Dividend Growth

Portfolio Update: First Quarter 2019

The Dividend Growth Portfolio (the “Portfolio”) increased +12.27% gross of fees (+12.14% net of fees) in the first quarter of 2019, behind the S&P 500 Index which increased +13.65% for the quarter ahead of the +11.45% return of the Morningstar U.S. Dividend Growth Index.

	3 Months	YTD	1 Year	3 Years	5 Years	10 Years	Since Inception (Annualized)
Dividend Growth Strategy	12.14%	12.14%	11.71%	12.37%	8.67%	12.79%	6.62%
S&P 500 Index	13.65%	13.65%	9.50%	13.51%	10.91%	15.92%	8.76%
Morningstar U.S. Dividend Growth Index	11.45%	11.45%	11.12%	14.33%	11.34%	16.13%	9.60%

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 performance, and there is a risk of loss of all or part of your investment.

We were modestly disappointed with the Portfolio’s relative return in the first quarter but encouraged by the absolute return after the substantial selloff that occurred in the previous three months. As a reminder, the Portfolio had strong relative performance in the fourth quarter when the market was getting hit hard. We feel the quality of the companies and arguably lower risk profile help relative performance during a large decline in the market, although these can be a hindrance when the market is surging as in the first quarter. Business models with strong economic moats, sound balance sheets, and well-funded, growing dividends rise to the surface during a time of stress for the market, but can lag when “risk on” sentiment is pervasive. Given that we are very long-term investors, it is hard to judge performance in such short three month periods, but on balance, the Portfolio performed as we would expect in these polar opposite market environments over the last six months. From a traditional attribution perspective, the Portfolio’s underperformance in the first quarter vs. the S&P 500 was mainly driven by stock selection, with a modest positive contribution from sector allocation. The Financials sector and, to a lesser extent, Industrials were both sources of negative attribution, with notable positive contribution from the Real Estate and Materials sectors. We will discuss our individual holdings impact on performance in a bit.

The first-quarter market environment was a drastic reversal from what we experienced in the fourth quarter, as the market rebounded dramatically. Continuing the storyline from the second half of 2018, domestic headlines were dominated by the trade war between the U.S. and China, with optimism around the likelihood of an eventual deal growing significantly. This increased probability of an agreement between the world’s two largest economies comes at a time that economic data has shown more signs of slowing global growth. While the U.S. remains one of the strongest and most resilient economies in the world, there have also been recent domestic data points showing the U.S. is starting to slow from a very strong 2018. This slowing growth is reflected in interest rates that continued to fall, with the 10-year Treasury yield falling from 2.69% to 2.41% in the quarter and down from 3.05% two quarters ago. For a brief period in late March, the yield curve became inverted with the 2-year yield greater than the 10-year. This flat-to-inverted curve implies that the bond market views the probability of an economic recession over the next one to two years as being fairly high. A change in Fed policy has been impactful in the decline in rates as well. The Fed has done a complete reversal in its messaging to the markets over the past six months from three 25-basis-point rate hikes in 2019 to an increased likelihood of actual rate *cuts*. This comes at a time where near-term U.S. economic indicators have clearly slowed in the past few months but remain quite strong by historical standards. Post quarter-end, the March jobs report released in early April remained healthy, helping allay near-term fears that growth was slowing more significantly. The dichotomy between the direction of the stock market and bond market on the future of the economy is remarkable.

Fourth quarter earnings reports released in the first quarter remained relatively strong overall and helped revert the negative sentiment that had overtaken the market during the fourth quarter, particularly in December. Revenues and earnings continued to surprise positively, although there are concerns under the surface about the sustainability of revenue growth as well as profit margins, which are at or near historical peak levels. We believe first-quarter earnings, which are about to be reported as we write this letter, could be somewhat of a wakeup call as year-over-year revenue and earnings growth has decelerated dramatically, even when adjusting for end of the benefit lower corporate tax rates on earnings growth. Current consensus is for only 4% growth in operating earnings for the S&P 500 in calendar 2019. Given high levels of uncertainty around global growth, we would expect management teams to remain on the conservative side when setting forward expectations, and we will watch closely for any change in management's tone toward demand for their products and services.

Our message about overall equity valuations is much less constructive than we were just three months ago after the quick snapback in the market. While not overly expensive, especially given the lower interest rate backdrop, we are not finding bargains to be abundant. From a bottom-up, individual company perspective, the Portfolio has more reward-to-risk ratios under one than it has greater than one. This is much different from where we stood at the end of December, which reflects the significant rebound in valuations in just one quarter. In fact, all the market return in the first quarter came from multiple expansion, not increases in earnings estimates. When talking about market valuations, we also must be cognizant of the fact that we are, more likely than not, in the late innings (if not extra innings) of a long positive economic cycle. While we don't necessarily see a recession as imminent, the probability has certainly grown. As we've discussed recently, the concept of "peak earnings" remains 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. Following up last quarter's strong performance the largest contributor to this quarter was American Tower (AMT), a Real Estate Investment Trust (REIT) that owns communications infrastructure assets, most notably cellular towers. The stock continued its momentum after another solid earnings report and a decline in market interest rates, which tend to benefit REIT valuations. AMT is a very defensive and predictable business model, given it has very long-term contracts with telecom carriers and steady demand for cellular connectivity from consumers. This gives it little exposure to the business cycle and produces consistent and predictable cash flows. We like AMT's long-term, slow and steady secular growth opportunity and it remains the largest position in the Portfolio at year end, although we have trimmed the position modestly as it has risen. Union Pacific (UNP), the iconic railroad operator was the second biggest contributor. The stock reacted positively to its fourth quarter earnings report that showed early success in the implementation on Precision Scheduled Railroading, a technique pioneered by others in the industry that helps improve efficiency on the rail network. Should UNP be successful with these efforts over the next couple of years, it can be a significant tailwind to lowering costs and improving earnings. UNP also raised its dividend and continues to buy back shares. Over the last decade, UNP has reduced its shares outstanding by over 20%, helping

Dividend Growth
FIRST QUARTER 2019 CONTRIBUTION REPORT
Ranked by Basis Point Contribution

	Basis Point Contribution	Return
Top Contributors		
American Tower	132	+24.6%
Union Pacific	102	+21.6%
Lowe's	95	+19.2%
Accenture	87	+24.8%
Microsoft	86	+16.6%
Bottom Detractors		
CME Group	-60	-12.1%
Amgen	-8	-1.7%
United Health	1	-0.4%
Watsco	13	+4.1%
Ritchie Brothers	22	+5.5%

Past performance is not indicative of future performance, 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.

boost value for long term shareholders like ourselves. While the stock is by no means inexpensive, we continue to like the longer-term opportunity and it's the Portfolio's fifth largest position at quarter end.

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. After being one of the largest positive contributors last quarter, CME Group (CME), the commodity exchange operator, was the largest detractor. CME's trading volumes slowed significantly after surging in the fourth quarter. Underlying volatility decreased in nearly all of its underlying asset classes: Interest rates, Equity Indexes, Foreign Exchange, Energy, Agricultural Commodities, and Metals. Volatility is good for business, as it creates demand for trading contracts from the principal users of derivatives: hedgers, investors, and speculators. As long-term shareholders, we do not get overly excited during peak periods of trading volumes, nor worried during slower periods, as, over the long term, volumes tend to grow. 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. 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 and, should the stock decline considerably more, would likely add to our position. Amgen (AMGN), a large biotechnology drug manufacturer, was the second largest detractor, although the stock was only down slightly in the quarter. The stock is a fairly defensive name and didn't participate much in the rebounding market. We continue to like the company and have about an average sized position in the name at quarter end.

Portfolio Activity

During the fourth quarter, the Portfolio purchased one new security, Vail Resorts (MTN) and also exited Snap On (SNA), a manufacturer of tools and equipment for the automotive and other industrial industries. We sold Snap On as our confidence in its ability to return to a more consistent low-to-mid-single digit organic growth rate had waned. While the stock is on the inexpensive side, we became increasingly convinced it was a value trap and no longer a top idea worthy of inclusion in a concentrated portfolio. We ended the quarter with a bit of transitory cash (around 4%) as we did not put all the proceeds from the Snap On back to work.

Vail Resorts is the leading global ski resort operator, owning five of the top six most-visited resorts in North American, including Whistler Blackcomb, Breckenridge, Vail, Park City, and Keystone, amongst many others. The company has strong geographic competitive position as no new supply has entered the industry. The last new ski resort was built over 30 years ago. Since becoming CEO in 2006, Rob Katz has transformed the ski resort industry with the introduction of an all-you-can ski Epic pass along with important investments in database marketing. As a result, Vail's profitability has significantly improved, and it created a network effect – resorts Vail acquires make the Epic pass more attractive to skiers, thus providing more cash flow for additional acquisitions to expand the network.

TOP 10 HOLDINGS AS OF 3/31/19

Company	% of Assets
American Tower	6.1%
Microsoft	5.6%
Lowes	5.5%
Becton, Dickinson & Co	4.9%
Union Pacific	4.8%
Morgan Stanley	4.4%
Microchip Technology	4.3%
Starbucks	4.1%
Accenture	4.1%
Amgen	4.0%

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 performance, 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.

We believe Vail Resorts will exceed long-term market expectations by continuing to consolidate the ski resort industry and drive more skiers into their Epic season pass. As more skiers become season pass holders, this helps reduce the inherent snowfall related volatility, while also providing more steady cash flows. Beyond the core North America market, Vail has an opportunity to make investments in international ski resorts providing long-term growth opportunities for the company. Vail's shares pulled back in January as the company announced weaker-than-expected skier visits during the early part of the ski season attributable to unfavorable snow conditions and fewer destination visitors. We believed the impact was likely temporary and provided an attractive entry point with a risk/reward approaching three to one. Indeed, our conviction was correct, as Vail reported much better season-to-date skier metrics later in the quarter and the stock responded positively. Vail has consistently grown its dividend over the past several years and the stock currently yields 3.2%. We believe it can be a core holding for years to come.

Outlook

From when we last wrote you just three months ago, market conditions have spun a complete 180 degrees. We have gone from hyper volatility with high levels of fear to one of lower volatility and renewed optimism. The reversal of the Fed's messaging of future interest rate hikes to one where they may actually cut rates at some point in the next several quarters is a massive change. 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 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 and rising energy prices 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. Near-term U.S. economic data points have stayed reasonably positive, although have decelerated from fourth-quarter levels. U.S. employment remains 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 should be positive for consumer spending, although winter weather, delayed tax refunds, and the government shutdown could have skewed short-term spending patterns. Consumers in the lower half of income levels should be healthier than they have been in recent years given rising wages and lower unemployment. These rising wages do present a challenge for corporate margins, which are already operating at peak levels. Business and consumer confidence remain at high levels, and we have seen capital investment increasing after several years of stagnant spending. If the trade war with China comes to some type of resolution, which has become current consensus thinking, the near-to-intermediate U.S. economic outlook may end up being better than what the bond market seems to be implying.

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 know 2019 earnings growth slows dramatically as the lower corporate tax rate anniversaries, but as mentioned earlier there are other sources of risks to revenue growth and margins. Over the past two quarters, market earnings estimates for 2019 have fallen from 10% growth to around 8% to about 4% growth currently. The cycle of Wall Street earnings estimates being too optimistic and having to be be ratcheted back is a recurring patter that the market typically sees through, but this is still a major reduction in growth expectations. With the overall market multiple reflating significantly after contracting in the fourth quarter, it sits now sits a bit under 17x, almost 2 points higher from a quarter ago. The long-term average for the market is around 16x, but given we may be nearing peak earnings, there may not be a whole lot of value implied in current market expectations. As always, while we may opine on our view of the market, we do not pretend to have any ability to predict 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 for years into the future. The opportunities to find high-quality 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 more 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 M Griesbach

Todd Griesbach
Portfolio Manager

Dividend Growth

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. (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.