Firm Commentary

The third quarter of 2019 was volatile as markets searched for direction against a backdrop of building economic and political uncertainty, reaching all-time highs in July, correcting in August, before quickly rebounding back to peak levels in September.

Indeed, markets were chasing all-time highs in July buoyed by the prospect of easing financial conditions via lower rates and a possible trade meeting between US and China in late September. The Federal Reserve did cut rates for the first time in 10 years on July 31st. However, lowered rates were not enough to sustain a rally in August as the yield curve inverted and trade tensions abruptly increased on August 23rd with the US announcement of additional tariffs on Chinese imports. Markets then turned higher in September propelled by optimism around a trade meeting set for early October and an additional interest rate cut by the Federal Reserve. We remain suspicious of such a steep climb back to near record highs against a backdrop of deteriorating economic indicators and rising policy risk, we wonder–as we did in July– if market's optimism might be misplaced.

In August we wrote:

> *"We continue to believe that trade and global growth were slowing prior to the US Administration's protectionist policy stance and related trade tensions. Nevertheless, at the margin these factors are negative for sentiment and business investment. Thus, "Trade Tension" headlines have become a proxy for global macroeconomic conditions. We are wary of this thinking. Even if we were able to "reset" trade overnight, the complex nature of global supply chains would ensure economic costs lingered."*

We believe an encompassing deal is unlikely and that while any form of a "partial deal" would be welcomed by markets in the immediate term, it may not relieve uncertainty given the equally uncertain response to a partial deal that could follow from the US executive branch.

We have seen various data series decline in sympathy with this uncertainty and have watched the rate of declines accelerate over the last quarter.

CEO Confidence as measured by The Conference Board, has declined to a reading of 34 in Q3'19 from 43 in both Q1'19 and Q2'19. This is the lowest reading since 2009 when the metric reached 30. Further analysis of the report yields equally uninspiring sentiment related to global growth and spending intentions. Unsurprisingly though, manufacturing CEO's were especially cautious.

Manufacturing has been weakening all year and slipped into contraction territory in September as measured by the Institute of Supply Management's Purchasing Managers Index, which conveyed a 47.8. While manufacturing is highly correlated to the percentage change in S&P 500 earnings due to the cyclical nature of manufacturers, concern this year has been the extent that this weakness spreads to the services economy, and employment trends more broadly. The ISM services PMI declined in September; however, it remains above the 50 expansion/contraction line, albeit in a downward trend.

If the slowdown we are experiencing is indeed a recession we would expect employment to be the next shoe to drop. Manufacturing is struggling, but we have seen this before in 2015-2016 and in aggregate, manufacturing is a smaller piece of the US economy than it once was. In order for the slowdown to have a measurable impact on unemployment growth, (recession vs slowdown signal) weakness in the services economy would need to become more pronounced.

To be clear, recessions are notoriously difficult to predict, but U.S. recession risks are rising and we will be watching incoming economic data very closely.

However, our caution is tempered by a backdrop of easing global financial conditions, uninspired valuations, conflicting MARKIT versus ISM PMI readings[1], housing green-shoots, already pessimistic sentiment and cautious positioning; that ultimately make us think a recession is less likely–but still a possibility. Indeed, we expect economic data to continue deteriorating into year-end before improving sometime next year as the Federal Reserve continues to cut rates and hinder the dollars ascent ("Soft Slowdown").

In the interim, markets will remain volatile and particularly vulnerable to external shocks, which the geopolitical backdrop remains increasingly willing to provide (China, Iran, North Korea, Turkey, Syria, Saudi Arabia, Yemen etc.)

Furthermore, at thereabouts 1% off all-time highs we remain cautiously positioned but ready to revert to risk-on cyclical portfolio positioning should conditions be met and confidence in an upturn solidified.

While our posture towards markets is cautious at this stage our enthusiasm for dividends has never been higher. Dividend equities remain a hallmark of our firm and it is often at this stage in the cycle that they truly display their merit. We believe, as we always have, that dividend paying stocks provide the best vehicles for through cycle equity investments, providing cash and superior downside capture to the benefit of investors.

1- *The ISM PMI survey has a longer track record and thus is often the preferred survey measure but focuses on larger companies that will necessarily be more globally focused and weights the components differently than the MARKIT/IHS*

survey. The MARKIT/IHS PMI survey has a different weighting method and focuses on smaller businesses and thus may be a better indicator of US manufacturing resilience. Indeed in 2015/16 the MARKIT PMI recovered earlier from a shallower trough than the ISM reading.

Disclosures

This letter may contain "forward-looking statements" which are based on Brookmont's beliefs, as well as on a number of assumptions concerning future events, based on information currently available to Brookmont. Current and prospective clients are cautioned not to put undue reliance on such forward-looking statements, which are not a guarantee of future performance, and are subject to a number of uncertainties and other factors, many of which are outside Brookmont's control, and which could cause actual results to differ materially from such statements. All expressions of opinions are subject to change without notice.

A complete description of Brookmont's performance calculation methodology, including a complete list of each security that contributed to the performance of this Brookmont portfolio is available upon request.

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The Brookmont Dividend Equity Strategy Composite contains fully discretionary accounts with similar value equity investment strategies and objectives. For comparison purposes, the Dividend Equity Strategy Composite is measured against the Russell 1000 Value Index. The Russell 1000 Value Index measures the performance of the large-cap segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Value Index is constructed to provide a comprehensive and unbaised barometer for the large-cap value segment. There is no representation that this index is an appropriate benchmark for such comparison. You cannot invest directly in an index, which also does not take into account trading commissions and costs. The Volatility of this index may be materially different from the performance of the strategy.

The firm maintains a complete list and description of composites, which is available upon request. Results are based on fully discretionary accounts under management, included those accounts no longer with the firm. Composite policy requires the temporary removal of any portfolio incurring a client initiated significant cash inflow or outflow of at least 15% of portfolio assets. The temporary removal of such account occurs at the beginning of the month in which the significant cash flow occurs and the account re-enters the composite at the beginning of the month which follows the cash flow by at least 30 days. Additional information regarding the treatment of significant cash flows is available upon request.

Brookmont's returns do not include reinvestment of dividends and are shown gross-of-fees. All transaction costs are included. The Russell 1000 Value cumulative return includes reinvestment of dividends and capital gains. During a rising market, not reinvesting dividend could have a negative effect on cumulative returns. There is no representation that this index is an appropriate benchmark for such comparison. You cannot invest directly in an index, which also does not take into account trading commissions and costs. The Volatility of this index may be materially different from the performance of the Strategy.

Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net-of-fees performance was calculated using actual management fees. Additional information regarding the policies for calculating and reporting returns is available upon request.

Your account returns might vary from the composites returns if you own securities that are not included in the Strategy or if your portfolio dollar-cost averaged into the Strategy during the reporting period.

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The recognitions are based on gross-of fees unless noted. Further information (including important disclosures) on each recognition is available upon request.

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