Alley Company Dividend Portfolio
2019 Q2 Letter

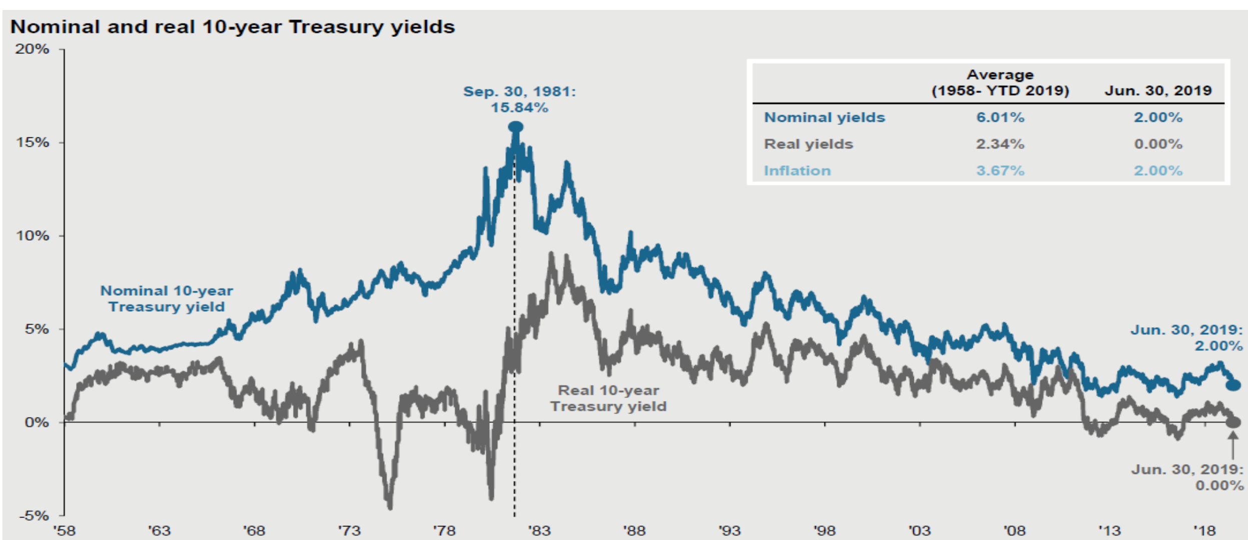
July 16, 2019

It is remarkable that the ten-year U.S. Treasury bond is now yielding 2 percent, back to near the lowest levels in recorded history. We have long posited that interest rates could stay "*lower for longer*," but ten years into a solid economic expansion and with the unemployment rate near record lows, two percent is indeed noteworthy.

Inflation, which has been in the range of 1.5 to 2.0 percent for most of the past decade, is technically the most important determinant of the level of long-term interest rates (see exhibit below[1]) and has been a major contributor to the lower for longer interest rate regime we are experiencing. There are a number of reasons why inflation has remained so low during the past ten years, all of which have served to keep interest rates low. The following are a few examples:

- Technological innovation that has increased competition for goods and services globally
- Slowing population growth in the U.S.
- Anemic growth in developed economies outside the U.S., where some major economies such as Germany and Japan have long-term interest rates that are actually *negative*
- Consumers living within their means post the Great Recession
- Increased regulation of the U.S. financial and banking system which has helped to rein in risky lending practices

Interest Rates and Inflation



Source: JP Morgan Guide to the Markets

Alley Company LLC
585 Bank Lane, Suite 2400
Lake Forest, IL 60045
Phone 847-482-0938
Fax 847-482-1237
www.alleycompanyllc.com

With interest rates low around the world, investing in high-quality dividend paying equities is an attractive alternative. In today's environment, we strive to find companies that can sustain and grow a healthy dividend payment to shareholders. Recently, our portfolio has had an average yield of approximately 3 percent and annual dividend growth in the high-single-digit range. This yield and growth combination can compete favorably with most fixed income alternatives and can stand up well versus alternatives in the equity market from a risk-adjusted return perspective.

Quarterly Performance Update

The Alley Company Dividend Portfolio outperformed the Russell 1000 Value Index in the second quarter and has outperformed the index on a year-to-date basis as well.

Top contributors and detractors from an individual holdings perspective in the second quarter were:

Top Contributors	Top Detractors
Lockheed Martin (LMT)	Altria (MO)
Microsoft (MSFT)	3M (MMM)
Starbucks (SBUX)	Abbvie (ABBV)

Top and bottom sectors in the marketplace during the quarter were:

Top Performing Sectors	Bottom Performing Sectors
Financials (-)	Energy (-)
Materials (-)	Health Care (-)
Technology (+)	Real Estate (+/-)

(+) indicates that the portfolio is overweight this sector and (-) indicates that the portfolio is underweight this sector relative to the benchmark.

Dividend announcements among Alley Company Dividend Portfolio holdings during the quarter were:

Company	Dividend Change
Apple (AAPL)	+5%
Discover Financial Services (DFS)	+10%
Exxon Mobil (XOM)	+6%
JPMorgan Chase (JPM)	+13%
Medtronic (MDT)	+8%
Paychex (PAYX)	+11%
Procter & Gamble (PG)	+4%
Wells Fargo (WFC)	+13%

During the past quarter, Broadridge Financial (BR) and Six Flags (SIX) were sold in their entirety, while new positions in Pepsico (PEP) and Phillips 66 (PSX) were initiated.

Broadridge was additive to the portfolio during the time in which we owned it, but the current valuation along with a lower dividend yield at this point in time led us to exit the investment. While we have been impressed with the turnaround of Six Flags over the past decade, we sold our holding as the architect of the turnaround, CEO Jim Reid-Anderson, is retiring and leaving the company. Additionally, we have concerns that the company's balance sheet and dividend payout ratio have become extended.

Pepsico (PEP) has built strong businesses through the years in both beverages and snacks. While the beverage business is growing at a more moderate pace these days, the snacks business (Frito-Lay) continues to churn out steady mid-single-digit growth. Both businesses have allowed for consistent earnings growth which has led to solid dividend increases over time. Phillips 66 (PSX) has refinery, mid-stream, and chemical operations. The management of this company has allocated shareholder's capital extremely well since being spun out of Conoco Phillips with significant share buybacks and impressive dividend growth. We look forward to the continued transformation of the company under their capable CEO, Greg Garland, and his team.

Alley Company Dividend Portfolio

The investment philosophy of the Alley Company Dividend Portfolio focuses on striking the balance between attractive absolute dividend yield and strong dividend growth underpinned by solid company fundamentals of our portfolio holdings. We employ a bottom-up, research-driven process focused on fundamental analysis of our portfolio holdings.

Alley Company, LLC

Alley Company is a boutique investment management firm that is dedicated to operating a discernible and disciplined investment philosophy and generating superior risk-adjusted investment returns. Alley Company was founded in 1998 and in 2006 established the Alley Company Dividend Portfolio to capitalize on investment opportunities in quality companies with strong dividend-paying cultures.

---

[1] The graph plots the nominal ten-year Treasury yield and the real ten-year Treasury yield. The difference between the two is the rate of inflation. During the past decade, real yields have come down significantly and have hovered around 0% for the past seven years.