BRADYCO

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Results

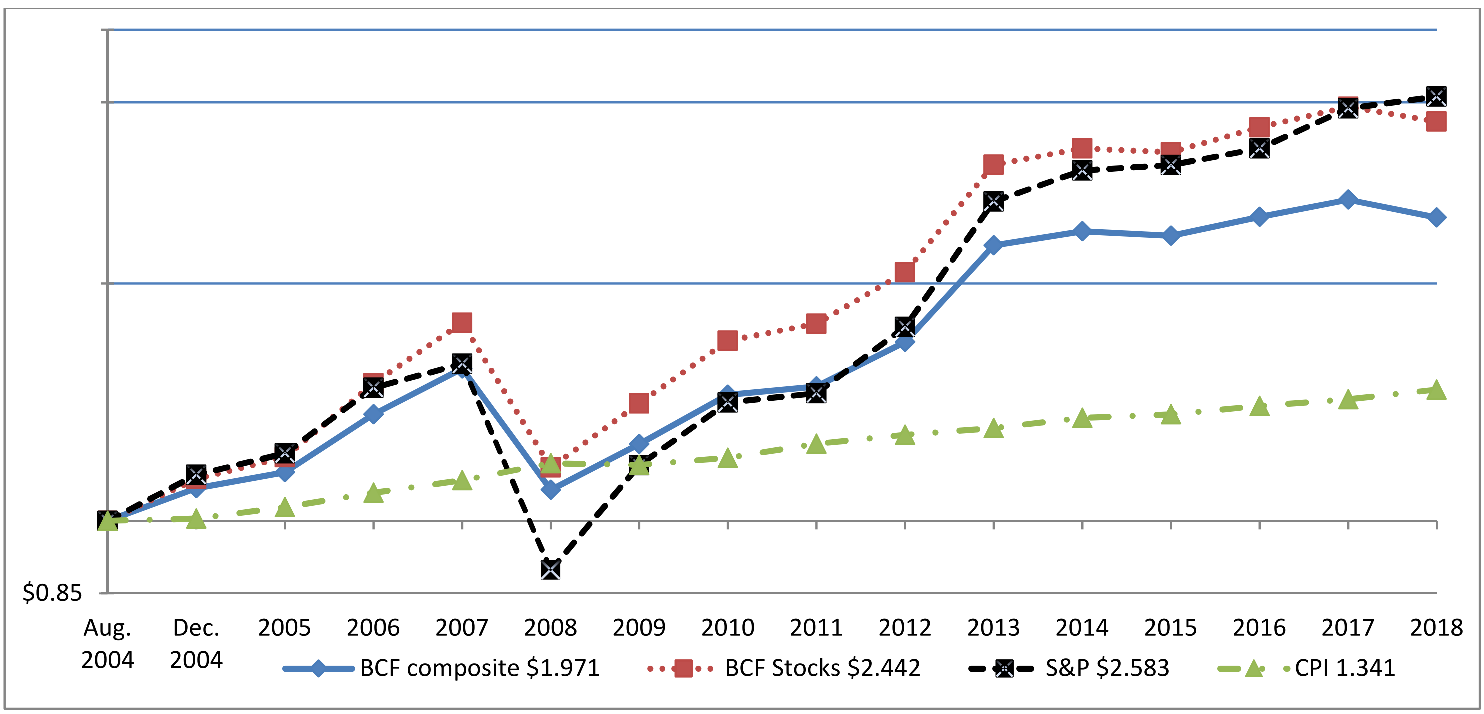
The Bradyco composite result for the first half of 2018 was a loss of -3.9%, net of expenses, while the S&P 500 index, including dividends, increased 2.7% during this same period.

The following table compares our results versus the S&P 500 index. Complete results are included at the end of this letter.

	2018 YTD	2017	2016	Last 2 yrs.	Last 5 yrs.	Last 10 yrs.	Since Inception
Bradyco composite	-3.9%	13.9%	8.4%	6.6%	8.1%	6.6%	6.8%
Bradyco stocks	-3.3%	17.6%	10.5%	9.0%	9.8%	8.3%	8.6%
S&P 500 (w/ DIV)	2.7%	21.8%	12.0%	16.1%	13.4%	10.2%	9.0%
CPI - U	2.2%	2.1%	2.1%	2.3%	1.5%	1.4%	2.1%

Returns are annualized; past performance is no guarantee of future results.

The following graph compares the performance of one dollar invested by Bradyco Financial since 7/31/04 to one dollar invested in the S&P 500 index.



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Commentary

The stock market – as represented by the S&P 500 index – gained 2.7% (including dividends) during the first half of 2018. During the same period, our stocks declined in value by 3.3% while our composite – which includes cash – declined by 3.9%. Inflation for the first six months rose by 2.2%.

The 1st half of 2018 was dominated by technology stocks. According to Goldman Sachs, 100% of the S&P 500 index's gain during the first half of 2018 was due to just 10 of the 500 stocks in the index whose combined weight makes up about 16% of the index. While we own some of the 10 stocks, we have generally avoided the three stocks which contributed the most to the S&P's gain since all three of them have been selling at very high valuations.

Cost of Selling an Appreciated Security

We sometimes need to sell shares of companies whose prospects have faded for various reasons including management retirements, changes in the marketplace, or an evolution in technology. Generally, our decision on whether to retain or sell our shares is based on a comparison of the relative valuations and future prospects of the company we own (company A) and an alternative (company B). (While going to cash is always an option in the short run, cash does not offer satisfactory returns over the long-term.)

Our decision to sell a stock becomes more complicated when the investment is held in a taxable account. Our analysis needs to account for the cost of paying capital gains on the sale of company A prior to our investment in company B. While capital gains taxes do not show up in your performance reports, taxes can have a significant impact on your long-term returns. Thus, if the potential capital gain taxes are substantial, the prospects of company B must be significantly better than those of company A to ensure that the after-tax result is positive.

For example, let's assume that our analysis of company A suggests that our investment, based on the company's current valuation, will earn a total return of $X during the next 5 years. In order for an investment in company B to make sense, its potential return must cover the cost of capital gains taxes owed on the sale of company A and still earn a return of more than $X during that period. Since our estimates of the future prospects of both companies will be educated guesses, our analysis should allow for a margin of safety so that if the gap between the actual performance of companies A and B is different than we expected, our investment will still turn out well.

One more consideration for those with significant unrealized gains in a taxable account is that under our estate tax law, if you retain an appreciated security until your death, your estate would receive a stepped-up basis for that stock. If you are unfamiliar with the term, "stepped-up basis," an example might be helpful. An investor purchases a stock for $10/share. Years later, the stock has done quite well and is selling for $100/share. If the investor sells the stock prior to their death, they would owe taxes on a capital gain of $90 (the difference between the $10 purchase price and the $100 sales price). On the other hand, if the investor still owned this stock when they died, their heirs would inherit the stock with a cost basis based on the price of the shares the day the investor died. Thus, assuming they died when the stock was selling for $100/share, the $90 in appreciation would never be taxed.

Trade Wars and Tariffs

Some of my clients have expressed concern about the impact of the Trump Administration's trade policies. Trade disputes including tariffs can have an impact at two levels – a company/industry level and an aggregate level on our overall economy. For certain companies and industries, the recent trade disputes including actual and threatened tariffs will have a short-term effect on costs, sales, and capital allocation planning. However, since negotiations between the Trump Administration and various foreign countries are still on-going, it too soon to know what the overall impact will be. It would take a major escalation in the current trade disputes to significantly harm our economy.

What's Next?

We continue to see a so-called "goldilocks" economy – where both growth and inflation rise at a moderate pace. Our economy's expansion has persisted despite gradually rising interest rates while wages have risen at a modest pace. A big unknown is whether wage inflation will accelerate as the number of new job seekers re-entering the workforce begins to decline. At some point, economic growth is likely to deteriorate if for no other reason than old age. The current expansion is already the second longest in history. Logic would suggest that an end to the economy's growth trend might occur sooner rather than later.

There are several factors that could alter this prediction. For example, recent changes in fiscal policy (e.g. the recent tax cut and significantly increased government spending) could extend the economy's growth streak. At the same time, the trade war discussed above as well as changes in monetary policy (e.g. higher interest rates) could have the opposite effect. My hunch is that in the short run changes in fiscal policy will outweigh the changes in monetary and trade policy.

Regardless of how long the current growth of our economy lasts, the next recession could end up being deeper and lasting for a longer period than most past downturns. This is because some of the tools used to soften economic weakness will be constrained. For example, the Fed fund's rate, which is currently 2%, is unlikely to be significantly above 3% by the time the next recession occurs. During past economic downturns, The Federal Reserve Bank has often cut interest rates by significantly more than 3%. Similarly, with a ballooning Federal deficit caused by recent tax cuts plus Defense and entitlement (Medicare/Medicaid/Social Security) spending increases, the ability of future Congresses to stimulate the economy with increased spending or tax cuts will be constrained by large budget deficits.

While all of this should concern us as citizens, it should not alter our long-term investment focus. America's economy has survived wars, terrorism, and all manner of catastrophes. Inflation has been too high or too low. Politicians and movements have come and gone. Over the long run, anyone who bet against the strength and durability of America's economic engine has lost.

Thank you for your confidence.

Brad

	Bradyco Composite (all)1	**Bradyco Composite (stocks only)2**	**S&P 500 Index**	**CPI**
08/04 – 12/04	7.5%	9.8%	10.9%	0.5%
2005	3.7%	5.0%	4.9%	2.6%
2006	13.8%	18.0%	15.8%	3.2%
2007	10.8%	14.5%	5.5%	2.9%
2008	-23.8%	-27.7%	-37.0%	3.8%
2009	10.8%	15.5%	26.5%	-0.4%
2010	11.6%	15.0%	15.1%	1.6%
2011	1.9%	3.9%	2.1%	3.2%
2012	10.5%	12.2%	16.0%	2.1%
2013	24.0	27.2%	32.4%	1.5%
2014	10.1%	11.7%	13.7%	0.8%
2015	2.0%	1.8%	1.4%	0.7%
2016	8.4%	10.5%	12.0%	2.1%
2017	13.9%	17.6%	21.8%	2.1%
2018 – 1H	-3.9%	-3.3%	2.7%	2.2%
08/04 – 06/18	6.8%	8.6%	9.0%	2.1%

All returns over 12 months are annualized. All calculations use prices provided by Fidelity Investments and Charles Schwab & Co. Non-discretionary accounts and accounts with 100% cash are not included. Index returns reflect the reinvestment of dividends.

1. The Bradyco Composite (all) is net of all expenses including investment management fees and trading expenses. All composite returns are asset-weighted monthly and include cash.

2. The Bradyco Composite (stocks only) does NOT include investment management fees. Returns are asset-weighted monthly and do NOT include cash. Investments in ETF, equity mutual funds, and non-discretionary accounts are NOT included.