DELTA ASSET MANAGEMENT

First Quarter Letter 2017

PERSPECTIVE

The current bull market celebrated its eighth anniversary on March 9, 2017. Since it began in the aftermath of the "Great Recession," the Standard & Poor's 500 benchmark index has gained 249%. While there are some pundits who point to evidences of a bubble, particularly after the post-election rally, other signs point to a global economy that's been picking up steam fueled by promises of corporate tax cuts and a fiscal spending boost.

How does this bull market compare to those of the past? As bull markets go, this one is neither the best performer nor the longest. The dot-com bull market of 1990 to 2000 is the longest on record and is also the best-performing with a 417% gain. In the area of valuation, the current bull market comes in second to the dot-com bubble, though it's getting close. The S&P 500 was trading at a multiple of 30 times earnings when the dot-com bubble popped in 2000.

The reason for pointing out the tenure of this bull market is that the natural order of asset prices is broadly cyclical and fluctuations are as inevitable as they are unpredictable. The history of the market shows that predictions of continued expansion in investment, business or economic cycles are neither reliable nor indefinitely sustainable. Investors might be surprised to know that the stock market suffered a 10% correction or worse in 22 of the last 35 years. Two investing disciplines that we embrace from this observation are investing with both a long-term mindset and a margin of safety. In this letter, we will address our rationale for long-term investing; next quarter we will discuss our commitment to using a margin of safety when making purchases.

Investing for the long term sounds simple in concept, though in practice it is actually a very hard discipline to follow. Emotions and investing are a bad mix. It is psychologically difficult to hold a stock when prices are falling in the backdrop of a 24-hour financial news cycle. The financial media generally focuses on short-term trends, direction and volume with scant attention to any analysis of long-term economic value. Long-term investing, however, puts the spotlight on what really matters – the growth of economic value and competitive advantages of a business.

Long-term investing puts the spotlight on what really matters – the growth of economic value and competitive advantages of a business.

The opposite of long-term investing is a market timing approach. We take the view that the markets are unpredictable in the short run and move in random directions reacting to incremental news. In the long run, the stock market tends to reflect the overall growth and productivity of the economy. While markets can always have a bad day, week, month or even

year, history suggests investors are less likely to suffer losses over a longer period. While one-year stock returns have varied widely since 1950 (+47% to -39%), a blend of stocks and bonds has not suffered a negative return over any five-year rolling period in the past 66 years.

Perhaps the most important contribution of adhering to long-term discipline is that it protects an investor from an emotional decision to sell at depressed prices and the risk of not participating in any subsequent price recovery. Six of the 10 best days in the market occurred within two weeks of the 10 worst days. In 75% of the years in which the market suffered a 10% correction, the year ended with a positive return. Other benefits of a long-term focus, such as lower transaction costs, lower taxes (for taxable accounts) and the ability to compound funds that would have been paid out as capital gains taxes serve as a powerful effect on investments over time.

Short-term focus is really driven by an obsession with price and not value. Long-term investing requires conviction, perseverance and the ability to stand aside when markets become volatile. In essence, a long-term approach puts the focus on what really matters – the economic viability and competitive advantages of companies and their ability to grow shareholder value over time.

March 15, 2017

COMPANY COMMENTS

Comments follow regarding common stocks of interest to clients with stock portfolios managed by Delta Asset Management. This commentary is not a recommendation to purchase or sell but a summary of Delta's review during the quarter.

United Technologies Corporation { UTX }

United Technologies is a diversified industrial company that provides products and services to the building systems and aerospace industries worldwide. Its businesses include Otis elevators, escalators and moving walkways; and UTC Climate, Controls & Security, a leading provider of heating, ventilating, air-conditioning refrigeration, fire and security systems and building automation and controls. The company's aerospace businesses include Pratt & Whitney aircraft engines and UTC Aerospace Systems.

United Technologies also operates a central research organization that pursues technologies for improving the performance, energy efficiency and cost of its products and processes.
The company is well positioned to benefit from three macro-trends that are shaping the world – urbanization, an expanding middle class in emerging markets and an extraordinary growth rate in aviation. Every day an additional 180,000 people move to urban areas.

By 2050, cities will be home to 2.5 billion more people than today, generating a need for more vertical buildings, airports and mass transit systems, all of which will be equipped with elevators and escalators, climate systems and fire and security systems. Otis is the world's largest escalator manufacturing, installation and service company. It was acquired by United Technologies in 1976. In addition to selling new equipment, Otis provides modernization products to upgrade elevators and escalators as well as maintenance and repair services for both its products and those of other manufacturers. Otis serves customers in the commercial and residential property industries around the world.

Otis has installed elevators in some of the world's most iconic structures, including the Eiffel Tower, Empire State building, the Petronas Twin Towers and Hotel del Coronado. Otis built a formidable reputation for safety and reliability since installing the world's first elevator in 1853. The company enjoys the largest installed base of elevators and escalators around the world, with approximately 1.8 million out of 2.5 million currently covered by service contracts.

The company is well positioned to benefit from three macro-trends that are shaping the world – urbanization, an expanding middle class in emerging markets and an extraordinary growth rate in aviation.

A slowing Chinese economy has led to increased competition for share in this market, which is forecast to be the world's largest. We expect that innovation and expansion of aftermarket services will help Otis' competitive position in the long run.

Pratt & Whitney is a leading manufacturer and supplier of aircraft engines for commercial, military, business jet and general aviation markets. The division also provides fleet management services, aftermarket maintenance, repair and overhaul services, including the sale of spare parts, auxiliary power units and industrial gas generators. Pratt & Whitney produces families of large engines for wide and narrow body aircraft in the commercial market and for fighter and transport aircraft in the military markets.

Pratt & Whitney has an installed base of nearly 13,000 commercial engines on commercial aircraft and 7,500 military engines primarily for fighter jets. The development of a new jet engine can take the better part of two decades and a substantial capital expenditure commitment.

Innovation is an important part of United Technologies strategy. Pratt & Whitney is an example of how innovation is revolutionizing commercial aviation. Pratt & Whitney's Pure Power Geared Turbofan (GTF) engine has transformed the single-aisle commercial aviation segment. More than 20 years in development, the new engine is much quieter, providing customers with double digit improvements in fuel efficiency, emissions and noise levels. The company delivered 200 GTFs in 2017, which is the first significant batch of approximately 7,000 orders.

In addition to Pratt & Whitney and Otis, the company has two other divisions: UTC Climate, Controls & Security and UTC Aerospace Systems. The former is a leading provider of HVAC and refrigeration solutions, including controls for residential, commercial, industrial and transportation applications. These products are sold primarily under the Carrier name. UTC Aerospace manufactures and sells aircraft components, including power management and

distribution systems, engine components, air data and flight sensing systems and engine control and electric systems. UTC Aerospace was formed in 2012 by combining two industry leaders, Goodrich and Hamilton Sundstran.

Based on the consolidated lines of business, we believe that United Technologies can grow revenue at an average annual rate of approximately 3%. Cash flow margins over the next 10 years should benefit from declining capital and research and development expenses once the GTF project is completed. We believe cash flow margins will average 16% over the forecast period. Using these assumptions, our stock valuation model based on United Technologies current stock price offers a long-term annual rate of return of approximately 10%.

United Parcel Service, Inc. { UPS }

UPS is the world's largest package delivery company, a leader in ground shipping and a premier provider of global supply chain management solutions. The company was founded in 1907 as a private messenger and delivery service in Seattle, Washington. UPS handled on average 19.1 million daily parcels in calendar year 2016. For comparison, the express and ground units together at FedEx moved about 11.7 million average parcels daily. Total revenue for UPS in 2016 was over $60 billion.

The parcel industry enjoys favorable competitive dynamics. A start-up would find it difficult to replicate a competitive network quickly. The barriers to entry are high as carrier providers own and/or secure large fleets of airplanes and trucks, trailers, terminals, sorting equipment, drop boxes, IT systems and skilled labor. UPS and FedEx have built relationships with customs authorities that let them save time by clearing items while they are still airborne. Customer bargaining power is highly fragmented and small business and retail customers are price takers. Larger customers such as Walmart and Amazon have notable bargaining power and receive material list rate discounts.

Although there is intense rivalry between UPS and FedEx, the pricing tends to be rational and price wars rare. UPS normally earns higher margins than its peers, due to its use of integrated assets to transport U.S. express and ground shipments through the same pickup and delivery network. In contrast, FedEx uses parallel networks of drivers and trucks to separately handle ground and express shipping. UPS clients have the convenience of using the same driver to handle both express and ground packages. The United States Post Office is both a competitor and partner, sometimes delivering UPS packages the last leg of a shipment.

The parcel industry is a major beneficiary of internet sales trends. Global e-commerce sales topped $1 trillion for the first time in 2012. Throughout the world, online buying has grown exponentially. The gains from internet sales have recently been tempered by product digitization and miniaturization, which reduces average package volume and weight. Media is shifting from physical books, VHS and DVDs to digital streaming and cable. Electronic equipment is shifting toward smaller, mobile devices. Despite these trends, a broader selection of products is being purchased online as younger generations are more comfortable with online transactions.

Roughly 25% of UPS revenue is international, with the company providing guaranteed express delivery to over 50 countries outside the U.S. Europe is the company's largest market outside of the U.S., accounting for roughly half of its international revenue. Although Europe has been slow to recover from the financial crisis, the long-term UPS European focus makes sense as exports make up a significant portion of the continent's gross domestic product (GDP). UPS is somewhat underrepresented in emerging markets, particularly Asia/China; however, the company has a strong balance sheet and the necessary expertise to meet this strategic challenge.

The barriers to entry are high as carrier providers own and/or secure large fleets of airplanes and trucks, trailers, terminals, sorting equipment, drop boxes, IT systems and skilled labor.

UPS invests a billion dollars a year in information technology investments. Such a level of commitment is a material part of its 2016 $3 billion capital expenditure. This investment has paid off in efficiency and lower costs. For ground delivery, UPS indicates its ORION route optimization saved $400 million last year. New IT projects target annual savings of $800 million to $1 billion within three to five years. The company intends to implement Saturday ground service to half the United States in 2017, which should boost asset utilization and add capacity. UPS will need to add workers before receiving efficient volumes, and costs will likely increase in the short term.

UPS has demonstrated high capital efficiency and strong cash flow generation throughout its history. The industry has benefited from three intertwined forces: the emergence of China, the broad trend toward just-in-time inventory and the rise of internet commerce. We believe the company should continue to benefit from volume growth from businesses shipping to consumer, an oligopolistic industry structure and growing global trade and supply chains. Based on these assumptions, our stock valuation model indicates a long-term average annual rate of return of approximately 6.4%.

StanleyBlack&Decker

Stanley Black & Decker, Inc. { SWK }

Stanley Black & Decker is a global leader in providing hand and power tools and related accessories, as well as a range of security products and services to consumers and industrial customers. The company has an iconic brand portfolio with a reputation for quality products spanning nearly 170 years.

Reliability and brand loyalty are important factors in the North American tool market. Customers have long memories and can be unforgiving if a manufacturer cuts corners. This brand consciousness helps Stanley in positioning with big box retailers. Retailers look for strong brands that command a premium margin and provide a broad umbrella of products to satisfy core customers. The company gets about 20% of its sales from major retailers and nearly 10% from its largest customer, Lowe's. Stanley's industrial and retail tools business, which makes up over 80% of total company profitability, is a highly profitable, cyclical, slow growth business.

The company is well positioned with strong brands, a good record of innovation, global reach and a track record of efficient operations.

Stanley has grown through acquisitions and has a successful track record of integrating over 70 acquisitions since 2004. On average, Stanley has improved the operating margin by 6 percentage points on acquired businesses. It absorbed the larger Black&Decker in 2010, significantly broadening its product portfolio and yielding revenue and cost synergies well beyond the original expectations. The merger has created the largest provider of hand and power tools with enormous global reach and channel access, including high growth emerging markets such as Brazil. The company plans to further consolidate the hand tools industry.

Stanley has grown through acquisitions and has a successful track record of integrating over 70 acquisitions since 2004. On average, Stanley has improved the operating margin by 6 percentage points on acquired businesses.

Stanley is sharply focused on driving organic growth, which has been consistent with the robust improvement in housing and home improvement. Stanley continues to expand into emerging markets with products specifically tailored to those regions. The acquisition of Black&Decker opened new distribution channels in these regions that Stanley is exploiting with new mid-priced products. To help maintain Stanley's overall level of profitability, the company is positioning itself in these markets with local management and product design teams and manufacturing processes.

Longer-term, acquisitions will continue to play a role in the company's outlook. Stanley has resumed dedicating 50% of its capital budget to acquisitions with a focus on tool industry consolidation and expanding its industrial platform. The branded tool and storage products are critically important aspects of the company that provide strong free cash flow and modest growth. Stanley will continue to invest in new product development, such as Smart Tools and higher voltage power tools and increase its brand support through marketing and promotional activities.

Stanley has a successful acquisition track record, but its acquisitive nature remains an ongoing risk. Acquisitions always introduce the risk of overpaying and later facing asset impairments or inadequate returns on invested capital. Stanley also faces commodity price risk. The company's consolidated customer base and competitive markets have prevented Stanley from fully passing along rising costs in the form of price increases.

We believe Stanley can grow organically in the low single digits. We also expect Stanley to continue its acquisition program and fund it through free cash flow and debt financing. Based on this growth, we anticipate operating margins just under 13% over the business cycle. Given these assumptions, our valuation model indicates that the company's stock is priced to generate an average long-term annual rate of return of 6%.

BED BATH &
BEYOND

Bed Bath & Beyond Inc. { BBBY }

Bed Bath & Beyond is the largest specialty retailer in domestics and home furnishings. Domestics include bedding, bath products, window treatments and kitchen textiles. In addition to the Bed Bath & Beyond stores, the company owns several smaller retail concepts, including buybuy BABY, a baby merchandise and accessories store; and the Christmas Tree Shops, a discount variety store with a focus on inexpensive home décor and accessories. Bed Bath's last large acquisition was a chain of 260 World Market stores, which offer home decorating items, furniture, and specialty food and beverage items.

Bed Bath & Beyond has been among the leading retailers in the home furnishings industry. The company has dominated the home furnishings niche by offering an unmatched depth and breadth of products with a relentless focus on the store experience and exceptional customer service. The company also has a unique, decentralized operating culture, which encourages store managers to act as independent owners. Managers make merchandising decisions and tailor the assortments for their specific store. This autonomy instills accountability and a strong "promote from within" culture and attracts and retains talented employees. Stores have a unique layout that groups related product lines into separate areas, creating the appearance and feel of a collection of individual specialty stores. The in-store presentation is very simple, keeping costs down and allowing for easy reconfiguration as categories expand or contract.

Bed Bath & Beyond has a unique, decentralized operating culture, which encourages store managers to act as independent owners. Managers make merchandising decisions and tailor the assortments for their specific store.

The company operates almost exclusively in the mature, domestic U.S. market. At year-end, it had 1,530 stores in all 50 states, the District of Columbia, Puerto Rico and Canada. New store expansion will be limited as quality locations become increasingly hard to find. In recent years, the liquidation and downsizing of weaker competitors has provided additional opportunities for market share gains. Although sales growth is slowing, Bed Bath should continue to generate good free cash flow and maintain competitive profit margins.

Bed Bath has acquired or developed several concepts, which are currently small contributors to the bottom line but could serve as catalysts for growth in the future. Its buybuy BABY stores generally have 20,000 items of merchandise for infants, babies and toddlers in a broad array of categories. World Market stores provide the potential opportunity to grow a new concept as well as cross merchandise between various store concepts. Cross merchandising between stores helps drive traffic by offering a broad and differentiated product offering.

Competition in the industry has intensified. Online shopping in home furnishings is now prevalent with Amazon.com and Wayfair.com taking an increasing share of the market.

Like most retailers, Bed Bath & Beyond is investing heavily in its ecommerce capabilities, including a better website and new distribution and support facilities. The company is competing well with its online sales growing rapidly but at a lower profit margin due to technology investments, price transparency and lower free shipping thresholds. In addition, the company continues to combat competition from specialty stores, such as Williams-Sonoma and Pier One; traditional department stores, such as JCPenny and Kohl's; discount chains, like Target and Walmart; and discount specialty stores, such as HomeGoods.

We believe the slower pace of growth and the increasingly competitive environment are somewhat mitigated by cross-selling opportunities and online, mobile site enhancements. With these efforts, we project the company can maintain its operating margins slightly ahead of the retail industry at 7.5% over our forecast period. Based on these assumptions, our stock valuation model indicates Bed Bath's current stock price offers a long-term annual rate of return of approximately 10%.

Dated: March 15, 2017

Specific securities were included for illustrative purposes based upon a summary of our review during the most recent quarter. Individual portfolios will vary in their holdings over time in relation to others. Information on other individual holdings is available upon request. The information contained herein has been obtained from sources believed to be reliable but cannot be guaranteed for accuracy. The opinions expressed are subject to change from time to time and do not constitute a recommendation to purchase or sell any security nor to engage in any particular investment strategy. Any projections are hypothetical in nature, do not reflect actual investment results and are not a guarantee of future results and are based upon certain assumptions subject to change as well as market conditions. Actual results may also vary to a material degree due to external factors beyond the scope and control of the projections and assumptions.