FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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Slowdown or recession? That seems to be the big question investors must grapple with today. To be sure, there are indications that global economic growth is trending lower. Strong earnings growth rates in the U.S. that were boosted by the 2017 tax cuts have mostly run their course, making further growth from current levels more challenging. The Trump administration's tough talk on tariffs has many analysts worried about damaging trade wars, particularly with China. The government bond yield curve is near inversion and the implications of that are uncertain. Furthermore, this month the U.S. economy is poised to eclipse the longest economic expansion on record, which begs the question, is time running out on this economy? And yet, even with these headwinds, the stock market started 2019 with its best six-month return to begin a year since 1997.

To help make sense of the situation, it is important to point out that the headwinds mentioned above are not new. In fact, they were largely to blame for the sharp selloff in the stock market late last year. Progress has been made to reduce the risk of a negative outcome from some of these issues. The Fed signaled at its June meeting that it would be willing to cut interest rates if it saw continued signs of economic sluggishness. The U.S. and China have resumed trade negotiations. And corporate earnings reports have generally been better than expected. Coming off an extremely oversold position in late 2018, stocks have performed very well.

If forced to answer the slowdown versus recession question, we put ourselves in the slowdown camp. Yes, the economic expansion is long in the tooth. But it is also the shallowest recovery on record. In our view, expansions are better measured by the magnitude of GDP growth, not age. Given the Fed's willingness to stimulate growth with rate cuts and the ongoing benefits to consumers and corporations from the 2017 tax cuts, we believe the economy will continue to grow. Further improvement in global trade relations could be an additional catalyst for extending the record-setting economic expansion.

Despite our relatively positive view of the economy, we would not be surprised to see stocks tread water in the second half of the year. With a forward P/E for the S&P 500 at 16.8 times, stocks today appear more fairly valued than they did at the end of last year, when they were relatively inexpensive. While we expect earnings growth to continue, but at a slower rate than last year, we don't believe that the momentum driving markets to double-digit returns year-to-date is sustainable for the full year. This does not mean we believe a selloff is imminent. While 5% or even 10% pullbacks are always possible in a bull market, we think a single-digit positive return for the balance of the year is likely.

We are pleased that the Equity & Dividend Plus strategy continued to meet its cash flow objectives. We are on pace to achieve one of the key portfolio goals of producing approximately 5% cash flow from dividends and option premiums each year. At quarter end, the dividend yield of the stocks in our portfolio was nearly double the 1.9% yield of the S&P 500. We are also pleased to have generated double-digit absolute total returns for the year, however, portfolio returns have lagged relative to the large-cap benchmarks. With approximately 25% of the portfolio optioned, total returns have naturally trailed in 2019 considering that call options cap the upside for stocks. We also experienced some unfavorable individual stock performance, particularly in the Energy and Consumer Discretionary sectors. If there was a common thread among these companies, it was cautionary management commentary about future earnings prospects rather than current sales or earnings shortfalls. Our Large-Cap Value portfolio experienced similar performance attribution as well, lagging both the S&P 500 and the Russell 1000 Value indexes so far this year. Longer term benchmark comparisons are more favorable, particularly compared to the Russell 1000 Value, with two- and three-year annualized returns exceeding the index. We added Bristol-Myers Squibb to both portfolios during the quarter. Bristol announced plans to acquire Celgene, which will create a leading biopharma company with especially strong exposure to the oncology market. We also purchased Molson Coors for our Equity & Dividend Plus portfolio. We expect favorable sales trends for its Miller Lite and Coors Light brands to continue. The company should also benefit from Blue Moon, one of the largest craft beer brands in the country.

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.