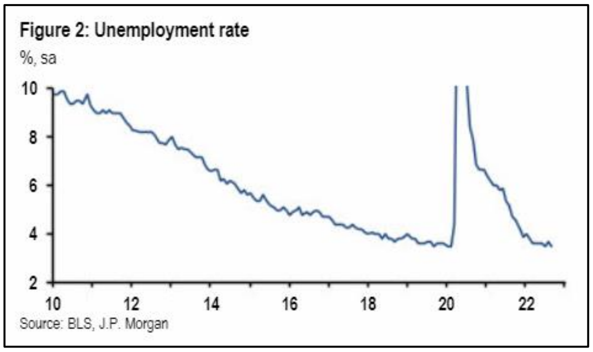
A Hawkish Fed and Attractive Valuations

There have been very few places for investors to find solace in 2022. Through the first three quarters of 2022, the S&P 500, NASDAQ, and the US Agg Bond Index are down -17.55%, -25.4%, -14.5%. The traditionally 60/40 portfolio has had its worst year ever and with inflation far from being curbed, we expect rates to continue to rise and unemployment to tick up.

Labor Market Dictating Fed Policy



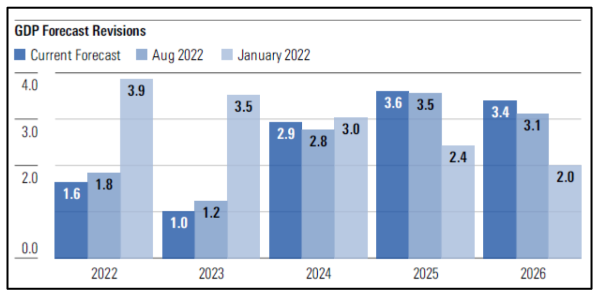
The Employment Situation report surprised markets this month as the unemployment rate reversed its upward trend, falling back to its recent low of 3.5%. Average hourly earnings increased 5% year-over-year, led by blue-collar wages up 5.8% versus the previous year. The Labor Department's Job Openings and Labor Turnover Survey (JOLTS) data made headlines by reporting a 15% drop in job openings which markets interpreted as a sign of a cooling labor market. The decrease in openings is noteworthy, however, the level of available jobs is still elevated compared to pre-pandemic standards. Higher quit rates and low layoff rates indicate the continuation of employees, rather than employers, dictating labor market conditions. Until recently, wage growth and labor cost have not been leading inflation drivers. Most, if not all, of inflation during the earlier phases of COVID recovery was driven by supply-side dislocations that pushed up the prices of goods; wage growth lagged other inflation components on a relative basis, particularly over the past year. This trend now seems to be shifting. Wage growth can be a significant driver of inflation because of its impact on employment costs required to produce a good or service. This increased cost typically results in broad price increases in attempts to maintain margins, which in turn causes more wage growth as employees negotiate to keep their real purchasing power constant. This is the wage-price spiral that the Fed has repeatedly emphasized as one of the primary reasons for frontloading rate hikes. We believe the fed will continue its aggressive stance toward financial tightening through the end of 2022 and into the new year based primarily on continued persistence in low employment and wage growth

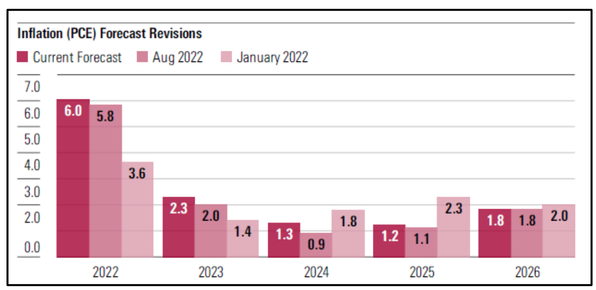
After another elevated Consumer Price Index (CPI) print from September, the market has now fully priced in a 75-bps increase in November, a 50-bps increase in December, and a 25-bps hike during the first meeting of 2023. A pause in hikes could happen following the first meeting next year as two Federal Reserve Presidents have recently spoken about the need to watch how financial tightening works its way through the economy as it takes time for these effects to fully express themselves. The Federal Reserve could conclude its tightening policy by the 2H 2023 but that will only happen if that labor market begins to weaken. With that requirement, we expect GDP to remain somewhat sluggish for the year as rates continue to rise in an effort to find labor market equilibrium.

Current Valuations Present Good Opportunities

Source: Morningstar

The S&P 500 has sold off -25.25% through the end of the third quarter of 2022 driven by weaker-than-expected economic growth, a more aggressive Fed, and stubbornly persistent inflation. These headwinds may continue to dictate the market in the short term but for long-term investors and on a historic basis the market looks undervalued. The graph on the right shows equity categories and their current valuation levels versus historic averages. The number reflects each style's current valuation versus their historical average Price Earnings ratio (e.g., Value at .77 is trading at a 23% discount to historical averages). The current valuation levels suggest that a barbell strategy of value and growth paired together could be the best way for long-term investors to take advantage of the current market environment. While the short-term is clouded with heightened volatility caused by central bank policy and geopolitical turmoil, the long-term outlook remains attractive and current market conditions offer the opportunity to buy strong companies at attractive discounts. The inflation (PCE) and GDP forecasts on the right show the strong possibility of an economic rebound occurring in the next 2 years. The through-cycle outlook is great for Brookmont Strategies as we buy quality companies for their durable competitive advantages with the current market decline providing various entry opportunities for the investment team. During periods of persistent inflation, investors seek companies with strong market positions and pricing power to navigate periods of volatility. There is currently a high correlation between individual stocks and the overall market (60%). On average, bouts of this unusually elevated correlation last approximately two to four months which leads us to expect that active management and quality companies will start to separate from the overall market in the next 6 months.





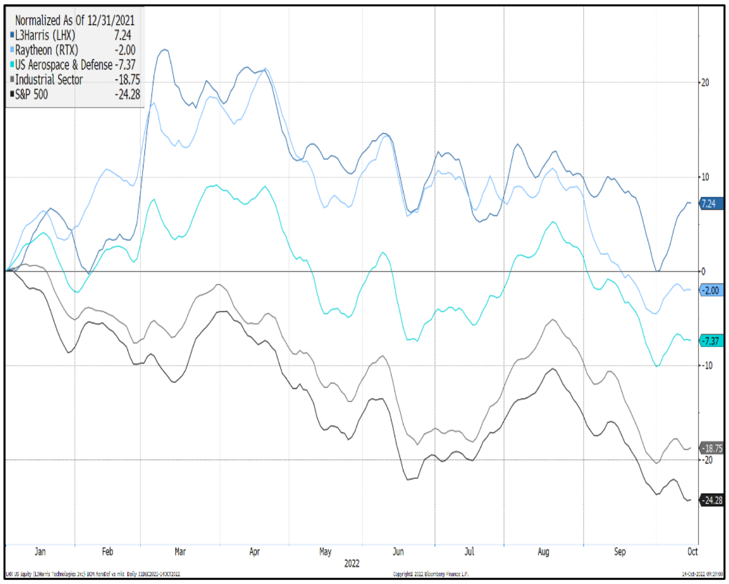
Source: Morningstar

Portfolio Positioning for Russia – Ukraine Conflict

The Russian invasion of Ukraine has been one of the most important market-moving events of the year, impacting supply chains, commodity prices, and defense budgets. During the 3rd quarter, there were numerous major developments and escalations in the conflict.In early September, Ukraine began a major counteroffensive that has since recaptured thousands of square kilometers. The rapid advancement of Ukrainian forces has caused frequent Russian retreats and the abandonment of hundreds of armored vehicles and artillery. The swift shift in momentum, combined with waning public support within Russia and the approaching implementation of multiple major sanctions on December 5th (EU embargo of Russian seaborne crude imports come into full effect; expiration of US sanction exemption for processing of Russian energy transactions), has amplified the pressure on Vladimir Putin to quickly conclude the conflict.

Russian army efficacy continues to decline as casualties force the conscription of less trained reservists. Persistent logistics issues continue to plague Russian forces. This, along with the shortened timeline and Ukraine's resilient anti-aircraft defenses, has resulted in Russia's increasing utilization of missiles to target civilian infrastructure and issue multiple nuclear threats.

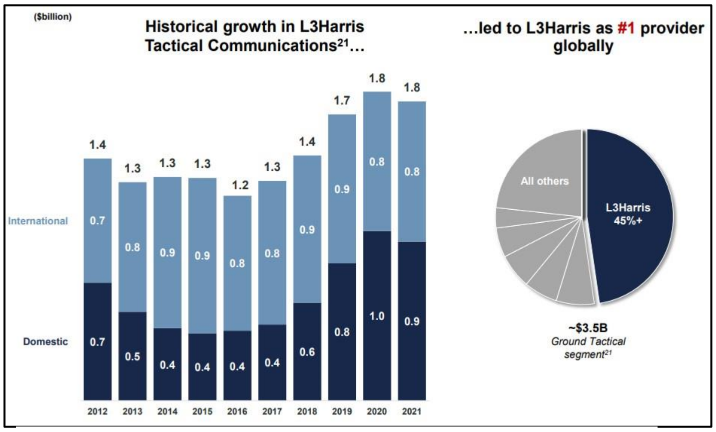
These developments have placed further emphasis on the importance of defense capabilities for both the US and its allies. At Brookmont, we have not only positioned our strategies to overweight the defense industry but also selected the companies within this allocation based on their specializations in areas that closely align with the United States and global strategic priorities. The criticality of these priorities — specifically, resilient communications, conventional missile defense, and hypersonic missile defense — has been demonstrated over the past 8 months during the first major conflict between developed states since WWII and the definitive end of the "Long Peace."



Source: Bloomberg

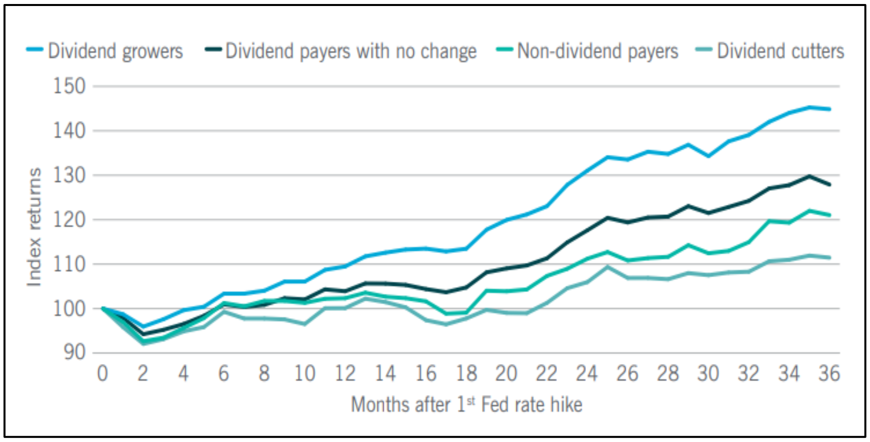
L3Harris Technologies (LHX) has substantial exposure to military communications and is the leading supplier of tactical radios to the US military. The company's Falcon IV family, including handheld and manpack radios, meets numerous criteria unique to the modern battlefield. The system offers strong encryption and anti-jam capabilities. Additionally, it offers interoperable communications capabilities for more than 20 US allies. With current conflicts and tensions involving increasingly global stakes, the ability of the Falcon IV family to easily facilitate communications across allied networks while maintaining secure channels is invaluable.

Both LHX and Raytheon Technologies (RTX) have been awarded contracts related to hypersonic missile defense. In July, LHX was awarded a $700M contract to build 14 satellites for the US Space Development Agency's (SDA) Tranche 1 Tracking Layer program. RTX also has substantial involvement in conventional air defense systems. Raytheon's Patriot missile system is one of the most globally recognized names in air defense and has the capability to counter advanced aircraft, ballistic missiles, cruise missiles, and drones. RTX is the leader in missile detection radar, with examples including the SPY-6 family for the US Navy and radars for NASAMS. The US recently announced that they will be sending 8 NASAMS to Ukraine. RTX also provides the majority of components for the Tamir missiles used in Israel's Iron Dome system.



Source: LHX Investor Report

Why Dividend Growers in this Market Environment



Source: O'Shaughnessy Asset Management

During periods of heightened volatility, uncertainty, and possible persistent inflation, investors typically favor companies that generate steady operating income and hold high market share. These characteristics favor dividend growers. Another economic driver is the rising rate environment. To curb inflation, the Federal Reserve has been transparent about its hawkish tone, and we expect further rate increases into next year. The graph above shows that dividend growers typically outperform their peers during this type of environment that we are currently facing. Valuations for the large-cap value stocks have dropped below their historical average so allocating to a dividend growth strategy in this current environment and holding for the long term will be buying companies below their fair value while also allocating to the best-performing equity class at the same time.

Certain economic and market information contained herein has been obtained from published sources prepared by other parties, which in certain cases has not been updated through the date of the distribution of this letter. While such sources are believed to be reliable for the purposes used herein, Brookmont does not assume any responsibility for the accuracy or completeness of such information.

These individual securities do not represent all of the securities purchased, sold, or recommended for this Brookmont portfolio and the reader should not assume that investments in the securities identified and discussed were or will be profitable.

The Brookmont Dividend Growth Strategy returns are based on an asset-weighted composite of discretionary accounts that include 100% of the recommended holdings. Individual accounts will have varying returns, including those invested in the Strategy. The reasons for this include, 1) the period of time in which the accounts are active, 2) the timing of contributions and withdrawals, 3) the account size, and 4) holding other securities that are not included in the Strategy. Dividends and capital gains are not reinvested. The Strategy does not utilize leverage or derivatives. Returns are based in U.S. dollars. The inception of the Strategy is January 1, 2008.

The Brookmont Dividend Growth Strategy Composite contains fully discretionary accounts with similar value equity investment strategies and objectives. For comparison purposes, the Dividend Growth Strategy Composite is measured against the Russell 1000 Value Index. The Russell 1000 Value Index measures the performance of the large-cap segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The Russell 1000 Value Index is constructed to provide a comprehensive and unbaised barometer for the large-cap value segment. There is no representation that this index is an appropriate benchmark for such comparison. You cannot invest directly in an index, which also does not take into account trading commissions and costs. The Volatility of this index may be materially different from the performance of the strategy.

The firm maintains a complete list and description of composites, which is available upon request. Results are based on fully discretionary accounts under management, included those accounts no longer with the firm. Composite policy requires the temporary removal of any portfolio incurring a client initiated significant cash inflow or outflow of at least 15% of portfolio assets. The temporary removal of such account occurs at the beginning of the month in which the significant cash flow occurs and the account re-enters the composite at the beginning of the month which follows the cash flow by at least 30 days. Additional information regarding the treatment of significant cash flows is available upon request.

Brookmont's returns do include reinvestment of dividends and are shown gross-of-fees. All transaction costs are included. The Russell 1000 Value cumulative return includes reinvestment of dividends and capital gains. During a rising market, not reinvesting dividend could have a negative effect on cumulative returns. There is no representation that this index is an appropriate benchmark for such comparison. You cannot invest directly in an index, which also does not take into account trading commissions and costs. The Volatility of this index may be materially different from the performance of the Strategy.

Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net-of-fees performance was calculated using actual management fees. Additional information regarding the policies for calculating and reporting returns is available upon request.

Your account returns might vary from the composites returns if you own securities that are not included in the Strategy or if your portfolio dollar-cost averaged into the Strategy during the reporting period.

Brookmont Capital Management claims compliance with the Global Investment Performance Standards (GIPS®). To receive a complete list and description of Brookmont's composites and a presentation that adheres to GIPS standards, please contact Suzie Begando at 214-953-0190 or write Brookmont Capital Management, 5950 Berkshire Lane, Suite 1420, Dallas, TX 75225.

The Brookmont Dividend Growth Strategy is available through several institutional platforms and registered investment advisors that are not affiliated with Brookmont Capital Management. Required minimum investments and advisory fees differ from one firm to another.

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Past performance is not indicative of future results