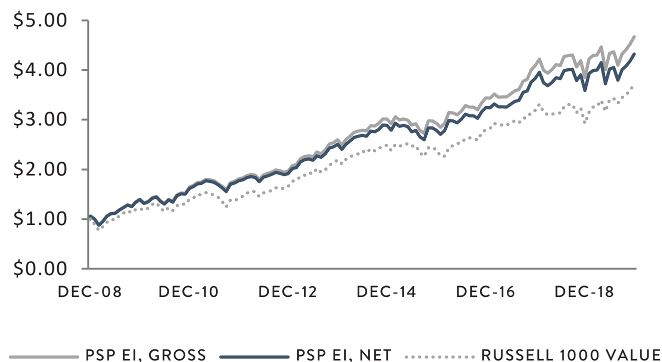
EQUITY INCOME STRATEGY

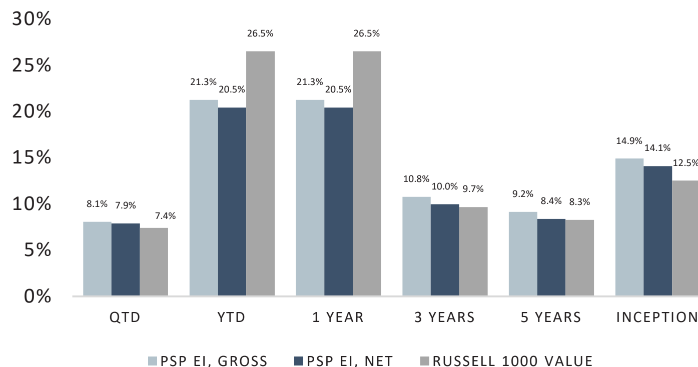
Q4 2019

The Principal Street Partners Equity Income Strategy ("PSP EI") is a domestic, large-cap dividend focused equity strategy derived from a repeatable, disciplined investment process designed to identify companies with attractive balance sheets that have a heritage of paying above market dividends coupled with dividend growth. The strategy is equally weighted across 10 economic sectors and excludes the real estate sector. The strategy consists of 40 equal-weighted positions and is reconstituted and rebalanced quarterly.

GROWTH OF INITIAL $1.00



COMPOUNDED ANNUAL GROWTH RATE (TOTAL RETURN)

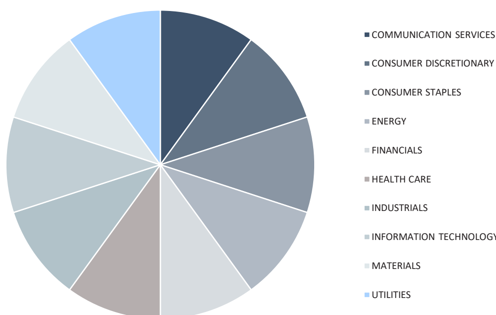


MONTHLY PERFORMANCE, NET OF FEES (TOTAL RETURN)

YEAR	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	TOTAL	R1000V
2019	9.61%	1.48%	0 .28%	3.68%	-10.27%	8.05%	0.74%	-6.29%	5.46%	1.87%	2.52%	3.32%	**20.5%**	**26.5%**
2018	3.15%	-5.37%	-1.58%	1.82%	2.45%	-0.51%	4.24%	0.50%	0.15%	-5.59%	2.99%	-8.05%	**-6.5%**	**-8.3%**
2017	-0 .21%	2.33%	-1.77%	0 .15%	-0 .18%	1.62%	1.88%	0.59%	4.58%	1.05%	4.73%	2.18%	**18.1%**	**13.7%**
2016	-2.61%	2.73%	7.28%	-0.21%	-1.37%	2.36%	3.53%	-1.16%	-0.03%	-1.65%	4.46%	2.73%	**16.7%**	**17.3%**
2015	-3.31%	4.93%	-2.12%	0.57%	-0.91%	-3.44%	0 .97%	-4.68%	-2.15%	9.18%	-0.06%	-1.91%	**-3.7%**	**-3.8%**
2014	-4.18%	4.32%	2.44%	2.90%	0.84%	0.79%	-0.61%	3.68%	-0.33%	1.66%	3.11%	-0.10%	**15.2%**	**13.5%**
2013	5.57%	1.05%	5.49%	2.06%	0.55%	-1.15%	4.30%	-1.53%	3.27%	4.98%	0.9 3%	2.29%	**31.3%**	**32.5%**
2012	1.14%	2.42%	1.23%	-0.92%	-4 .54%	4.90%	1.56%	1.49%	2.26%	-1.05%	-1.32%	0.82%	**7.9%**	**17.5%**
2011	2.20%	2.93%	0.84%	2.93%	-0.57%	-1.04%	-3.19%	-3.59%	-4.35%	9.44%	1.40%	2.61%	**9.1%**	**0.4%**
2010	-5.18%	2.03%	5.59%	1.67%	-6.30 %	-3.94%	6.62%	-3.08%	9.37%	2.78%	-0 .67%	8.11%	**16.6%**	**15.5%**
2009	-5.83%	-12.03%	8.11%	11.10%	5.44%	0.22%	5.93%	4.41%	3.83%	-2.22%	6.73%	3.99%	**31.1%**	**19.7%**
2008	-	-	-	-	-	-	-	-	-	-	-	6.07%	**6.1%**	**1.3%**

	PSP EI NET	PSP EI GROSS	R1000V
TOTAL RETURN	14.11%	14.92%	12.53%
STD DEV	13.67%	13.67%	14.34%
SHARPE RATIO	1.00	1.05	0.86
BETA	0.89	0.89	1.00
DIVIDEND YIELD	3.82%	3.82%	2.38%
MAX DRAWDOWN	-17.17%	-17.07%	-23.32%

SECTOR WEIGHTING



SUMMARY TERMS

STRUCTURE:	SEPARATELY MANAGED ACCOUNT
COMPOSITE:	$308M
MINIMUM:	$250K
MANAGEMENT FEE:	0.75%
LIQUIDITY:	DAILY
WITHDRAWAL NOTICE:	1 DAY

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The U.S.-China trade dispute once again was the primary driver of performance in the capital markets in the fourth quarter. The nearly two-year trade war between the world superpowers has been responsible for much uncertainty and volatility in equity market returns earlier in the year. Investors were encouraged by the announcement in mid-October that a "phase one" deal had been agreed upon in principal, although the details of the deal were not announced until December with a January 15th signing date. China agreed to increase purchase of U.S. products (primarily agriculture). Investors had been concerned about the impact of the trade war on the global economy and the subsiding of trade tensions drove capital into risk assets over the course of the fourth quarter.

The Federal Reserve announced a third consecutive rate cut during its October meeting, but indicated that it is likely on hold for the foreseeable future. Chairman Powell stated that "monetary policy is in a good place" after the announcement. The three cuts were seen as an "insurance" cut after eight rate increases over a two-year period. The Fed's intention was to loosen monetary policy in the face of global economic uncertainty due to U.S.-China trade tensions. Inflation remains very low by historical standards, meaning the Fed is less concerned about keeping rates at what are still historically low levels. Chair Powell remarked that they "would need to see a really significant move up in inflation that's persistent before we would consider raising rates". The Fed's December "dot plot" projections indicated that members expect to hold rates steady in 2020 with a single hike in both 2021 and 2022.

U.S. economic growth was mixed for the quarter. Employment and the consumer remained strong, yet manufacturing weakened further. The ISM Manufacturing PMI has been in contractionary territory for the past five months and fell to a ten-year low in September. The manufacturing slowdown is likely a direct consequence of trade and tariff uncertainty, which could shift with the announced agreement. The ISM Nonmanufacturing PMI also fell to a three-year low in September but remains at expansion levels (services make up a larger share of the U.S. economy). The consumer continues to drive the U.S. economy and consumer spending remains strong as consumer confidence is near twenty-year highs. Jobs growth averaged 205,000 per month over the quarter, the unemployment rate is near long-term lows at 3.5% and wage growth remains in the 3% range.

U.S. corporate earnings fell for the third consecutive quarter as expected, marking the first time this has occurred in almost four years. The good news was that the drop was lower than expected (-2.2% versus -4.6% expectation for S&P 500 earnings), which buoyed equity markets further. The energy sector was especially weak with an average year-over-year earnings decline of -40%. Q4 2019 earnings expectations are for another drop (-1.7%), but given increased confidence because of a pending trade deal, this number could flip positive.

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Equity markets rode the positive sentiment wave from cooling trade tensions in the fourth quarter. The S&P 500 rose 9.1% for the quarter; finishing the year up 31.5%, its best calendar year return since 2013. Small cap stocks (Russell 2000) rose nearly 10% in the quarter (+25.5% YTD) and international stocks (MSCI ACWI ex-US) rallied 9% (+21.5% YTD). Growth stocks beat value stocks for both the quarter (+10.6% vs. 7.4%) and the third consecutive year (+36.4% vs. 26.5%). Daily S&P 500 returns remained very tame as there were only five trading days where the index gained or lost more than 1%. Most major equity markets ended the quarter at or near all-time highs. The technology sector was the top performing sector for both the quarter and the year (+14.4% / +50.3%) as investors continued to flood back into these companies after the dramatic sell-off at the end of 2018. Health care stocks also rallied in the quarter after "Medicare for All" proposals by progressive Democratic presidential candidates lost momentum.

Fixed income asset performance moderated in the fourth quarter as the Fed indicated it was on hold and investors' concerns about the economy subsided. The Bloomberg Barclays US Aggregate Bond index rose 0.2% for the quarter and 8.7% for the year and the best return since 2002. The 10-year Treasury bond yield rose from 1.68% to 1.90% at quarter-end; still much lower than when it started the year at 2.68%. The Fed's three rate cuts appeared to do the job as the yield curve flattened after being inverted for most of the third quarter.

The Green Square Equity Income Strategy returned 8.1% gross of fees (7.9% net) in the fourth quarter versus 7.4% for the benchmark Russell 1000 Value. All ten sectors represented in the portfolio were positive for the quarter and 34 out of 40 companies had positive performance. For the full 2019 calendar year the strategy returned 21.3% gross (20.5% net) versus 26.5% for the benchmark. Despite a difficult year compared to the value benchmark, our strategy is very much in line with many of the dividend-based indexes which returned in the 20-23% range for the year.

The Strategy's health care sector allocation was the top performing sector for the quarter (+16%). The Strategy's top three individual performers were Best Buy (+28%), Bristol Myers Squibb (27%) and Carnival Corporation (+25%). Best Buy and Carnival rose on stronger than expected earnings as well as increase forward guidance. Bristol benefited from Elizabeth Warren's drop in the polls, the closing of the Celgene acquisition and a strong drug pipeline.

The Strategy's worst performing sector was communication services (1%). Cinemark (-12%) was the worst performing company followed by CenterPoint Energy (-9%) and J.M. Smucker (-5%). Cinemark was pressured by weak overall box office revenues and falling profits. CenterPoint fell following indications that the Texas Public Utility Commission would issue a worse than expected outcome for Houston Electric's rate case. Smucker fell despite a profit beat for the quarter as defensive companies were sold off as the overall market rallied.

Thirteen portfolio companies announced dividend increases this quarter, led by Broadcom (+23%), Texas Instruments (+17%) and AbbVie (+10%). The average quarterly increase for the companies that increased dividends was 6.3 percent. Eight portfolio companies paid increased dividends during the quarter, averaging a 7.1% increase.

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For the year, thirty-two companies paid an increased dividend while in our portfolio by an average of 8.0%. 37 of the year-end portfolio companies paid an increased dividend in 2019 (also an average 8% increase). Our portfolio continues to provide above-market dividend growth with a 5-year dividend growth rate of 16% compared to 7.3% and 6.6% for the S&P 500 and Russell 1000 Value indices, respectively.

As of the end of the quarter, the portfolio's average dividend yield was 3.8%; in line with our historical average of 3.7% and well above the Russell 1000 Value's dividend yield of 2.4%.

As we enter a new decade (and our 12th year of running the strategy), we want to begin with thanking our investors for their confidence over the years. Since our inception, we have not only outperformed our benchmark by 2.39% gross annualized (1.58% net) but have also outperformed the broader market (S&P 500) on a gross basis by 25 basis points annualized. Largely thanks to the "FAAMG" stocks (Facebook., Amazon, Apple, Microsoft and Google (now Alphabet)), growth stocks have significantly outperformed value stocks by close to 4.6% annualized since our strategy's inception and have driven the return of the S&P 500 (currently FAAMG represents 20% of the market capitalization of the index).

Looking out into 2020, we are faced with many uncertainties. The post Great Financial Crisis economic recovery is over ten years old and the bull market is almost eleven years old, both records. Despite that, most economists predict another year of growth and most analysts are calling for another positive year for the equity markets. Because of flat earnings growth for the past 4 quarters, the S&P 500's 2019 return was almost entirely a function of P/E expansion, leaving valuations at high but not historically extreme levels of 18x NTM P/E. Geopolitical concerns abound (China, Iran, Brexit) and we likely face a very divisive election in the fall. Questions abound as to if U.S. corporate business investment will finally increase now that a "phase one" deal has been signed and whether there will be a "phase two" agreement.

However, when looking at our portfolio, we are very encouraged. We fully expect the aforementioned growth outperformance versus value to reverse as growth stock valuations (23.4x) are at levels last seen during the 2000 tech bubble while value stocks trade at a more moderate 15.2x. Our portfolio currently trades at a 13.7x forward multiple, which gives us an even greater value cushion than our benchmark. Our dividend yield remains very attractive compared to our benchmark, the S&P 500 (1.8%) and investment grade taxable bonds (Bloomberg Barclays US Aggregate Bond index yield is 2.31%). As more Baby Boomers retire, we believe they will actively seek out dividend yield as an alternative to historically low interest rates which could drive prices performance higher. Most importantly, higher yielding dividend stocks are trading at 40-year relative lows to non-dividend paying stocks, which we believe makes this a tremendous opportunity to invest in our strategy.

Please feel free to reach out to us with any questions.

James West, CFA

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