ALLEY COMPANY

Separate Account Investment Management

Alley Company Dividend Portfolio
2019 Q4 Letter

January 22, 2020

As the calendar turns to a new decade, many investors will take this opportunity to re-evaluate the "big picture," including goals, objectives, and risk tolerance, and reaffirm their commitment to a disciplined investment philosophy.

As a useful guide, investors can look back at historical investment returns of the stock and bond market over the past nine decades (see table below) for some instructive insights.

Stocks, Bonds, and Risk by Decade

Decade	Bond Market	Stock Market	Stock Market Standard Deviation	$1.00 in Stock Market grew to:
2010s	3.8%	13.5%	11.6	$3.55
2000s	6.3%	-1.0%	20.2	$0.91
1990s	7.7%	18.3%	13.7	$5.37
1980s	12.4%	17.7%	12.2	$5.09
1970s	7.0%	5.8%	18.7	$1.76
1960s	3.5%	7.8%	14.2	$2.11
1950s	1.3%	19.6%	19.1	$5.99
1940s	1.8%	9.1%	16.1	$2.38
1930s	4.6%	-0.1%	33.1	$0.99
Averages:	**5.4%**	**10.1%**	**17.7**	**$3.13**

Notes: Stock market data is obtained from Prof. Robert Shiller and Yahoo Finance and represents the S&P 500 Index. Bond Market data is obtained from Morningstar and represents a broad Government Bond Index. All return data represents the Compound Annual Growth Rate (CAGR) for the period defined. Standard Deviation is a statistical measurement of the volatility of returns and is commonly cited as a measurement of risk (the higher the standard deviation, the higher the risk associated with the period measured). Past performance is not a guarantee of future results. The impact of inflation is not reflected in these data. Investors cannot invest directly in an index.

There are any number of observations that can be taken from the data above – the following is a short list to help investors think about moving forward into the next decade:

- Stock market returns on average have been almost double bond market returns. This reflects the reward that equity investors typically receive for the willingness, ability, and mindset of being an owner in a business relative to that of being a lender to a business.

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- While stock market returns in the 2010s were indeed above average, this would be at least somewhat expected having come off the worst decade in modern history. (The 2000s included not just one, but two bear-market periods, including the aftermath of the dot com bubble and the September 11th terrorist attacks as well as the global financial crisis itself.)

- The poorest returns for the bond market occurred in the 1940s and 1950s – this was an extended period of low interest rates in the U.S. Today's interest rate environment is showing similar signs to that two-decade period.

- Despite seemingly no shortage of risk factors in the 2010s (e.g., geopolitical tensions, divisiveness in U.S. politics, negative interest rates outside the U.S. and inverted yield curves inside the U.S., etc., etc.), the decade actually had the lowest risk of the past nine as measured by the standard deviation of returns. The highest risk periods (1930s and 2000s) tend to occur around major disruptions in markets.

- The 1980s and 1990s were back-to-back banner decades. While this period was fruitful for investors in that era, it left valuations in the stock market at peak levels at the end of the 1990s. The table below depicts the high valuation levels of that time and how valuations today are far less lofty, especially when considering the respective levels of interest rates and relatively attractive dividend yields.

Valuation Comparison – Then and Now

Metric	2000	Today
S&P 500 Index	1,527	3,283
Forward P/E Ratio	27.2x	18.2x
Dividend Yield	1.1%	1.8%
10-Year Treasury Yield	6.2%	1.8%
Percent of S&P 500 Companies w/ Div. Yield greater than 10-Yr. Treasury Yield	6%	54%

Notes: Data for '2000' is obtained from Barron's and is as of the market peak of March 24, 2000. Data for 'Today' is obtained from Thomson Reuters and JPM Guide to the Markets and is as of January 14, 2020. Forward P/E Ratio represents the index price divided by the expected next-twelve-months earnings per share.

At the dawn of a new decade, big and important trends have developed and look likely to continue with positive implications for investors: the use of various forms of technology are permeating the business world on a global basis, leading to advances in productivity; innovation in healthcare is leading to better outcomes, including a declining cancer death rate; the consumer sector of the economy, which represents two-thirds of U.S. GDP, is benefiting from low unemployment and rising real wages; the U.S. banking sector is arguably in its strongest position ever based on capital ratios and low loan losses; the U.S. has reached "energy independence" after decades of relying on others for these resources; and low interest rates are both a boon to borrowers and represent a low 'discount rate' for the valuation of equity securities.

Notwithstanding some favorable macro-oriented factors discussed above, we will continue to manage the Alley Company Dividend Portfolio on a “bottom-up” fundamental analysis basis. Our investment philosophy and process have not changed since the inception of our portfolio and we will continue to run the portfolio with the same discipline for the next decade and beyond.

Quarterly Performance Update

The Alley Company Dividend Portfolio modestly underperformed the Russell 1000 Value Index in the fourth quarter. For the full year 2019, the portfolio had a strong year of relative performance, outperforming the Russell 1000 Value Index by a nice margin.

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

Top Contributors	Top Detractors
Apple (AAPL)	Home Depot (HD)
Altria (MO)	BCE Inc. (BCE)
JPMorgan Chase & Co. (JPM)	Kimberly-Clark (KMB)

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

Top Performing Sectors	Bottom Performing Sectors
Technology (+)	Real Estate (+/-)
Health Care (+)	Utilities (-)
Financials (-)	Consumer Staples (+)

(+) 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
Abbott Laboratories (ABT)	+13%
Abbvie (ABBV)	+10%
Crown Castle Intl. (CCI)	+7%
JPMorgan Chase & Co. (JPM)	+13%
Merck (MRK)	+11%
RPM International (RPM)	+3%
Starbucks (SBUX)	+14%

During the fourth quarter, position sizes in Apple (AAPL) and Microsoft (MSFT) were trimmed in favor of increased weightings in Abbvie (ABBV), Verizon (VZ), and Wells Fargo (WFC).

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.