LARGE CAP DIVIDEND GROWTH
3Q 2020 COMMENTARY

MARKET OVERVIEW

The S&P 500 recouped the last of its pandemic-induced losses during 3Q and closed the quarter with an 8.93% return. Many of the typical gauges of economic and financial health, while showing great improvement, were not the key drivers of the rally, in our view. Instead, we see the fuel driving stocks higher as:

1. The massive fiscal and monetary policy responses that injected over $5 trillion of liquidity into the economy through the CARES Act and the Fed's quantitative easing,
2. The Fed's zero interest rate policy and its "we will do whatever it takes" commentary,
3. Improved optimism from:
    a. The rapid and smoother-than-expected transition to work-from-home and other online commerce made possible by technology
    b. The ongoing development of improved COVID treatments and progress toward a vaccine,
    c. The fact that the "worst-case" health and economic predictions did not come to pass, and the domestic economy was able to reopen, or at least begin the process.

In this environment, 10 of the S&P 500's 11 sectors reported positive returns with Consumer Discretionary as the strongest at 15.06%. Other sectors outperforming the S&P's return were: Materials (13.31%), Industrials (12.48%), Information Technology (11.95%), Consumer Staples (10.38%) and Communication Services (8.94%). Energy had the only negative return in the quarter at -19.72%, while Utilities (6.14%), Health Care (5.87%), Financials (4.45%) and Real Estate (1.92%) also underperformed.

Earnings estimates were slashed during the first half of the year so that P/E multiples expanded as stocks rallied—from roughly 15x the 2021 estimate at the beginning of April to almost 22x at the end of September. Valuations backed off their August peak of about 23.5x due to a combination of lower stock prices and positive estimate revisions. For example, FactSet reported that the bottom-up 3Q S&P 500 estimate increased by 4.1% between June and September, which represents the first positive bottom-up revision of the S&P 500 quarterly earnings estimate since 3Q 2018. The full-year 2020 and 2021 consensus estimates have been increased similarly.

PORTFOLIO REVIEW

The Large Cap Dividend Growth composite lagged the S&P 500's strong 3Q return due to stock selection. This is not a complete surprise as more cyclically sensitive (ex-Energy) and lower dividend/no dividend stocks were among the market's leaders. Recall that this portfolio is populated with the stocks of companies that have a history of consistent dividend increases, which are usually generated by more consistent earnings growth, and is constructed to have a current yield equal to or greater than the S&P 500's.

The portfolio's Information Technology sector had an 8.10% return vs. 11.95% for the benchmark, costing 162 bps of relative performance. Six of the 12 holdings underperformed, with Analog Devices (ADI) and Cisco Systems (CSCO) recording negative performance. CSCO was trimmed in August over concerns regarding potential long-term market share loss. We view the relative performance of the other holdings in this sector as short-term in nature.

Stock selection in the Industrials cost another 100 bps of relative performance, with a 3.31% return vs. the benchmark's 12.48%. The portfolio's aerospace/defense holdings, Northrup Grumman (NOC), Lockheed Martin (LMT) and Raytheon Technologies (RTX) were impacted by defense budget concerns and by the effects of COVID on travel, which we view as transitory, as well as a rotation into stocks with more economic leverage.

The portfolio's lack of exposure to Energy was the greatest relative contributor, adding 80 bps. Sector weights are based on the team's bottom-up stock selection methodology and reflect where they have identified the most attractive risk/return opportunities.

TOP CONTRIBUTORS

Apple, Inc. (AAPL) posted exceptionally strong fiscal 3Q results, with broad-based strength across its product lines (iPhone, Mac, iPad, Services and Wearables, etc.). Positively, management expects this momentum to carry into the fiscal 4Q.

Lowe's Companies, Inc. (LOW) reported very strong calendar 2Q results with revenues and earnings far exceeding consensus forecast. Additionally, same-store sales growth of 34.2% was more than twice investor expectations. It remains clear that home improvement spending continues to benefit from a wallet-share shift in consumer spending.

Abbott Laboratories (ABT) exhibited strong 2Q results that topped forecasts driven by the medical devices and COVID-19 testing businesses. Management guided current year earnings well above consensus expectations suggesting the disruption from COVID-19 is significantly less than once feared. Finally, the company announced the approval of its BinaxNOW COVID-19 test, capable of generating results in 15 minutes without the need for lab instrumentation.

BOTTOM CONTRIBUTORS

Cisco Systems, Inc. (CSCO) finished its fiscal 4Q for the period ending July 25, 2020 on a negative note. Revenues declined 9% year-over-year and management projected that its fiscal 1Q would continue to exhibit year-over-year revenue declines in the -9% to -11% range. The stock is under review due to the combination of limited visibility into a recovery in Enterprise information technology spending and concerns regarding potential long-term market share loss.

American Tower Corp. (AMT) was negatively impacted by slower-than-expected tower leasing activity from the newly merged T-Mobile and Sprint. While we believe the new T-Mobile will eventually increase spending, potentially as soon as the end of the year and into 2021, this pause forced AMT to bring down guidance for the current year.

Eli Lilly & Co. (LLY) reported slightly lower-than-expected 2Q revenues due to COVID-19 impact from inventory destocking and lower new patient prescriptions. We believe these disruptions to be short-term in nature and continue to see LLY well positioned to grow revenues well above peers with high-teens annual earnings growth over the near-to-intermediate term.

PORTFOLIO POSITIONING

The portfolio's composition changed little during the quarter with turnover of less than 3%. A position in American Express (AXP) was initiated while the Broadcom (AVGO) position was increased. Cisco Systems' weighting was trimmed and Maxim Integrated Technologies (MXIM) was sold as it is being acquired by another portfolio holding, Analog Devices. As such, the portfolio remains overweighted to Information Technology, Health Care, Real Estate and Industrials due to the constituent companies' strong bottom-up fundamentals. The portfolio continues to be underweighted to Communication Services, Consumer Staples, Energy and Utilities as the team has not been able to identify compelling issues at attractive valuations in these spaces.

TOP AND BOTTOM ABSOLUTE CONTRIBUTORS

3Q 2020 TOP CONTRIBUTORS	WEIGHT	RETURN	IMPACT
Apple, Inc.	5.83%	27.21%	140 bps
Lowe's Companies, Inc.	4.48	23.20	96
Abbott Laboratories	3.97	19.46	73
TE Connectivity Ltd.	3.12	20.44	60
Stryker Corp.	3.70	15.96	58

3Q 2020 BOTTOM CONTRIBUTORS	WEIGHT	RETURN	IMPACT
Cisco Systems, Inc.	2.95%	-15.03%	-49 bps
American Tower Corp.	4.46	-6.06	-29
Eli Lilly & Co.	2.04	-9.39	-21
Raytheon Technologies Corp.	3.09	-5.88	-19
Analog Devices, Inc.	2.77	-4.30	-13

LARGE CAP DIVIDEND GROWTH COMPOSITE PERFORMANCE NOTES:

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