FLIPPIN, BRUCE & PORTER, INC.
INVESTMENT COUNSEL

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Business shutdowns mandated in response to the coronavirus pandemic were gradually lifted across the country and around the world during the second quarter. To be clear, the reopening of America is not a return to "business as usual" prior to Covid-19. Significant restrictions remain in place, yet some green shoots of economic recovery emerged, giving equity investors a reason to be optimistic. Most major benchmarks of domestic and international equities experienced double-digit returns while the technology-heavy S&P 500 experienced its strongest quarterly return since 1998.

This year has certainly been full of the unexpected and the unusual. It may be that we look back and see we experienced the steepest economic recession in history, immediately followed by a sharp recovery, giving us the shortest recession as well. Record high levels of unemployed workers in March and April were followed by somewhat surprisingly strong jobs numbers in May and June. The latest ISM Manufacturing Index numbers indicate economic expansion is already underway. Possibly, the much-discussed V-shaped recovery has begun, but uncertainty remains. As we begin July, it appears that Covid-19 cases are spiking in the South and West, while the outbreak has subsided in the Northeast. The good news is that we have not seen a commensurate spike in the death rate nationwide. We continue to believe that investor sentiment will rise and fall along with news about possible coronavirus treatments and progress on potential vaccines. The virus isn't the only uncertainty we face, as Trump vs. Biden will heat up later this year. Whoever is elected will govern a country that appears to be strongly divided and will also likely face the challenge of steering an economy with lingering Covid-19 outbreaks. It will be no small task. While we may see volatility in the markets as the election nears, we take comfort in the fact that the U.S. economy has demonstrated resilience through the years, with a remarkable ability to adapt and advance regardless of which political party has the upper hand.

Even as stocks recovered, business commentators and pundits speculated that markets had run up too quickly and separated from the underlying fundamentals, which were still reflecting recessionary conditions. It appears that stock market investors are looking past the 2020 trough in sales and earnings and towards the recovery in 2021 and 2022, realizing that enormous fiscal and monetary stimulus will continue to provide positive effects to the system. No doubt, the stimulus is part of the reason the stock market is priced as it is today. There is more to the story, however. The growth segment of the market has significantly outperformed the value segment for the last several years, leading to very narrow market leadership, akin to the technology bubble of the late 1990s. The Nasdaq and other large-cap growth indices are at all-time high levels, while the S&P 500 is very close to its record closing price from mid-February. These benchmarks are all heavily weighted towards a small group of technology companies represented by the now well-known acronym FAANG (Facebook, Apple, Amazon, Netflix and Alphabet (parent company of Google)). While certain indices are at record levels, the average stock has not gotten back to its previous high price, and, in our opinion, is not excessively valued. Many of these companies offer attractive return potential, and we are focused on identifying opportunities among them. The Russell 1000 Growth forward P/E is now over 30 times, while value portfolios like ours are 15 times or below, indicating significant relative return potential for value stocks. The timing of a leadership shift is uncertain, but history tells us that as economic growth improves, value strategies tend to cycle back into favor and lead the market. During the technology bubble 20 years ago, we heard many people question whether value would ever outperform growth again. There are echoes of that same question today. Rather than concern ourselves with the cyclicality of value versus growth, or whether we will have a V-, W- or L-shaped recovery, we are focused on the future earnings potential for our companies in the economic recovery that we foresee. While the path there may be bumpy, we have tremendous valuation support at current price levels.

We purchased new positions in HP Inc., Tyson Foods, and Duke Energy during the quarter. We sold Molson Coors following a disappointing earnings report in which it indicated it may alter its dividend policy in the wake of poor sales trends. We also sold small positions in Carrier Global and Otis Worldwide which were spun off from United Technologies, which simultaneously changed its name to Raytheon Technologies. The market rally during the quarter gave us multiple opportunities to sell call options, therefore we are on pace to exceed our target for option premium income for the year. We are also on pace to match 2019 dividend levels. Given that several stocks cut or suspended dividend payments to preserve liquidity during the lockdown, we are pleased that overall portfolio dividend income has been maintained. As you are aware, we target 5% cash flow from dividends and option premiums on an annual basis. Despite the challenging market this year, our 5% cash flow target is well within reach and may even be exceeded in 2020.

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.