SKBA Market Perspectives

July 31, 2020

Pendulums
Market Anomalies, Mean Reversion
& Value vs Growth

| Pendulums

Pendulum [pen-juh-luh m, pen-duh-luh m]
noun

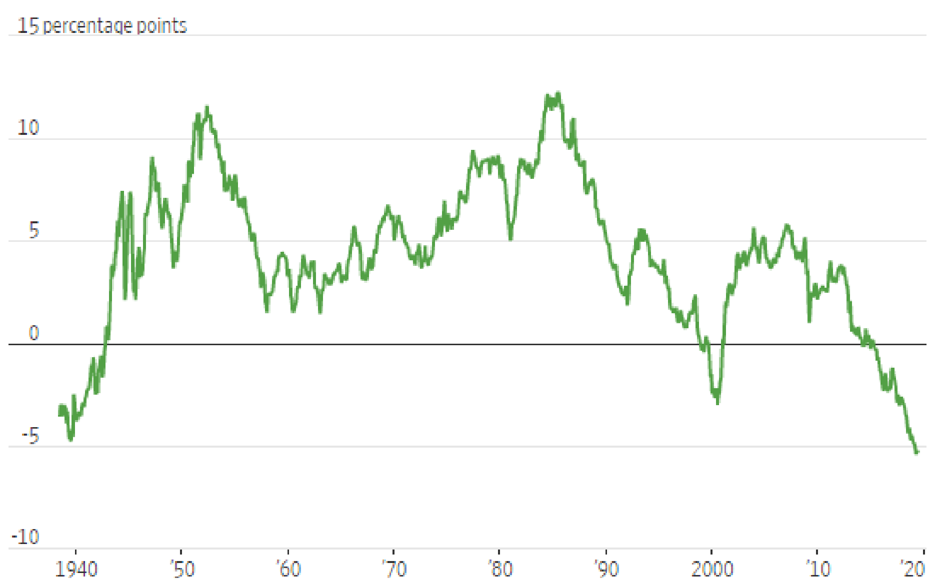
Something that tends to move from one position, condition, etc., to the opposite extreme and then back again.
Source: Dictionary.com

The first half of 2020 was filled with unprecedented events, none more significant than the emergence of the COVID-19 pandemic. Along with the health crisis came the government-mandated economic shutdown that brought many sectors of the economy to a near-complete halt. The resulting decline (real GDP plunging over 30%!) was the sharpest, deepest, and most dramatic recession in history, as was the panic selling in the stock and corporate bond markets.

Pendulums by their nature don't stay in one position forever, even if the cycle becomes uncomfortably long. As value investors at SKBA, we believe the same can be said for investing. Amidst all of the political, social and financial volatility we've experienced, we now begin to ask ourselves if we are at or near an inflection point. What has worked well for investors in the past may not be the same going forward. While growth has experienced a strong run relative to value, are we not at a time where the headwinds for value will begin to subside?

| A Growing Divide – 12-Year rolling annualized total return on U.S value portfolio minus growth portfolio

Last time cheap "value" stocks fell this far behind expensive "growth" stocks was in the late 1930s and early 1940s. Most likely the difference has gotten even larger over the last 12 months.



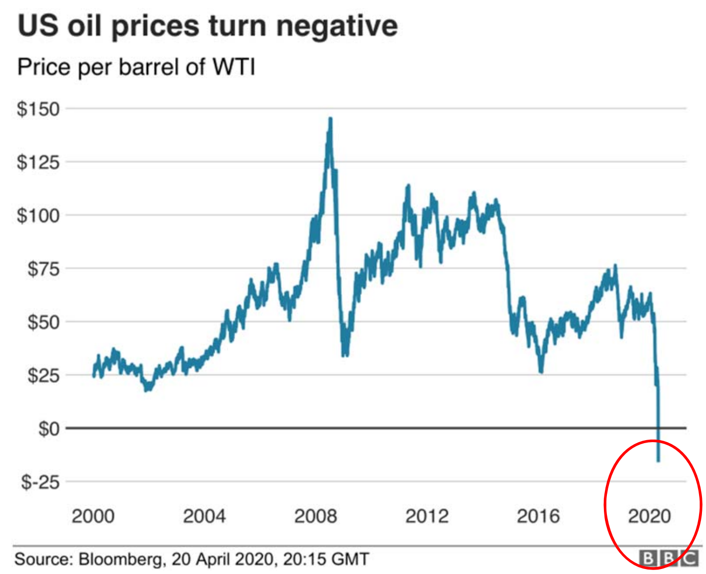
*Rolling 143-month periods; latest data May 2019
Source: Prof. Kenneth French

Source for graph and analysis: The Wall Street Journal, "The Agony of Hope Postponed, by a Value Investor" July 14, 2019, article by James Mackintosh.

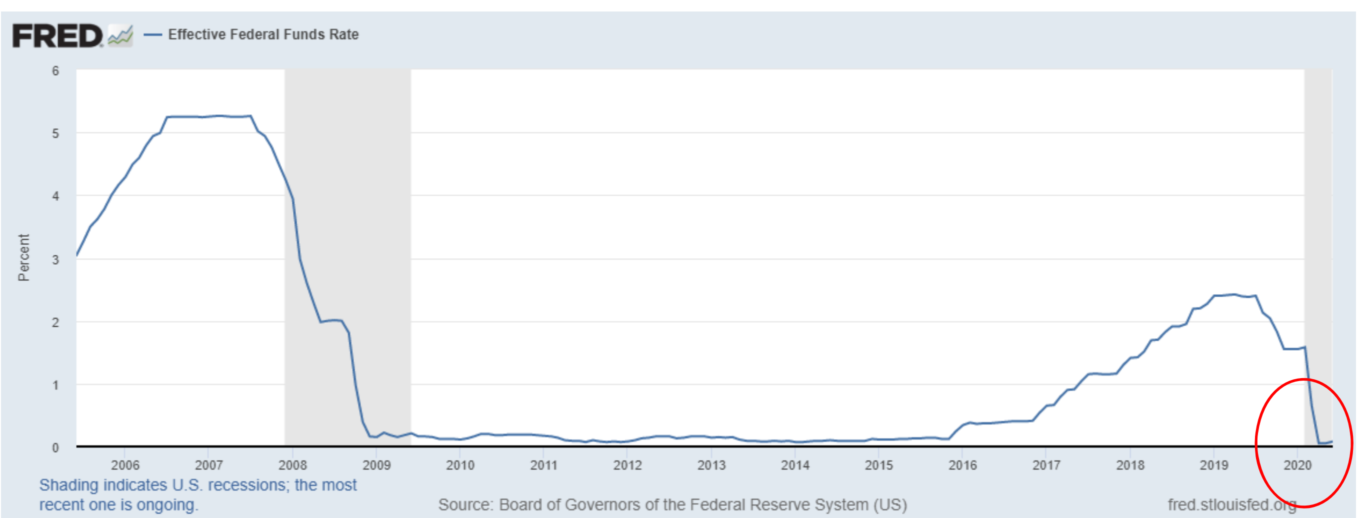
| Anomalies

Over three decades the team at SKBA has never seen an investment environment like the one experienced over the past six months. We've seen countless examples of market anomalies that run counter to what any of us may have learned during business school. For example, never have oil markets, even if for only one day, produced a negative price! We witnessed further anomalies in the performance of low risk stocks and in monetary policy just to name a few. As we saw in the swiftness of the market decline and recovery, in the crash and rebound with crude and again with the underperformance and then outperformance of low beta stocks; the pendulum can swing violently and quickly.

You may recall that it wasn't that long ago that the unthinkable happened with oil prices as crude traded below $0! In any rational market, commodity prices cannot remain negative more than temporarily. At $40 a barrel today, oil prices are currently much more balanced and reflective of the still depressed underlying economics.



Finally anomalies crept up in monetary policy in the US and around the world. One of the Fed's responsibilities is to prevent financial market panic. As markets began to freeze up, the Fed properly came in to shore up liquidity. This should be a short-term effort, but it has turned into a massive injection of monetary reserves to allow it to go well beyond shoring up liquidity. The Fed has returned to its prior ZIRP, or zero interest rate policy and it has committed to keep rates set near 0% until the end of 2022. Despite the generally held view this helps the economy, it doesn't. It encourages speculation and distorts the allocation of credit.



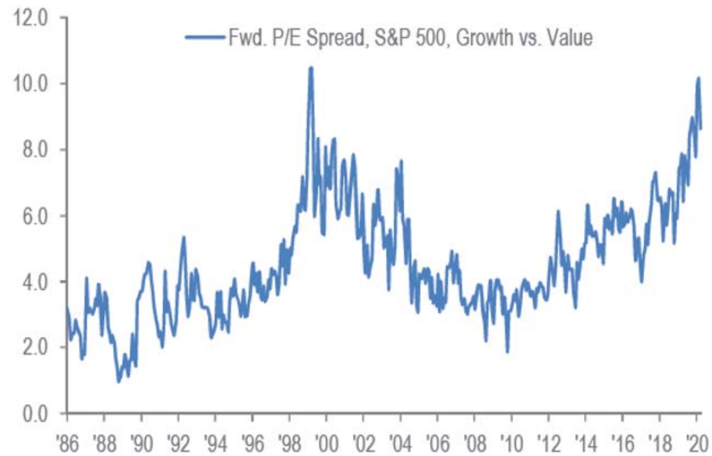
While history doesn't repeat itself it may often rhyme. And if this sounds eerily familiar to you then you may recall a very similar environment around the turn of this century when technology focused companies were leading the markets higher. However, now we find the spread in valuations and relative performance for growth and value to have reached such extremes that they are near or have surpassed the excesses seen nearly 20 years ago.

| Mean Reversion

As value investors, we look for inflection points and opportunities for mean reversion. We believe that as the current recovery continues, a strong argument can be made for stocks outside the mega caps, as well as more undervalued companies, are the more likely to continue to rally. Pendulums by their nature don't stay one side for too long and will eventually and quickly swing back. Would it not be more likely that the sectors, industries and stocks that aren't at excessive valuations – and have not roared back as strongly thus far from the March 2020 bottom – would be more likely to be this winners in the future?

| Relative Valuation of Growth vs Value

Source: J.P. Morgan, as of March 2020



In this environment, we continue to note that fewer and fewer stocks are driving overall index returns. With the market's infatuation with passive ETFs, the domination of growth oriented companies has continued and been reinforced. As more money has gone in to ETFs based on market capitalization weighted indexes, the same dollars then are invested in the same mega capitalization stocks in a self-reinforcing cycle. These names dominate growth indices and have also taken over broad market indices like the S&P 500. You can see this effect in the returns for the first half of the year with growth and mega cap stocks significantly outperforming smaller capitalization and value oriented stocks. These discrepancies are also prevalent in the valuation spreads between these investment styles.

| Conclusion

Overall, value investors have faced a multitude of headwinds for a while now. But, when you look at absolute returns in 2019 value benchmarks were up over 25%. Even with the historical drawdown in 2020, the same value benchmarks have generated a return in excess of 10% per year over the past ten years! So while investors bemoan the relative performance of Value versus Growth one needs to keep the entire story in context.

Our focus on active management will allow us to take advantage when opportunities arise as we did earlier this year. Despite the headwinds to value, extremes continue to be stretched. We now wonder if the pendulum will begin to swing the other way? Inflection points are typically recognized in hindsight only, but if you chip away at some of these headwinds, the potential for value to outperform becomes easier to believe as the pendulum swings back in favor of value.

| Disclosures

The information contained herein represents the opinion of SKBA and should not be construed as personalized or individualized investment advice. Analysis and opinion expressed in this report are subject to change without notice.

| Value*Plus* Composite Annual Disclosure Presentation

	Firm	AUS	Composite		Annual Performance Results						3-Yr Standard Deviation		
Year End	Assets (millions)	Assets * (millions)	Assets (millions)	Number of Accounts	Composite Gross	Composite Net	Morningstar Large Cap Value	S&P 500 Value	Composite Dispersion	Percentage Carve-Out	Composite	Morningstar Large Cap Value	S&P 500 Value
2019	699	435	610	9	24.7%	24.3%	25.7%	31.9%	0.4%	1.2%	13.0%	11.6%	12.7%
2018	686	268	602	14	(10.2%)	(10.5%)	(5.9%)	(9.0%)	0.3%	1.7%	11.5%	10.6%	11.0%
2017	854	250	736	15	19.2%	18.8%	15.1%	15.4%	0.6%	1.6%	10.1%	10.1%	10.3%
2016	949	250	825	15	18.9%	18.5%	18.9%	17.4%	0.6%	1.3%	10.2%	10.3%	10.7%
2015	1,093	234	953	19	(3.0%)	(3.4%)	(1.4%)	(3.1%)	0.2%	1.0%	9.9%	10.4%	10.6%
2014	1,413	243	1,017	18	8.9%	8.5%	9.2%	12.3%	0.3%	0.9%	8.4%	9.0%	9.5%
2013	958	190	758	21	32.0%	31.4%	28.9%	32.0%	0.4%	1.2%	11.1%	12.2%	13.0%
2012	765	105	473	19	12.7%	12.2%	12.9%	17.7%	0.1%	1.3%	14.3%	14.7%	15.8%
2011	546		312	16	4.7%	4.3%	2.2%	(0.5%)	0.3%	1.9%	19.6%	19.0%	21.1%
2010	645		401	13	18.9%	18.4%	14.7%	15.1%	0.1%	1.9%			

* AUS is defined as assets that SKBA does not manage and where SKBA does not have investment or trading discretion. SKBA acts only as a research provider and our role is strictly to provide a model to unaffiliated investment advisers. The unaffiliated investment adviser determines how and when to act upon the recommended changes to the model portfolio. SKBA cannot place or effect a trade for any investor. AUS is estimated and is shown as supplemental information.

ValuePlus Composite *contains all fee-paying and non-fee paying institutional or tax-exempt discretionary accounts that employ SKBA's ValuePlus strategy. ValuePlus is a large-capitalization, value-oriented investment philosophy that seeks to achieve long-term capital appreciation by investing in undervalued equity securities as identified by the firm's Relative Dividend Yield (RDY) valuation discipline. The benchmarks used for comparison purposes were retroactively changed on October 1, 2017. The primary benchmark for comparison was changed from the Russell 1000 Value Index to the Morningstar Large Cap Value Index. The benchmark for general market comparison purposes was changed from the S&P 500 Index to the S&P 500 Value Index. These changes were made to better align the benchmark characteristics with those of the composite. Index Data Source: Morningstar. The composite includes institutional or tax-exempt accounts with a minimum market value of $500,000. Prior to January 1, 2004, the minimum size for inclusion was $100,000. The ValuePlus Composite was created and incepted October 1, 1989.*

SKBA Capital Management, LLC ("SKBA") claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. SKBA has been independently verified for the periods January 1, 1996 through March 31, 2020.

A firm that claims compliance with the GIPS standards must establish policies and procedures for complying will all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The ValuePlus composite has been examined for the periods October 1, 1989 through March 31, 2020. The verification and performance examination reports are available upon request. GIPS ® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content herein.

SKBA, an investment advisory firm registered with the Securities & Exchange Commission, was founded in 1989 as an independent investment advisory firm. In 1999, SKBA became an affiliate of Convergent Capital Management LLC ("CCM"). In 2003 CCM was acquired by City National Corporation ("CNC"). Effective May 2011 SKBA employee shareholders bought back a majority controlling share of the business from CCM, with CCM Holdings III, LLC maintaining a minority stake. In November 2015, CNC was merged into RBC USA Holdco Corporation, which is a wholly-owned subsidiary of Royal Bank of Canada. SKBA operates independently from CCM Holdings III, LLC, RBC USA Holdco Corporation and Royal Bank of Canada. SKBA manages a variety of equity, fixed-income & balanced assets for U.S. institutional and high net worth clients. Firm assets under management are defined as all institutional & private client accounts managed by SKBA. A complete list of composite descriptions is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Between October 1, 2008 through November 30, 2013 one account was included in the composite which did not pay an actual fee, due to the account's fund administration fee superseding the management fee. This account was composed exclusively of proprietary assets and represented less than 2% of total managed assets. Composite performance is presented net of foreign withholding taxes. Capital gains, dividends and interest received on ADR's may be subject to withholding tax imposed by the country of origin and such taxes may not be recoverable. Past performance is not indicative of future results.

Effective January 1, 2010, a significant cash flow (SCF) is defined as any inflow or outflow occurring during the calendar month which is equal to or greater than 35% of an account's beginning month value.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Net-of-fee performance was calculated using actual management fees, except for the case of the one account described above, that has not paid an actual fee yet, for which net performance is calculated using the highest fee per the standard fee schedule. The annual composite dispersion is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. All risk measures presented in this report are calculated using gross-of-fee returns. Policies for valuing investments, calculating performance, and preparing GIPS reports are available upon request.

Standard Fee Schedule: For accounts up to $25 million: 1.00% on the first $2 million, 0.85% on the next $3 million, 0.50% on the next $20 million. For accounts over $25 million: 0.50% on the first $25 million, 0.35% on the next $25 million, 0.30% on the next $25 million, and 0.25% on the next $25 million. For accounts over $100 million: 0.33% on the first $100 million, 0.25% on the next $50 million, 0.20% on the next $100 million, and 0.15% on the next $100 million. Actual investment advisory fees incurred by clients may vary. Carve-out accounts were included in this composite since January 1, 2004. Starting on January 1, 2010, 100% of cash reserves are managed with the equity segment of the account. Under the prior method, cash reserve returns were allocated to equity returns relative to (in proportion to) the size of the equity weight within the total weight of stocks and bonds.

Bundled fee accounts were included in this composite for the period December 1, 2010 through December 31, 2013. For this period, gross returns for bundled fee accounts were not calculated using actual trading expenses, however the impact on the composite is immaterial. Bundled fee accounts pay a fee based on a percentage of assets under management. Other than brokerage commissions this fee may include investment management, portfolio monitoring, consulting services, and custodial services. As of 12/31/10 bundled fee paying accounts represented 0.3% of composite assets, as of 12/31/11 they represented 0.4%, as of 12/31/12 they represented 0.3%, and as of 12/31/13 they represented 1.8%. Prior to December 1, 2010 there were no bundled fee paying accounts in the composite.