Brookmont Capital Dividend Equity Strategy

Reducing Our Exposure to Mid-Cap Stocks

Dating back to March 2009, the Brookmont Dividend Equity Strategy has always maintained a 30%-35% weighting in small and mid-cap stocks. It is an area of the market that includes attractive dividend-paying stocks that are often overlooked by our peers.

Knowing that mid-cap stocks often lead a market recovery, we rebalanced the portfolio in February 2009 and were active buyers in mid-cap names such as Packaging Corporation of America, Tupperware, Hubbell, Heinz, and Lubrizol (the latter two stocks were eventually acquired by Warren Buffett). From 2009 through 2013, it was not uncommon for our mid-cap holdings to produce one-year returns as high as 115%. Knowing that these type of gains are not common, we rebalanced the portfolio on several occasions to realize these significant profits.

Historically, as the market cycle progresses over the years, mid-cap stocks will eventually give way to larger companies as investors become more cautious and risk averse. Likewise, when interest rates begin to rise, mid-cap stocks will often suffer as credit is more expensive and harder to find. We saw this happen in 2011 when the Federal Reserve's Quantitative Easing was uncertain and again in 2014 when Quantitative Easing came to a definite conclusion.

There is also the question about earnings growth. Mid-cap companies gain the majority of their revenue from the domestic economy, which can be a double-edge sword. It insulates them from the negative impact of a strong dollar, but also leaves them vulnerable to the fortunes of a single economy. When the economy is beginning to rebound from a recession, mid-cap stocks are very attractive investments. Likewise, when data is indicating slower economic growth, small and mid-cap stocks historically suffer more than the rest of the market.

Taking all of this into account, we reduced our exposure to small and mid-cap stocks today and did so across the board. Our weighting in each mid-cap stock was reduced from 2.5% to 1.25%. We liquidated our exposure to one mid-cap stock that had already been reduced to a 1.25% weighting.

This tactical decision increased our cash weighting by 8.75% of the total portfolio. This is a temporary situation and should not be viewed as a sign that the markets are in trouble. The proceeds from this week's transactions will be reinvested as we progress through more first quarter earnings announcements.