Dividend Growth

Portfolio Update: Second Quarter 2019

The Dividend Growth Portfolio (the "Portfolio") increased +5.09% gross of fees (+4.97% net of fees) in the second quarter of 2019, modestly ahead of the S&P 500 Index and Morningstar U.S. Dividend Growth Index, which increased +4.30% and +4.65%, respectively. Year to date, the Portfolio increased +18.11% gross of fees (+17.84% net of fees) versus +18.54% for the S&P 500 and +16.63% for the Morningstar index.

	3 Months	YTD	1 Year	3 Years	5 Years	10 Years	Since Inception (Annualized)
Dividend Growth Strategy	+4.97%	+17.84%	+13.28%	+13.28%	+8.95%	+11.68%	+6.87%
S&P 500 Index	+4.30%	+18.54%	+10.42%	+14.19%	+10.71%	+14.70%	+8.87%
Morningstar U.S. Dividend Growth Index	+4.65%	+16.63%	+14.33%	+14.61%	+11.43%	+15.08%	+9.77%

Inception date: April 1, 2005. Performance is presented net of RMB Asset Management's maximum management fee and transaction costs. Performance is not net of RMB's Wealth Management advisory fee (if applicable). Please see important disclosures at the end of this document. Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment.

We were encouraged by the Portfolio's relative return in the second quarter, with modestly better relative performance vs. the two benchmarks. Given the substantial rebound in the market year to date, we're also reasonably content with year-to-date returns, as we believe the Portfolio is more defensive than the overall market given the quality of the companies and correspondingly lower-risk profile that we own. Business models with strong economic moats, sound balance sheets, and well-funded, growing dividends should rise to the surface during a time of stress for the market but can lag when "risk on" sentiment is pervasive as it has been year to date. From a traditional attribution perspective, the Portfolio's outperformance in the second quarter vs. the S&P 500 was mainly driven by sector allocation with a small positive contribution from stock selection. The technology sector was the dominant positive contributor followed by energy and consumer staples, partially offset by a negative contribution from the consumer discretionary sector. We will discuss individual holdings impact on performance in a bit.

The second-quarter market environment was a continuation of the rebound from the late 2018 selloff with most major indexes approaching or exceeding new all-time highs. Keeping with the storyline from last year, domestic headlines continued to be dominated by the trade war between the U.S. and China, with the pendulum swinging between optimism and pessimism around the likelihood of an eventual deal. This overhang comes at a time when economic data continues to show more signs of slowing global growth. The U.S. has remained one of the strongest and most resilient economies in the world over the past couple of years, although recent domestic data points are pointing to some deceleration post a very strong 2018. This slowdown has been reflected in the bond market with the 10-year Treasury yield falling 40 basis points from 2.41% to 2.01% in the quarter and down from 3.06% just three quarters ago. A flattish yield curve is telling us that the bond market is pricing in an increased probability of an economic recession over the next one to two years. The Fed has also taken a dramatic change in its tone with the market expectation for two to three 25-basis point *cuts* in 2019. Remember, it was only a year ago when consensus for the Fed policy direction was multiple *hikes* going forward. It's quite remarkable how quickly we've gone from a hawkish to dovish environment, and we'll get another update on Fed policy on the last day of July. Thus far, the stock market has applauded lower rates, outweighing slowing economic data and the higher recession risk implied by the bond market.

First-quarter earnings reports released in the second quarter saw revenues and earnings continue to surprise positively vs. low expectations, although year-over-year earnings growth for the market as a whole was actually negative. While there continues to be concerns under the surface about the sustainability of revenue growth and historically high profit margins, the market has largely shrugged this off thus far. With second-quarter earnings about to be reported as we write this letter, we harbor some concerns about the forward outlook for the second half of 2019 and 2020. Current consensus is for about 4% growth in operating earnings for the S&P 500 in the second half of 2019 (bringing the full year to only +3%), with 12% growth in 2020. These estimates have been slowly revised lower over the past few months, and we wouldn't be surprised to see them notched lower again after the current round of reporting. Estimates for 2020 particularly look overly optimistic at this point. Given high levels of uncertainty around global growth, we would expect management teams to remain on the conservative side when

setting forward expectations and will watch closely for any change in management's tone toward demand for their products and services.

Our message about overall equity valuations is consistent with how we felt at the end of last quarter. While not overly expensive, especially given an even lower interest-rate backdrop, we are not finding bargains to be abundant by any means, particularly in our quality growth universe. From a bottom-up, individual company perspective, the Portfolio has more reward-to-risk ratios under one than it has greater than one. This was much different from where we stood at the end of 2018 after the big fourth-quarter selloff, which reflects the significant rebound in prices year to date without any upward revisions in earnings estimates. Said another way, the market return this year has come entirely from multiple expansion. From a longer-term perspective, we also must be cognizant of the fact that we are, more likely than not, in the late innings of a historically long positive economic cycle. While we do not necessarily see a recession as imminent, the probability continues to grow, and the bond market is sending a strong signal. As we have penned recently, the concept of "peak earnings" has remained a debate these days that, even if the U.S. does not roll into a meaningful economic recession, we could be close to the peak in corporate profitability given outside pressures on margins (particularly wage inflation) and weakening economies outside the U.S. As always, macro-market predictions are very difficult to make, and we remain focused on opportunistic, bottom-up stock selection, continuing to manage a concentrated, yet diversified, portfolio of high-quality individual companies that can grow their earnings and dividends for years into the future. No matter what happens with the current market cycle, we strongly believe the strategy positions us to outperform over the long run without taking undo risk.

Contributors and Detractors

The table to the right shows the Portfolio's largest contributors and detractors to performance ranked by basis point contribution. Microsoft Corp. (MSFT) was the largest contributor as the stock continued to move higher following a strong fiscal third-quarter report showing robust growth in its commercial cloud business and solid growth in both of its business software and personal computing segments. We continue to like Microsoft for its long-term growth and capital return prospects, although we acknowledge the valuation is much less compelling compared to where we first bought the stock a few years ago. Futures exchange operator CME Group Inc. (CME) was the second-largest contributor, rebounding after being the largest detractor in the first quarter. Trading volumes improved as volatility in many of its underlying asset classes increased in the quarter. Volatility is good for business, as it creates demand for trading contracts from the principal users of derivatives. As we told you last quarter, as long-term shareholders, we do not get overly excited on CME during periods of stronger trading volumes, nor worried during slower periods as volumes tend to grow over the very long term. CME is a "toll road" business where it collects fees in a relatively fixed-cost business model such that incremental volumes tend to be very profitable, from which it dividends back nearly all of its free cash flow to shareholders. We continue to like the long-term prospects for CME and consider it a core position for the Portfolio.

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SECOND QUARTER 2019 CONTRIBUTION REPORT

Ranked by Basis Point Contribution

	Basis Point Contribution	Return
Top Contributors		
Microsoft Corp. (MSFT)	+76	+14.00%
CME Group Inc. (CME)	+71	+18.38%
TE Connectivity Ltd. (TEL)	+67	+19.24%
Starbucks Corp. (SBUX)	+54	+13.29%
CDW Corp. (CDW)	+53	+15.51%
Bottom Detractors		
Lowe's Companies Inc. (LOW)	-0.38	-7.43%
Raytheon Co. (RTN)	-0.19	-6.24%
Amgen Inc. (AMGN)	-0.08	-2.17%
Ritchie Bros. Auctioneers Inc. (RBA)	-0.05	-1.77%
UnitedHealth Group Inc. (UNH)	-0.00	-0.88%

Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. The above does not represent all holdings in the Portfolio. To obtain a copy of RMB's calculation methodology and a list of all holdings with contribution analysis, please contact your service team. The data provided is supplemental. Please see important disclosures at the end of this document.

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On the negative side of the performance ledger, we had a few names whose prices underperformed the market in the quarter, adversely affecting the Portfolio's overall return. Home improvement retailer Lowe's Companies Inc. (LOW) was the largest detractor as the stock declined following a relatively weak fiscal first-quarter earnings report. Lowe's is undergoing a fairly radical transformation under a new, highly regarded CEO that took over leadership of the company about a year ago. While the quarter had both negative external influences (largely weather) and internal missteps that led to the earnings disappointment, we believe that the longer-term strategy to improve profitability and return capital to shareholders holds promise. We used the pullback in the stock to add very modestly to our position, and it remains one of our top holdings at quarter-end. Defense contractor Raytheon Co. (RTN) was the second-largest detractor, which we will discuss shortly given it was a new holding added during the quarter. Amgen Inc. (AMGN), a large biotechnology drug manufacturer, was the third-largest detractor with a small negative return. The stock drifted sideways in the quarter with a modestly disappointing first-quarter earnings report offset later in the quarter by some positive data presented about one of its key pipeline drugs designated for lung cancer treatment. We continue to think the stock is undervalued but have the position sized slightly below average in the Portfolio.

Portfolio Activity

During the second quarter, the Portfolio purchased one new security, Raytheon Co. (RTN), and also exited one name, HVAC equipment distributor Watsco Inc. (WSO). Our sale of Watsco was largely to make room in the Portfolio for Raytheon, but we also had increased fundamental concerns on the name, and its dividend payout ratio rose to a very high level, which could limit future growth. The following is a brief description of Raytheon and our investment thesis as well as some comments on the proposed transaction with United Technologies Corp. (UTX), which was announced shortly after our purchase.

Raytheon is one of just a few Prime Defense contractors in the U.S. The company's focus is on missiles and missile defense, intelligence/surveillance/reconnaissance (ISR), communications, and cyber security, which are well-positioned in the defense budget and well-aligned with the National Defense Strategy. A critical aspect of Raytheon's strategy is having several diversified business "franchises" that can grow over time without being tied to any one high-profile, expensive program like the F-35, refueling tankers, or large Navy ships. Roughly 30% of RTN's sales are to international customers who are approved by the U.S. Government.

TOP 10 HOLDINGS AS OF 6/30/19

Company	% of Assets
Microsoft Corp. (MSFT)	6.01%
American Tower Corp. (AMT)	5.95%
Lowe's Companies Inc. (LOW)	5.02%
Becton, Dickinson and Co. (BDX)	4.76%
Union Pacific Corp. (UNP)	4.62%
Morgan Stanley (MS)	4.44%
Starbucks Corp. (SBUX)	4.35%
CME Group Inc. (CME)	4.30%
Raytheon Co. (RTN)	4.27%
Microchip Technology Inc. (MCHP)	4.22%

Holdings are subject to change. Portfolio characteristics are intended to provide a general view of the entire portfolio, or Index, at a certain point in time. Characteristics are calculated using information obtained from various data sources. Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. The data provided is supplemental. Please see disclosures at the end of this document.

Our thesis is that Raytheon can continue to experience a prolonged period of growth in excess of GDP, driven by its strong position within a moderately growing Department of Defense budget, recent increases in customer-funded R&D that will eventually lead to program wins, and a high and increasing mix of international sales on its long-lived franchise platforms like the Patriot Missile. Margins are likely near the high end of the achievable range, but strong sales growth and low capital intensity will fuel return on invested capital (ROIC) improvement. Strong free-cash-flow dynamics help support continued organic growth, R&D spending, and higher payouts to shareholders. Raytheon has consistently grown its dividend over the past decade and should continue to grow payouts in line with or faster than earnings given its payout ratio is only 32%, and the balance sheet has a low level of net debt. The stock's 2.1% yield is slightly above market, and Raytheon has also consistently returned capital to shareholders through share repurchases, having lowered its shares outstanding by 25% over the last decade. We like this slow and steady de-equitization part of the long-term return profile. With the stock currently trading around 13x next year's earnings estimates, we think there is opportunity for the stock to outperform the market over the next three to five years, particularly if we are in a lower overall market return

environment. From a Portfolio perspective, we also like the defensive, low cyclical nature of the stock's impact on the overall Portfolio.

Shortly after we purchased Raytheon, a merger of equals through a stock swap was announced with United Technologies Corp. (UTX). We have long had a positive view toward UTX as a high-quality collection of aerospace and industrial businesses and coincidentally happen to own the stock in one of the smaller strategies that RMB manages. The proposed merger would bring UTX's aerospace business together with Raytheon to create the second-largest aerospace company. UTX is in the process of spinning off its Carrier HVAC equipment business and Otis elevator business, which would be completed prior to the merger. Our view on the proposed transaction is fairly lukewarm. The strategic benefits don't appear to be all that great, and the $500 million in financial synergies don't seem all that compelling to us either. We can see how the larger company packaged together could have some longer-term appeal to Wall Street given the dampened cyclicality from having both commercial and defense aerospace combined. The balance sheet would have a manageable level of debt, allowing for sizeable capital returns over time. Netting out the positives and negatives, we are sticking with our position in Raytheon and will continue to keep an open mind and learn more about the proposal. There is also an activist investor in United Technologies that is advocating against the merger of equals.

Outlook

From when we last wrote you three months ago, market conditions have remained about the same with the addition of further declines in long-term interest rates and an increasingly accommodative Fed. Market volatility has dampened somewhat, although picked up late in the quarter heading into earnings season. The upcoming corporate earnings report season that is about to kick off will once again refocus the market back on individual company fundamentals, which we think are generally decent for U.S. companies, but we have some areas of concern. Inflationary pressures from a tighter labor market, overseas demand levels, and the shorter-term impact from tariffs will be areas of focus. Given a fair amount of macro uncertainty, we think management teams will continue to have an extra level of conservatism embedded in their 2019 guidance, consistent with the tone that we got last quarter. Near-term U.S. economic data points have generally been decent, although they have decelerated from first-quarter levels. Employment in the U.S. remains quite healthy with improving labor participation rates. However, with unemployment so low, increasing scarcity for skilled labor in various industries is a real problem as many job openings are going unfilled. Real wage growth and consumer confidence should continue to be positive for consumer spending. Consumers in the lower half of income levels should be healthier than they have been in recent years given rising wages and very low unemployment. Rising wages do present a challenge for corporate margins, which have been at or near peak levels. Business confidence remains at high levels, although well off peak, and we have seen some signs that capital investment is no longer accelerating. Much of this near-term slowdown and uncertainty could be attributable to the trade war with China, thus some type of resolution could improve the near-to-intermediate term U.S. economic outlook. We can't ignore that 2020 is a presidential election year, and any type of stimulus to help the economy, including a trade deal, can have an impact on the election.

Overall, we have some reservations about the momentum in U.S. corporate earnings growth, which is the biggest long-term driver of stock prices. We all knew that 2019 earnings growth would slow dramatically as the lower corporate tax rate hit its first-year anniversary, but, as mentioned earlier, there are other sources of risks to revenue growth and margins. Over the past three quarters, market earnings estimates for 2019 have fallen from 10% growth to about 3% growth currently. The cycle of Wall Street earnings estimates being too optimistic and having to be ratcheted back is a recurring pattern that the market typically sees through, but this is still a major reduction in growth expectations. With the overall market multiple having re-inflated from 2018 year-end levels, it now sits a bit under 18x 2019 and 16x 2020. The long-term average for the market is around 16x, but given we may be nearing peak earnings, there might not be a whole lot of value implied in current market expectations. As always, while we may opine on our view of the overall market, we do not pretend to have any ability to predicting where the market is heading in the short or intermediate term. Market timing is a very difficult, if not impossible, task to add value with. We continue to focus the Portfolio's efforts on owning companies with good growth prospects, strong economic moats, underleveraged balance sheets, superior management teams, and an ability to grow dividends. These are

companies we believe can compound value for shareholders years into the future. The opportunities to find high-quality[1] dividend growth companies selling at attractive valuations are becoming more abundant after the recent sell off, and we continue our "bottom-up" search to optimize the Portfolio. Our disciplined investment process focuses on individual company fundamentals and less on the overall market. We also believe that a strategy focused on high-quality companies can distinguish itself in a more volatile market environment.

Thank you for the continued trust you place in us to manage your assets. If you have any questions, please do not hesitate to contact us.

Sincerely,

Todd Griesbach
Portfolio Manager

Past performance is not indicative of future results, and there is a risk of loss of all or part of your investment. The opinions and analyses expressed in this letter are based on RMB Capital Management, LLC's ("RMB Capital") research and professional experience, and are expressed as of the date of our mailing of this letter. Certain information expressed represents an assessment at a specific point in time and is not intended to be a forecast or guarantee of future performance, nor is it intended to speak to any future time periods. RMB Capital makes no warranty or representation, express or implied, nor does RMB Capital accept any liability, with respect to the information and data set forth herein, and RMB Capital specifically disclaims any duty to update any of the information and data contained in this letter. The information and data in this letter does not constitute legal, tax, accounting, investment, or other professional advice. The information provided in this letter should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in the Portfolio at the time you receive this letter or that securities sold have not been repurchased. The securities discussed do not represent the entire Portfolio and in the aggregate may represent only a small percentage of their holdings. It should not be assumed that any securities transaction or holding discussed was or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. A complete list of security recommendations made during the past 12 months is available upon request. An investment cannot be made directly in an index. The index data assumes reinvestment of all income and does not account for fees, taxes or transaction costs. The investment strategy and types of securities held by the comparison index may be substantially different from the investment strategy and types of securities held by your account. The Morningstar U.S. Dividend Growth Index is a subset of the Morningstar U.S. Market Index, a broad market index representing 97% of U.S. equity market capitalization. It is a benchmark consisting of securities that: (i) pay qualified dividends; and (ii) are screened for a minimum of five years of uninterrupted annual dividend growth. The S&P 500 includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 focuses on the large-cap segment of the market and covers approximately 75% of U.S. equities. The Russell 3000 measures the performance of the largest 3000 U.S. companies, representing approximately 98% of the investable U.S. equity market. The Russell 3000 Index is constructed to provide a comprehensive, unbiased, and stable barometer of the broad market and is completely reconstituted annually.

[1] High-quality investing is an investment strategy based on a set of clearly defined fundamental criteria that seeks to identify companies with outstanding quality characteristics. The quality assessment is made based on soft (e.g., management credibility) and hard criteria (e.g., balance-sheet stability).