Monthly Portfolio Commentary

September 30, 2017

You may recall that we were disappointed by our performance last month, so we were pleased to post better performance in September. The portfolio appreciated by about 3.5% versus a gain in the S&P 500 Index of 2.1% and an increase in the S&P 500 Value Index of 3.3%. On a monthly basis, this is only the second time that "value" has outperformed "growth" this year. Perhaps the gap between "growth" and "value", as measured by the year-to-date returns for the S&P 500 Growth Index and the S&P 500 Value Index, of nearly 11%, will continue to narrow. If this were to happen, it would likely benefit our relative performance since the major drivers for "growth" this year have been the FAANG stocks, Facebook, Apple, Amazon, Netflix and Google. These five companies have accounted for approximately one fifth of the S&P 500's year-to-date return, or about 3% of the 14% performance. Essentially all of our outperformance this month came from stock selection with double digit returns from Dollar General, Ross Stores and W.W. Grainger leading the way.

For the quarter, the portfolio also rose about 3.4% which lagged the 4.5% return for the S&P 500 and slightly trailed the S&P 500 Value's return of 3.5%. Our underperformance relative to the S&P 500 this quarter was entirely due to our underweight in Technology, which was the best performing sector and our overweight in Consumer Staples, which was the worst performing sector.

On a year-to-date basis, the portfolio has returned nearly 11%, which puts us in the middle of the 14.2% return for the S&P 500 and the S&P 500 Value's return of 8.5%. Energy was the worst performing sector posting a negative return for this period despite the sector being the best performer in September. Technology remains the best returning sector this year. It has outperformed by a wide margin with a 27.4% return versus the next best sector, Health Care, up 20.3%. Fortunately, we have been overweight Health Care for some time and this has been helpful, but our underweight in Technology has been a larger detractor. Consumer Staples posted weak results and our overweight here has been detrimental.

The year-to-date period reflects some outsized "highs", and sadly, some frustrating "lows." The "highs" would include the solid performance from our Health Care holdings, which we continue to believe remain attractively priced. We have been overweight this sector for a long time and our patience has been rewarded so far this year. Our stock selection within Financial Services has also been good as all of our holdings easily outperformed the sector's return. Finally, on the good news front, we had two very large winners in Abbott Labs and Microchip Technologies. Both of these stocks have risen more than 40% this year. We have trimmed Microchip Technologies into this strength, and we are evaluating our position size for Abbott Labs.

On the other side of the ledger, we are disappointed by our Consumer Staples holdings as only one of these companies, Philip Morris International, outperformed the S&P 500's return. However, our valuation models suggest that these companies possess some of our most attractive

returns in the portfolio. We are carefully monitoring the operating performance at both J.M. Smucker and Kroger, whose stock prices have struggled this year.

Amazon's perceived threat to a number of our holdings has also been frustrating since we believe these companies have excellent defenses and bright futures. Nevertheless, this "Amazon Effect" has hurt a number of our positions including CVS, Dollar General, Kroger, Lowe's, and W.W. Grainger. The majority of the negative impact has been concentrated in Kroger and W.W. Grainger. These two holdings have subtracted 230 basis points of return so far this year. We respect Amazon as a world class company but we still believe all of the aforementioned holdings have durable business models that can survive and thrive against all competitors. Additionally, we have looked to take advantage of the market's deference to Amazon to identify new investment opportunities that we believe have been unfairly discounted due to perceived disintermediation concerns. Our recent initiation of a position in Ross Stores is an example of the execution of our process and philosophy to take advantage of what we believe to be a short-term dislocation to establish a position in a long-term, stable earnings and dividend growth company at an attractive valuation.

The market continues its uninterrupted climb and has now posted a positive return in each of the first nine months of the year, a feat only equaled once (1995) in the last 90 years. If the market advances in October, it will have had 12 consecutive monthly gains, something it hasn't done since 1950. We don't pretend to have any insight as to market timing, but it's hard not to notice the extremely low volatility and consistent upward bias of the market over the past year. We remain focused on minimizing risk all the time, but even more so at this moment.

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