AMI Equity Income Quarterly Update

Growth Through Stability

Q1 ▪ 2021

Strategy Overview

In Q1, the markets rose as the vaccine rollout began in earnest, slowly accelerating distribution with nearly 20% of the U.S. population now fully vaccinated. This has driven states to ease restrictions across the board, allowing many businesses to reopen and rehire employees that were previously furloughed. Also boosting economic optimism was another round of fiscal stimulus which was passed in the form of a $1.9 trillion relief package, with the Biden administration also proposing a $2.2 trillion infrastructure bill at the end of the quarter. We believe our companies have sufficient exposure to an increase in economic activity such that we can benefit from these proposals. Higher consumer spending has helped our positions in Home Depot and Target. The increased economic optimism has also driven interest rates higher, which has benefitted Schwab and J.P. Morgan. In addition, we added another bank during the quarter, Comerica, which we believe is exposed to high growth regions in the U.S. and can also benefit from a growing economy in the form of loan growth and higher margins. The company also has a near 4% dividend yield. We also added to our position in Broadcom which we believe can continue to grow as demand for semiconductors remains elevated amid growth in industrial applications, auto sales, and traditional use cases such as telephony and data centers.

The other side to this is that stocks that did extremely well during the pandemic have lost some luster. Specifically, Consumer Staples stocks which had a banner year as pantries were loaded, have seen their shares languish on a relative basis. We continue to believe our holdings in the sector remain well capitalized and the Equity Income portfolio strives to seek a balance between companies that should fare well in an economic recovery but also do well should this economic recovery be bumpy. As always, we seek capital preservation, earnings growth, and a steady or growing dividend income stream. We believe the companies in the portfolio should achieve these objectives.

In Q1, the Large Cap Equity Income strategy rose 3.40% (3.15% on a net basis), vs. the S&P 500 index, which rose 6.17%. Approximately two-thirds of the relative performance was driven by asset allocation, with the balance driven by security selection. Outperforming stock picks in Financial and Industrials were offset by picks in Healthcare and Technology. Being underweight Technology and Utilities helped but this was offset by being underweight Energy and being overweight Consumer Staples.

The top contributors to Q1 performance J.P. Morgan, Schwab, Kansas City Southern, Avery Dennison, and Target. The bottom contributors to Q1 performance were Merck, Pepsi, Walmart, Ball, and Apple.

Top Contributors in Q1		
Company	**Avg. Weight**	**Contribution**
J.P. Morgan	3.95%	0.74%
Schwab	3.14%	0.66%
Kansas City Southern	2.31%	0.65%
Avery	2.80%	0.49%
Target	3.95%	0.47%

**Please see last page for important disclosures.

Bottom Contributors in Q1		
Company	**Avg. Weight**	**Contribution**
Merck	2.58%	-0.14%
Pepsi	3.41%	-0.15%
Walmart	2.82%	-0.16%
Ball Corp.	2.35%	-0.23%
Apple	6.84%	-0.57%

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AMI
ASSET MANAGEMENT

Top Contributors

J.P. Morgan posted a strong Q4 as vaccine development gave the bank confidence on its loan book, allowing for a significant credit reserve release. The investment banking and trading businesses also had a banner quarter, helping to increase non-interest revenue 13% higher y/y. The consumer appears healthier with mortgage and auto activity up and credit card charge-offs fell more than $600M y/y. The company plans to resume share buybacks in Q1.

Schwab stock benefitted from the rise in interest rates in Q1 as the company generates over 50% of revenue from the spread on interest rates. Schwab earnings have been impacted since the Fed cut rates last year and an uptick in rates is signaling a possible return to more normal interest rate levels.

Kansas City Southern ended Q1 on a high note after announcing its strategic merger with another major railroad, Canadian Pacific. The deal values the company at $29 billion ($275 per share) in cash and stock and is expected to close next year.

Avery Dennison reported a better-than-expected Q4, driven by increased volumes in the core label business as the economy reopened. Improving demand trends in Q4 led to FY21 guidance that was well above estimates. Optimism over continued economic recovery, as well as company-specific productivity initiatives and longer-term growth in high-value segments (RFID) sets the stock up well for FY21 and beyond.

Target experienced continued strength in Q4 as recent investments in digital and other pick-up options are helping to drive growth, and management noted that they plan to increase investment in these areas, citing customer convenience. Target has been investing in omnichannel, spending on Covid-protection for stores and employees, and yet has been able to still gain operating leverage and improve margins. The company has also resumed share repurchases during the quarter.

Bottom Contributors

Merck continues to see Covid-related headwinds with a $400M negative impact in Q4 given the company's higher physician injected exposure. Better expense controls offset the impact, but not enough to meet consensus estimates. Given much of this is somewhat expected, the guidance, which was better than estimates, was encouraging. Keytruda continues to do well and is expected to do so. The much-anticipated CEO succession plan was also announced with long-time CEO Ken Frazier being replaced by the current CFO (Rob Davis) effective June 30.

Pepsi reported solid Q4 results and gave FY21 guidance that was in-line with estimates. The stock lagged during the quarter as all Consumer Staples generally fell out of favor, with difficult comparisons in 2021, elevated input costs and rising interest rates. We continue to like Pepsi as we believe the company's advantaged portfolio of snacking and beverage brands should drive superior organic growth over the long-term, while also benefitting from some areas of the economy that will reopen in 2021, such as on-premise beverage consumption and the snacks business in convenience stores.

Walmart's Q4 revenue was strong although EPS missed expectations on some one-time items and higher COVID costs. Comps were also much stronger than expected as consumer buying patterns and methods, which changed during COVID, has largely persisted and company expects this to continue. Some investor heartburn over the rise in wages but company seems to be managing this with EPS guidance inline with consensus. Walmart is taking share in many categories and has improved its online sales program. This should bode well as margins bottom (Covid costs offset some wage pressure). Capital return also increasing should limit downside.

Ball reported Q4 FY20 results above estimates, although demand continues to outstrip supply as Ball invests to increase capacity. Ball is planning to spend at elevated levels during FY21 and into the near future to build new plants to meet this demand, which will be a near-term headwind to cash flow growth. Despite these additional costs, we continue to view the beverage can space positively as demand shifts away from plastics and towards aluminum driven by sustainability concerns

Apple blew past Q1 expectations for almost all products, especially the iPhone as the 5G cycle is off to a strong start. Apple continues to benefit from stay-at-home measures as consumers needed to upgrade their home office and home school environment. Similar to other technology companies, Apple shares pulled back from very lofty levels at the end of December, as investors sought other sectors in which to invest. Given the more than 80% increase in Apple's share price in 2020, this pause is not unexpected. We remain bullish on the company's prospects on the 5G upgrade cycle which could accelerate as world economies reopen.

Portfolio Additions & Deletions

In Q1, we added Comerica.

Comerica is a regional bank delivering banking services in Texas, California, Florida, Arizona, and Michigan. The company offers a variety of traditional banking services such as commercial lending, retail banking (deposits, mortgages, etc.), and wealth management. We like the company's regional focus and its recent focus on cost which has helped drive earnings, even in a low interest environment. As rates normalize and the economy strengthens, we believe Comerica can be a beneficiary as loan growth and net interest income improve and credit reserves fall. The company has a 3.9% dividend yield and its dividend has been stable.

Disclosures

* Performance Disclosures: AMI Asset Management (AMI) is an independent investment management firm registered with the Securities and Exchange Commission since 1994. Registration does not imply a certain level of skill or training. AMI provides discretionary asset management services to institutional and individual clients through separately managed accounts using seven equity and fixed income strategies. The Domestic Large Cap Equity Income Composite includes all fully discretionary, fee-paying and non-fee-paying, taxable and nontaxable accounts with at least $400,000 in large cap equity income securities on the last day of each previous quarter. The composite was created on January 1, 2015. Returns are presented gross and net of management fees and include the reinvestment of all income. Gross returns are presented before management fees but after all trading expenses. Net returns are calculated by deducting 1/4th of the highest applicable annual fee of 1.00% from the gross composite returns on a quarterly basis. Clients should not assume that managed accounts will attain similar investment performance in the future. All accounts are individually managed; therefore, returns for separate accounts may be higher or lower than the average performance stated above. The benchmark we use is the S&P 500® Total Return Index which is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. It includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The S&P 500® Total Return focuses on the large cap segment of the market with over 80% coverage of U.S. equities. Index performance is provided as a point of reference only and does not imply that a Strategy will achieve returns, volatility, or other results similar to the index. The total returns for the index do not reflect the deduction of any fees or expenses which would reduce returns. Indices are unmanaged, and one cannot invest directly in an index.

** Source: AMI and Bloomberg. The top five and bottom five contributors information is based on a representative account taken from the AMI Large Cap Equity Income composite. The representative account was selected because it closely reflects the AMI Large Cap Equity Income investment strategy. Due to factors such as portfolio size, specific investment guidelines and inception dates of individual accounts, there will be dispersion between the weight, returns, and contributions of this account and other accounts in the composite. The Contribution is calculated by multiplying the weight (i.e., percentage of the total account) invested in each holding times the rate of return for that holding during the measurement period. The holdings identified do not represent all of the securities purchased, sold or recommended for AMI's clients. Actual client holdings and characteristics may vary and holdings are subject to change. The reader should not assume that (1) an investment in the securities identified was or will be profitable or (2) that the AMI Large Cap Equity Income Strategy will hold these stocks in the future. References to specific securities are not intended as representative of past recommendations by AMI. The securities shown should not be considered recommendations or solicitations and may not have been, or in the future be, profitable. Nothing presented herein is or is intended to constitute investment advice, and no investment decision should be made based on any information provided herein. Past performance is not an indication of future returns. There is a risk of loss from an investment in securities, including the risk of loss of principal.

To obtain free of charge (1) a complete list of composite descriptions, (2) the calculation's methodology and a list showing every holding's contribution to the overall account's performance during the measurement period, and/or (3) a complete list of all buy and sell recommendations for this strategy within the last 12 months, please contact Katharine Kim at (424) 320-4003 or katharine@amiassetmanagement.com.