DELTA ASSET MANAGEMENT

Fourth Quarter Letter 2018

PERSPECTIVE

Concerns of increasing debt levels, tightening monetary policy, technology stock valuations, potential trade wars and slowing eurozone growth coalesced in the 4th quarter to fuel a higher level of volatility. At nine-and-three-quarter years, the bull market is the longest on record and one of the best performing. The S&P 500 has risen 333% from its bottom in 2009 to its most recent peak before the 4th quarter turbulence.

Some market pundits question whether the bull market will make it to its 10th birthday in March 2019. Investors seem nervous about its longevity. A bull market doesn't technically end until there's a bear market resulting from a 20% drop from its peak. This particular bull market is unusual in that it followed the 2008 financial crisis, which was so severe in that it was second only to the Great Depression in US history.

The good news is that the global economy still shows signs of robust health. Gross domestic product (GDP) growth topped 4% in the second quarter, the best expansion since 2014, and unemployment at 3.7% is at a 49-year low. Rising interest rates also indicate an increasing demand for funds. Rates tend to climb when the economy is humming. A recent bank study found that companies' price/earnings multiples expanded during half of recent rising interest rate cycles and contracted during the other half, indicating that the market is agnostic about a gradual change in rates.

Extended volatility can offer a window to buy solid companies at reduced prices since the herd behavior of bear markets often depresses prices below their long-term economic value.

Bear markets are a normal component of investing in stocks. The emotional desire to avoid the pain of losses often causes investors to sell at the bottom and lock in below average returns. Bear markets over the past 70 years have averaged 11 months to reach bottom and then, depending on what type of bear market (recessionary or non-recessionary), take at least a comparable or longer period to reach a new high. The average number of months to achieve a new high from bottom is 11 months during a non-recessionary bear market and 27 months during a recessionary bear market. The important takeaway is that after each bear period the market has gone on to reach new highs.

What is Delta's approach in periods of market turbulence? We are not market timers, and we do not speculate on the direction of the market. Good market timing requires two successfully consecutive actions – being in the market at the right time and out at the right time. If you miss either move, you'll underperform a simple buy-and-hold strategy, which is what makes market timing nearly impossible.

These challenges are compounded by the fact that a small number of days account for the bulk of stock market returns. An investor in the S&P Index would have earned an annualized return of 9.2% throughout the 20-year period ending on December 31, 2013. When the five best-performing days in that time period were missed, the annualized return shrank to 7.0%; and if an investor missed the 20 days with the largest gains, the returns were reduced to just 3.0%.

We invest in companies with strong market leadership that continually reinvest their cash flows to strengthen their relative competitive positions and demonstrate adaptability to changing consumer tastes and preferences.

As long-term investors, our objective is to purposefully select companies for our model portfolio that have resilience to weather periods of economic downturns. We invest in companies with strong market leadership that continually reinvest their cash flows to strengthen their relative competitive positions and demonstrate adaptability to changing consumer tastes and preferences. We also seek companies with strong balance sheets and conservative capital structures that are not constrained by higher levels of interest rates. This investment criterion is a margin of safety during protracted volatility.

In addition to the resilient characteristics of our portfolio companies, we look at volatility opportunistically. Extended volatility can offer a window to buy solid companies at reduced prices since the herd behavior of bear markets often depresses prices below their long-term economic value. If the discount is large enough, we will add to positions and initiate new ones.

Turbulent markets can be difficult to live through, but a diversified portfolio based on strong fundamentals and the opportunity and willingness to add quality companies at discounted prices provides a construct to survive them. Historically, exposure to the stock market has been well worth the occasional pain of a bear market. Over the last century, the stock market's average return is about 10% annually. Even if the market is volatile, it tends to be positive in a given year. Of course, it doesn't rise every year, but over time the market has gone up in about 70% of years. It is important to remember that while 10% may be the average, the returns on any given year may be far from average – that is why we stress a long-term commitment and approach. Delta's value proposition is most pronounced during volatile periods. Our objective is to avoid the excesses of market psychology and the related poorly timed trades that erode returns, and, instead, over the long-term, profit from them.

December 16, 2018

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.

Emerson { EMR }

Emerson, formed in 1890, is a diversified global manufacturing company, which provides solutions to customers by bringing technology and engineering together in the industrial, commercial and consumer markets around the world. The company operates in a wide variety of businesses, including diagnostic controls and measurement products for industrial processes, manufacturing automation and climate technologies. Headquartered in St. Louis, MO, Emerson has over 235 manufacturing locations worldwide with 55% of sales outside of North America.

Although Emerson generated over $17 billion in global sales in 2018, it has the flexibility of a smaller, more nimble player due to its regional operating structure. Emerson innovates, engineers, sources, manufactures and sells within each region of the world. What is made in Asia is sold in Asia, what is made in Europe is sold in Europe and what is made in the US is sold in the US. Sales in emerging markets have expanded to 35% of sales. Emerson's overall strategy is to provide differentiated products with leading technology, volume leverage and pricing, which results in higher profit margins than competitors and most industrial companies.

Emerson's largest and most profitable segments – automation solutions and climate technologies – turn customer reliance on total system solutions, which combine Emerson equipment with human and knowledge capital into higher margin sales and more entrenched customer relationships. Emerson's competitive advantages stem from its industry-leading installed base of equipment valued at $100 billion, which increases customer switching costs. In addition, its manufacturing scale provides a cost advantage versus most competitors.

Emerson's competitive advantages stem from its industry-leading installed base of equipment valued at $100 billion, which increases customer switching costs.

In automation solutions (60% of total company profitability), Emerson offers leading technology and a complete system solution that allows the company to earn profit margins comfortably above peer levels. Customers from various industries, including oil and gas, power, chemical and life sciences, pay a premium for Emerson's complete front-to-back automation solutions. Although others have subsequently developed competitive products, Emerson's strategy is to develop or acquire a unique technology, implement it at the beginning of the cycle, establish a lead and expand market share.

Emerson's next phase of growth will involve a broader push into higher margin solutions and services sales. Its strategy is to move from being a high quality supplier of engineered products and components to collaborating with customers to better understand their operations and what they value. This information is valuable for Emerson because it leads to innovative technology and a tailored software solution for the customer. Emerson also benefits from high margin recurring software sales as companies typically update their system software every few years. Globally, the company is increasing its investments in engineering and development spending as well as sales, customer service and project management to enhance its relationship with customers, support product development and increase market penetration.

Emerson is still a cyclical company and does face risks within its portfolio of businesses. Any slowdown in the global economy or reduced capital spending in the oil and gas industry would have a negative impact on revenue and profits. Emerson historically has been an acquisitive company in order to gain technology and expand its market footprint. There is always the risk of overpaying or a failure to integrate new businesses leading to a less than adequate return on investment.

We believe the company's extensive installed base and long-term customer relationships should provide support for its stated transition to a services and solutions strategy. We expect Emerson will grow revenues in the low single-digits on average with cash flow margins of 20% over our 10-year modeling period. Based on these assumptions, our stock valuation model indicates Emerson's current stock price offers an average annual long-term rate of return of approximately 9.5%.

Wells Fargo & Company { WFC }

Wells Fargo is one of the largest community-based, diversified financial services companies in the US, with close to $2 trillion in assets. The bank offers a full range of consumer banking, commercial banking and investment banking services. Founded in 1852 and headquartered in San Francisco, it is consistently one of the top deposit gatherers in the US. The Wells Fargo model delivers a vast product set through a scaled domestic office / technology infrastructure with disciplined risk management.

Wells Fargo is largely a conventional lender. The bank's $1.3 trillion plus deposit base and near dominant market position in fast growing markets are its biggest advantages. The bank has consistently paid less for balance sheet funding than most of its competitors over the last decade. It is also able to generate more revenue per dollar of assets than most peers. This low-cost funding has continued through the bank's recent challenges to its reputation. Account closures did not spike during the worst of the sales problems, underscoring that customers are willing to stick with the bank.

The company has a leading position in the mortgage market. The firm benefits from economies of scale in both origination and servicing as well as a scaled technology platform. An additional strength is the diversification of revenue relying on more stable revenue generated by its brokerage, advisory and asset management businesses. Unlike its major competitors, Wells is not a major player in the cyclical investment banking and capital markets businesses. Trading gains make up only a small percentage of non-interest income.

Wells Fargo has more than 260,000 employees, and the firm's practices are being examined with a fine-toothed comb by regulators and external auditors. The bank is still sorting through a number of issues. In February 2018, the bank entered into an agreement with the Federal Reserve to freeze assets until certain tests and requirements are met. Until current issues are resolved, management is unlikely to have full flexibility in capital allocation and in optimally deploying shareholder capital.

We feel the bank can manage through its issues and has undertaken multiple steps to restore customer trust. The company has eliminated product sales goals and implemented a new retail banking compensation program in 2017. The new program weights incentives toward team goals, customer satisfaction and product usage. Additional monitoring and controls were put into place to provide enhanced supervision of sales processes. The company now sends out confirmation emails an hour after opening new accounts to ensure customers are only receiving those services for which they signed up.

Wells boasts strong market share positions in many of the largest, fastest-growing and wealthiest markets in the country. This expanse should help the bank grow organically faster than the banking industry on average once regulatory issues are resolved.
In addition, Wells Fargo's balance sheet strength has allowed it to gain market share from banks needing to reduce assets and raise liquidity. Over time we believe the bank's net interest margin will expand as interest rates rise and the lending environment stabilizes.

Wells boasts strong market share positions in many of the largest, fastest-growing and wealthiest markets in the country.

We anticipate the company's efficiency ratio will improve over the intermediate term as the company benefits from a declining regulatory burden, rising interest rates, a somewhat smaller branch network and annual non-interest income growth. We have assumed Wells will continue to maintain excess capital and liquidity above the required norm. Based on our assumptions, our financial model indicates that at the present stock price Wells Fargo's stock offers a potential long-term annual return of just under 10%.

Baxter

Baxter International Inc. { BAX }

Baxter International provides a broad portfolio of essential renal and hospital products, including acute and chronic dialysis, IV solution and administrative sets, infusion systems and devices, nutrition therapies, biosurgery products and inhaled anesthetics as well as pharmacy compounding, drug formulations and software and service technologies.

The company's global footprint and the critical nature of its products and services play a key role in expanding access to healthcare in emerging markets and developed countries. Baxter is among the global market share leaders in all its businesses, with manufacturing in 20 countries and products and systems sold in 100 countries. The company's good manufacturing scale with worldwide distribution and product breadth in injectable and inhaled therapies make the firm a vital supplier to caregivers.

Baxter's medical delivery and dialysis businesses are made up of a diversified mix of both basic and innovative products. The company maintains large global market shares in mature but stable products, such as IV-administered therapies, infusion systems and nutritional solutions. Baxter offers the broadest selection of pre-mixed drugs in the industry and continues to expand revenue from innovative drugs, such as inhaled anesthesia. Baxter's renal division, its largest business, should continue to benefit from the strong dialysis market growth due to rising global rates of

diabetes. The consumable and medically necessary nature of Baxter's products provides relatively consistent revenue and operating cash flow.

The company's good manufacturing scale with worldwide distribution and product breadth in injectable and inhaled therapies make the firm a vital supplier to caregivers.

Baxter has created a strategy centered on portfolio optimization, operational excellence and strategic capital allocation. The company's plan to continue to drive sales growth and profit margin improvement includes management's focus on the anticipated growth of several high margin businesses (biosurgery, nutrition, acute renal therapy, and inhaled anesthesia), the launch of new, high margin products and services as well as exiting certain low margin businesses. The company also will continue to reduce its manufacturing footprint and capture additional supply chain efficiencies. Execution of this long-term strategy has already led to substantial profit improvement, and we expect further profit and free cash flow gains in the years ahead.

Baxter's main challenge is the continued cost containment efforts in the healthcare industry in general that may exert pricing pressure on medical products. In addition to government regulation, managed care organizations' purchasing power has strengthened due to their consolidation into fewer, larger organizations with a growing number of enrolled patients. Quality control is also a risk factor. Product recalls can harm relationship trust. Lost market share is hard to regain.

We believe Baxter can generate long-term revenue growth in the 3-4% range with cash flow margins over 24%. Based on these assumptions, our valuation model indicates Baxter's current stock price offers a long-term average annualized rate of return of 7%.

United Parcel Service Inc. { UPS }

UPS is the world's largest package delivery company, in an industry where network size matters, both in terms of customers and in spreading costs over a larger volume of packages. The company was founded in 1907 as a private messenger and delivery service in Seattle, WA. UPS handled on average 17 million daily parcels in calendar 2017. For comparison, FedEx's express and ground units together moved about 14 million average parcels daily. Total revenue in 2017 was over $65 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 carriers own and/or lease large fleets of airplanes and trucks, trailers, terminals, sorting equipment, drop boxes, IT systems and skilled labor. Despite its asset intensity and extensive unionization, UPS produces returns on invested capital about double its cost of capital and margins well above its competitors, which is due to the firm's investment in technology and operational efficiency.

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 FedEx and UPS, 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's 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 a UPS package the last leg of a shipment.

Despite its asset intensity and extensive unionization, UPS produces returns on invested capital about double its cost of capital and margins well above its competitors.

The parcel industry is a major beneficiary of internet sales trends. Global e-commerce sales are estimated to be $2.8 trillion in 2018. 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, CDs 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.

UPS's international business grew 11% in 2017 to over 20% of revenue, with the company providing guaranteed express delivery to more than 50 countries outside the US. Europe is the company's largest market outside the US, accounting for roughly half of its international revenue. Although Europe has been slow to recover from the financial crisis, UPS's long-term European focus makes sense as exports make up a significant portion of the continent's 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.

UPS invests a billion dollars a year in information technology investments. Such a level of commitment is a material part of its 2017 $5 billion plus capital expenditure. This investment has paid off in efficiency and reducing 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 $1billion within three to five years. UPS will need to add workers and infrastructure before receiving sufficient 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 consumers, 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 10%.

United Technologies Corp. { UTX }

United Technologies (UTX) is a diversified industrial company that provides high technology products and services to the building systems and aerospace industries worldwide. Its businesses include Otis elevators, escalators and moving walkways; UTC Climate Controls and Security; 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.

In addition to revenue and profit growth driven by new aircraft engines, 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 continued global growth rate in aviation.

In November 2018, UTX completed its acquisition of Rockwell Collins, a leader in aviation solutions for commercial and military customers with a focus on avionics, flight controls, aircraft interiors and data connectivity systems. The acquisition will make the UTX aerospace division, including Pratt & Whitney engines, UTC Aerospace and Rockwell, a virtual one-stop shop for building an airplane by producing engines, cockpit systems, seats, landing gear and auxiliary power units. In concert with the Rockwell transaction, the company announced it would separate into three independent companies. Pratt & Whitney, Rockwell aerospace and UTC Aerospace Systems will form United Technologies while Carrier (UTC Climate Controls) and Otis will be spun out independently over the course of 2019.

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 has an installed base of nearly 13,000 commercial engines on commercial aircraft and 7,500 military engines primarily for fighter jets. Once an engine is placed on an aircraft, attachment rates for high margin after-market services are approaching 80% indicating high customer switching costs. Only a few companies in the world have the engineering capability to design, produce and service aircraft engines.

Innovation is an important part of United Technologies strategy. Pratt & Whitney is an example of how innovation is revolutionizing commercial aviation. P&W's Pure Power Geared Turbofan (GTF) engine has transformed the single-aisle commercial aviation segment. More than 20 years in development, the new engine provides customers with double-digit improvements in fuel efficiency, emissions and noise levels. The company expects to deliver up to 2,500 GTF engines over the next three years, which is the first significant batch of approximately 10,000 orders.

In addition to revenue and profit growth driven by new aircraft engines, 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 continued global growth rate in aviation. Every day an additional 180,000 people move to urban areas. By 2050, cities are estimated to be home to over 2 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 elevator and escalator manufacturing, installation and service company. 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. The company also enjoys the largest installed base of elevators and escalators in the world, with approximately 1.8 million out of 2.5 million currently covered by service contracts. 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.

Based on the consolidated lines of business, we believe that United Technologies can grow underlying 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 Geared Turbofan project is completed. We believe cash flow margins will average nearly 17% 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 12%.

BNY MELLON

The Bank of New York Mellon Corp. { BK }

The Bank of New York Mellon is a global investment company offering institutional, corporate and individual client expertise in managing and servicing financial assets throughout the investment lifecycle. It enables clients to create, trade, hold, manage, service, distribute or restructure investments. BNY Mellon has $34.5 trillion in assets under custody and $1.8 trillion in assets under management. The company has a vast global footprint delivering investment management and investment services in 35 countries.

BNY Mellon is a uniquely positioned company with a business model that is quite attractive in the banking industry. The bank provides a full spectrum of the investment process and has the ability to provide sophisticated solutions to many of the most advanced and complex financial companies and investors globally. While others offer similar services, few other firms offer the scale or breadth of products necessary to service customers in this technology-driven business at a competitive cost. BNY Mellon is deeply involved in the operations of its clients. These strong relationships result in sticky customers due to the high switching costs associated with back-office disruption that changing providers would entail. These competitive strengths have consistently delivered the highest profit margins and returns on tangible capital in the industry.

BNY Mellon's largest business, the Investment Services segment (75% of total company revenue and profitability), is the largest global custody bank with approximately 20% global market share. The bank tends to have the top market share in most of the servicing businesses in which it competes. Although it does face some cyclicality due to asset valuations, the vast majority of revenues are recurring in nature with high switching costs. Historically, asset values have outpaced global GDP growth, and we expect continued growth in cross-border investment and capital flows along with expanding international market client relationships. BNY Mellon should also continue to benefit from changing regulations driving client demand for new solutions and services while encouraging many asset managers to outsource their back-office operations for greater security and oversight.

The bank provides a full spectrum of the investment process and ability to provide sophisticated solutions to many of the most advanced and complex financial companies and investors globally.

Technology remains at the core of operations as new CEO, Charles Scharf, considers the firm a software-as-a-service (SaaS) company at its core. Technology will continue to grow in importance in banking, particularly the types of services provided by BNY Mellon. The firm is seeing a payoff with faster execution, lower costs and faster time to market for new applications, which further strengthens client relationships. Going forward the firm remains at the forefront of utilizing new technologies to enhance the user experience including cloud-enabled service platforms, developing business and client analytics, faster access to data and improved search capabilities as well as expanding mobile access for clients.

BNY Mellon's revenue is 80% fee-based, which is usually fairly stable; however, there is still some cyclicality in the business as market swings do have an impact on fees. A prolonged period of ultra-low interest rates will have a negative impact on revenue due to money market fee waivers and lower profitability on lending products. In addition, the bank's business is built on its reputation as a qualified and trustworthy manager of risks and other sensitive operations, and any harm to its reputation could negatively impact revenues for an extended period.

Given the current level of assets under custody and management, we believe BNY Mellon will be able to grow revenue in the low single digits on increased services, modest market share gains and international market expansion. We expect the custody bank can generate return on equity approaching 10% over the next decade. Based on these assumptions, our financial model indicates that at the current stock price BNY Mellon's stock offers a potential long-term annual return of approximately 13%.

Dated: December 16, 2018

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.