TRIBUTARY
CAPITAL MANAGEMENT

EQUITY INCOME MARKET COMMENTARY

PORTFOLIO MANAGERS: DON RADTKE & NICHOLAS NEVOLE | **FIRST QUARTER 2019**

	Quarter	YTD	1 Year	3 Years
Tributary Capital Management (Gross of Fees)	12.0%	12.0%	10.7%	11.9%
Tributary Capital Management (Net of Fees)	11.9%	11.9%	10.2%	11.3%
Russell 1000 Value Index	11.9%	11.9%	5.7%	10.5%
S&P 500 Index	13.7%	13.7%	9.5%	13.5%

PORTFOLIO REVIEW

The Equity Income Strategy performed well in the first quarter, +11.9%, as equity markets rebounded from the late selloff in 2018. This rally has largely been driven by the expansion of valuation multiples as markets have climbed higher while earnings growth expectations have continued to slow. This is evidenced by the S&P 500 P/E expanding from 14.4x at the beginning of the year to 16.4x at the end of March, a 14% increase. The S&P 500 generated a solid return of +13.7% while the Russell 1000 Value, a benchmark commonly utilized by equity income strategies, returned +11.9% for the first quarter.[1]

Of particular importance to this and other income-oriented strategies was the Fed's change in tone to a more dovish stance in January. Fed funds futures are now indicating a 0% chance of a rate hike and a 55% chance of at least one rate cut by the end of 2019.[2] This has brought investor interest back to some of the higher yielding areas of the equity market. As of quarter end, our Equity Income strategy is yielding 2.9% compared to the S&P 500 Index of 2.0% and Russell 1000 Value of 2.6%.[1] Dividend yield is an important component in managing this strategy but not the only factor we use to assess current and potential holdings. We also want to invest in quality companies that can grow their dividends over time while maintaining a diverse portfolio across sectors.

For the quarter, information technology (+19%) and industrials (+15%) were the top sector drivers for the strategy's performance, while healthcare (+5%) and financials (+9%) were the only two sectors that did not generate double-digit returns.

TOP CONTRIBUTORS

Things are going well on numerous fronts as **Cisco** has experienced broad based strength despite an increasingly difficult macro environment. Management continues to successfully transition the business to a higher margin, recurring software and subscription model. The company is also increasing its capital returns to shareholders via a growing dividend payment and a large share repurchase plan.

Nestlé closed 2018 above expectations, it is expecting to finish its share buyback plan ahead of schedule, and management is exploring a possible sale of its charcuterie business.

Paychex continues to execute well and is expecting double-digit EPS growth in 2019.

Air Products is generating mid-single digit volume growth on top of pricing traction. Combined with margin improvement, Air Products is generating good earnings growth at a time when more commodity-type materials names are facing pressures.

A portion of **Accenture's** outperformance in the first quarter was a result of the stock's underperformance in fourth quarter on recession fears. Accenture also closed out the quarter with a strong earnings report.

TOP DETRACTORS

Investors had mixed reactions of **Altria's** recent investments in JUUL and a cannabis company, and the additional debt results in a riskier balance sheet. Regulatory risks have also increased lately with more scrutiny on menthol and other flavored products.

Pfizer reported reasonable fourth quarter results but initial 2019 guidance came in below expectations. It is worth noting that the company's pipeline still looks strong entering 2020.

Amgen reported decent fourth quarter results, but initial 2019 EPS guidance came in below consensus expectations.

RPM is undergoing a restructuring plan which is expected to eventually generate solid margin improvement, but this will take time to work through. In the meantime, the company reported an all-around weak quarter in early January which weighed on the shares.

The performance "drag" from **Leidos** was more due to our shortened holding period (it was added in mid-March) than poor performance in the stock.

PORTFOLIO CHANGES

There was one addition to the Strategy this quarter. *Leidos* is a provider of IT and professional services to the U.S. Government. This business has higher visibility, less volatile revenue streams, the opportunity for margin improvement and a relatively attractive dividend yield for an IT company.

There was one elimination from the Strategy during the quarter. *Altria* was eliminated from the strategy due to a few recent investments in non-core businesses (JUUL and a cannabis company), management's decision to significantly increase debt and heightened regulatory risks.

PORTFOLIO OUTLOOK

Equity markets have acted in a bipolar manner of late, with prospects for slowing growth pushing stocks down in a dramatic fourth quarter selloff. The start of the year followed with an optimistic recovery fueled, in part, by the Fed's decision to back off its hawkish interest rate trajectory and move to the sidelines.

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The stock market's recovery does not imply that all is well. We have observed cuts to earnings estimates, reduced global GDP expectations and a yield curve that inverted during the quarter. Recent speculation about broader EU tariffs is also negative after indications that the U.S. and China have been making progress on a trade agreement.

The U.S. economy is slowing but is underpinned by a number of positive fundamental factors. According to the Bureau of Labor Statistics, employment remains strong across all age groups. Recently, real wages have begun increasing and outpacing inflation. Nearly 70% of the U.S. economy is driven by personal consumption and a strong consumer can continue to drive broader economic growth. Additionally, mortgage rates are currently hovering near 4%, which should support a housing market that has yet to fully recover.

The S&P 500's 16.4x price/forward 12 month EPS valuation is over one turn above the longer term average, but is also roughly the average of the past five years. Large cap stocks are not cheap, but they are not at overly inflated values either. We believe the high quality companies in our portfolio will be able to grow their intrinsic value over time as the economy continues to expand, and our preference for low leverage will help us protect capital if markets are turbulent. Our search for good companies at attractive valuations continues every day.

[1] Factset Research Systems

[2] CME FedWatch Tool

The performance numbers shown above are for the Tributary Equity Income Composite and are expressed in U.S. dollars. The composite includes all discretionary accounts with an initial market value of $750,000 that are generally invested in the Equity Income Strategy. The inception date of the Equity Income Composite is September 30, 2014.

The S&P 500 Index is a basket of 500 stocks that is weighted by market value, and its performance is thought to be representative of the stock market as a whole. The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance. It is not possible to invest directly in the S&P 500, FTSE High Dividend Yield Index, Russell 1000 Index or the S&P 500® Equal Weight Index.

Net performance is reported using the standard management fee schedule and transaction costs. Capital gains and dividends are reinvested for performance calculations.

It should not be assumed that an investment in securities identified was or will be profitable or that the investment decisions we make in the future will be profitable or will equal the performance of the securities discussed herein. Holdings are subject to change. The holdings identified do not represent all of the securities purchased, sold or recommended for the portfolio. The holdings listed should not be considered recommendations to purchase or sell a particular security. The "Top Contributors" and "Top Detractors" represented are based on contribution to portfolio return. To obtain the contribution calculation methodology and a complete list of every holding's contribution to the overall portfolio's performance during the quarter, please contact clientservices@tributarycapital.com. Sector performance in commentary is stated gross of fees.

Tributary, an SEC Registered Investment Adviser, is the combined entity of the prior Tributary (formed Jan. 1, 2005) and First Investment Group (formerly a department of First National Bank of Omaha) which merged in May 2010. This event constituted a change in ownership only, as the investment strategies and personnel remained the same for each of the prior firms. Tributary is a wholly owned subsidiary of First National Bank, a wholly owned subsidiary of First National of Nebraska, Inc. and manages mutual funds and equity and balanced portfolios. Tributary Capital Management, LLC ("Tributary") claims compliance with the Global Investment Performance Standards (GIPS®). A fully compliant presentation can be requested by emailing clientservices@tributarycapital.com.

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