16.5 times earnings. With earnings projected to grow 5-7% this year and interest rates still very low, we believe the stock market remains attractively valued.

During the market rally we were able to identify a number of option selling opportunities for your Equity & Dividend Plus (EDP) portfolio. Generating cash flow from dividends and option premiums is a key objective of the strategy. We are on pace to generate more than 5% cash flow from the portfolio this year from dividends and option premiums combined, which is consistent with prior years. In addition, projected portfolio dividend income is approximately 10% higher than it was last March.

Notable portfolio activity included the elimination of Eli Lilly from both your EDP and Large-Cap Value portfolios after the stock reached our price objective. The bulk of the stock was sold through option exercises.

As noted above, this quarter marks the ten-year anniversary of the beginning of the current bull market. Equity markets have compounded annual total returns in the mid-teens since then. Admittedly, the current bull market started at very depressed levels coming out of the severe recession of 2008, but the length and strength of the market recovery is still notable. We believe, with the economy still showing resiliency, stocks should continue to outperform other asset classes going 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.