AMI Equity Income Quarterly Update

Growth Through Stability

Q3 ▪ 2020

Strategy Overview

Similar to actions taken last quarter, in Q3 we made several small adjustments to the portfolio as a result of the impact on the economy from the coronavirus. Many of the companies that did well in Q2, like Target, Wal-Mart, and Home Depot, continued to do well in Q3. As seen in the pages below, we added two new Healthcare companies as we believe there will be an increased focus on health long after the pandemic subsides. In addition, we added to existing positions in a few of our food companies as we believe at-home food consumption will remain elevated in the near term until a vaccine is approved and produced at scale. We also added to our position in JP Morgan. Despite the challenges of operating in a zero-interest rate environment, JP Morgan is the preeminent banking franchise and should emerge a winner as the economy recovers. Moreover, the company's more than 3.5% dividend yield is attractive relative to other investments. The Equity Income portfolio strives to seek a balance between companies that should fare well should the economic recover falter but also do well should economic growth accelerate. 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 Q3, the Large Cap Equity Income strategy rose 9.53% (9.28% on a net basis), vs. the S&P 500 index, which rose 8.93%. Performance was driven mostly from asset allocation with security selection being a slight detractor. Outperforming stock picks in Technology and Healthcare were offset by picks in Materials and Utilities. Being underweight Energy and overweight Materials helped performance. This was partially offset by being underweight Technology and overweight Utilities.

The top contributors to Q3 performance were Apple, Target, Church & Dwight, McDonald's, and Kansas City Southern. The bottom contributors to Q3 performance were Becton Dickinson, AT&T, Medical Properties Trust, Energizer Holdings and Reynolds Consumer Products.

Top Contributors in Q3

Company	Avg. Weight	Contribution
Apple	6.31%	1.54%
Target	3.16%	0.92%
Church & Dwight	3.28%	0.66%
McDonald's	3.26%	0.60%
Kansas City Southern	2.17%	0.46%

**Please see last page for important disclosures.

Bottom Contributors in Q3

Company	Avg. Weight	Contribution
Becton Dickinson	3.34%	-0.04%
AT&T	3.02%	-0.10%
Medical Properties Trust	1.94%	-0.12%
Energizer Holdings	1.39%	-0.25%
Reynolds Consumer	2.29%	-0.41%

**Please see last page for important disclosures.

Top Contributors

Apple posted a very strong fiscal Q3 with iPhone revenue rising despite store closures throughout much of the world. Mac and iPad were even more impressive, clearly benefiting from the need for additional devices to be able to work and attend school from home. The company also announced a stock split which increased interest in owning the shares among retail investors.

Target executed well in Q2, easily beating the already high expectations and proving to be a best-in-class retailer. A lot of this is driven by the company's successful implementation of delivery (Shipt) and BOPIS (buy-online-pickup-in-store). Q2 saw higher-margin merchandise sales recover with strength across the board. Based on commentary from management, they do not see the online success in Q2 abating materially any time soon.

Church and Dwight reported Q2 results above expectations, as demand for detergent and vitamins accelerated meaningfully as people spent more time at home. Given the unprecedented demand for Church's core products, profitability also grew meaningfully as the company was able to scale back promotions and marketing. While unlikely that demand will remain at such elevated levels in perpetuity, Church's well-known brands should allow the company to continue to perform well over time.

As expected, McDonald's Q2 results were down given restaurant closures across the world. The U.S. fared better and what was most encouraging was the significant improvement in comps throughout the quarter and that July comps turned positive. With 99% of stores open for business, albeit mostly drive-thru and takeaway, and plans for 950 new stores, the company strongly believes Q2 was the bottom in terms of results.

Despite Q2 being down year-over-year from a volume and revenue standpoint, Kansas City Southern noted that its operational improvements have helped to preserve margins. The company also believes railcar volumes have bottomed as businesses in the U.S. and Mexico have begun to reopen. A perhaps bigger catalyst for the shares was the report that private equity firms were interested in acquiring the railroad and take it private at a significant premium to the share price. Currently, the two sides remain at odds over the value of the company so it is unclear if a transaction will occur. Even absent a deal, we believe the progress the company has made on the operational front, combined with improving volumes, should bode well for the company.

Bottom Contributors

Becton Dickinson reported better-than-expected earnings in July, but it was affected by the shutdown of elective procedures which offset the benefit from COVID-related sales. The company is also being impacted by a recall of infusion pumps that somewhat muddles the quarterly results. As COVID cases began to rise again in September, investors feared that elective procedures could be shut down again, resulting in weakness in the medical device industry. However, we do not envision this happening and expect earnings growth to improve going forward as electives have resumed and COVID testing levels remain elevated, which benefits Becton's diagnostics business.

AT&T's Q2 results were largely in line with expectations. The Entertainment group was down but improved vs. the prior quarter. However, the lack of theatrical and lower ad revenue hurt the newly acquired Warner business. The company incurred a high level of debt when it acquired Warner Bros. and given the current state of the film and TV business, this could put a strain on the dividend. As a result, we felt it was prudent to exit the position.

Q2 was strong as the Medical Property Trust's portfolio of hospitals have begun to restart elective procedures. Volumes have returned or exceeded pre-Covid levels. Importantly, cash flows from the company's portfolio are more than 2.5x lease payments which is a key measure of the health of the portfolio. The underlying operators also have ample liquidity (over $5B) and 98% are paying rents.

Energizer's Q3 was below expectations as the company is incurring additional COVID-related costs which will also impact Q4. These costs appear to be transitory and should normalize over time. The company is still seeing high demand and share gains and no excess inventory in pantries. Positive trends in the auto care segment also boosted confidence. Overall organic growth is better than expected and once costs return to normal levels, we believe earnings growth should also return.

Reynold's reported decent Q2 results, but the company's sales growth from people cooking and baking more at home was below elevated expectations. Much of the blame for the disappointment was poor communication from Reynolds, which as a brand-new public company failed to effectively delineate how reported results would differ from sales reported through data from Nielson. That said, later in the quarter the company raised guidance for Q3 and expects elevated demand for its products to persist well into next year. Now that the communications issues are in the past and expectations are set more appropriately, we expect Reynolds will perform well moving forward.

Portfolio Additions & Deletions

In Q3, we added Johnson & Johnson and Merck. We exited our position in SAIC and AT&T.

JNJ's high level of diversification makes it a relatively resilient company to own during uncertain economic times. The company pharmaceutical division is performing well as new and existing drugs (Imbruvica, Stelara, and Darzalex) continue to grow nicely. The company's pipeline (new and extended label) also remains robust which could fuel growth if and when those drugs come to market. Some of the positive results in pharma are being offset by some sluggishness in medical devices due to coronavirus delaying certain procedures but we believe this will return. The company is also advancing in trials for a COVID-19 vaccine which could also provide additional upside. We believe that these attributes plus a dividend yield above 2.5% make the company an attractive opportunity at current levels.

Merck has become a leader in oncology and vaccine treatments and has a pipeline of underappreciated assets in these areas. The market discounts the stock due to the high percentage of revenue associated with Keytruda (LOE in 2025) but the pipeline optionality coupled with a strong, under-leveraged balance sheet provides for strategic opportunities which could help the company navigate through that event. Moreover, the margin profile of the company could improve following the spin-off of the women's health business (Oraganon). Thus, we believe the shares are undervalued at current levels plus offer a dividend yield above 3%.

Despite an average Q2, SAIC's top-line growth remained sluggish even though their main customer is the U.S. government to which SAIC provides an essential service. Despite recent acquisitions and a large increase in defense spending, SAIC's growth prospects did not improve as much as we anticipated. This, combined with the prospect of ongoing budget battles in Congress in a new administration, we believed that there were better growth opportunities within small cap technology and exited the position.

As mentioned previously, we sold our position in AT&T.

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.