Valuentum Securities, Inc. 11/1/2020 Edition 3, Volume 11

HIGH YIELD DIVIDEND NEWSLETTER

Our Thoughts on Philip Morris International's Latest Earnings Report

Latest Changes to High Yield Dividend Newsletter
Weighting Changes: 2.5% Reduction in PM and T (Reducing Weighting to 5.0% each) – July 21
Removed: BP and SJB – July 21 Added: 5.0% to Both CCI and CONE (5.0% each) – July 21

INSIDE THIS ISSUE

1 Our Thoughts on Philip Morris International's Latest Earnings Report
3 Crown Castle Continues to Shine
7 **Spotlight: *NEW* High-Yield Dow Inc Making Major Changes to Its Business Model**
11 JPMorgan, Citigroup Third Quarters Not Terrible, But Still Reason to Own Financials
13 Global Net Lease's Yield is Flashing Signs of Trouble
17 The High Yield Dividend Newsletter Portfolio
18 Dividend Report Page 2 – Exxon Mobil (XOM)

© 2020 Valuentum. All rights reserved. Reproduction by any means is prohibited.

"WE EXPECT CAPITAL MARKETS AROUND THE GLOBE TO EXPERIENCE SIGNIFICANT VOLATILITY BEFORE AND AFTER THE UPCOMING ELECTION IN THE UNITED STATES. OUR HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO IS WELL-POSITIONED TO RIDE OUT THE STORM."

– CALLUM TURCAN

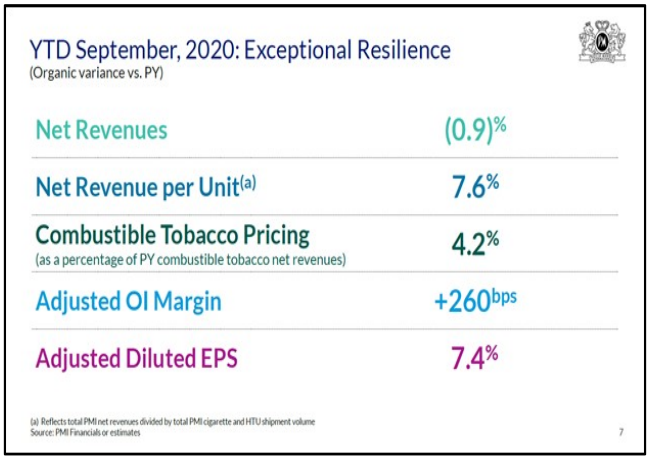


Image Shown: *Philip Morris International Inc has been able to maintain its global market share in the tobacco industry while pushing through price increases as indicated by its relatively strong 'Combustible Tobacco Pricing' performance seen through the first nine months of 2020.* ***Image Source:*** *Philip Morris International Inc – Third Quarter of 2020 IR Earnings Presentation*

By Callum Turcan

Philip Morris International Inc (PM)--**6.8% yield**--reported third quarter 2020 earnings on October 20 which saw the company beat both consensus top- and bottom-line estimates. **Philip Morris International also raised its full-year guidance for 2020** in part due to industry volumes holding up better than expected in Indonesia, which raised the minimum selling price for cigarettes while also increasing cigarette taxes at the start of 2020. For the full-year, the company now expects to generate $5.03 - $5.08 in GAAP diluted EPS (up from $4.84 - $4.99 previously) and $5.37 - $5.42 in non-GAAP adjusted diluted EPS (up from $5.23 - $5.38 previously).

Philip Morris International continued to maintain its ~28-29% market share (excluding China and the US) of the global tobacco industry in the third quarter. Additionally, the firm has been able to also push through price increases versus year-ago levels. We continue to like shares of Philip Morris International as a holding in our High Yield Dividend Newsletter portfolio. Shares of PM yield ~6.4% as of this writing on a forward-looking basis after the firm raised its quarterly dividend by roughly 3% in September.

2020 FULL-YEAR FORECAST

	Full-Year		
	2020 Forecast	2019	Organic Growth
Reported Diluted EPS	$5.03 - $5.08	$4.61	
Tax items	(0.06)	(0.04)	
Asset impairment and exit costs	0.04	0.23	
Canadian tobacco litigation-related expense		0.09	
Loss on deconsolidation of RBH		0.12	
Russia excise and VAT audit charge		0.20	
Fair value adjustment for equity security investments	0.04	(0.02)	
Adjusted Diluted EPS	$5.05 - $5.10	$5.19	
Net earnings attributable to RBH		(0.06) [a]	
Adjusted Diluted EPS	$5.05 - $5.10	$5.13 [b]	
Currency	0.32		
Adjusted Diluted EPS, excluding currency	$5.37 - $5.42	$5.13 [b]	5% - 6%

[a] Net reported diluted EPS attributable to RBH from January 1, 2019 through March 21, 2019.
[b] Pro forma.

Image Shown: *Philip Morris International now expects its non-GAAP adjusted diluted EPS will grow by mid-single-digits on an annual basis in 2020.* ***Image Source:*** *Philip Morris International – Third Quarter of 2020 Press Release*

In the third quarter, Philip Morris International's GAAP net revenues were down 3% year-over-year though **cost containment efforts and rising sales of non-conventional tobacco products helped boost its GAAP operating income by 16% year-over-year.** The company posted $1.48 in GAAP diluted EPS last quarter, up 21% year-over-year. Philip Morris International is contending with serious headwinds from the ongoing coronavirus ('COVID-19') pandemic, and through various initiatives, management has been able to adeptly navigate the company through the storm.

Future of the Tobacco Industry

One realm of the tobacco industry Philip Morris International has had a lot of success in concerns the heated tobacco space. The company's IQOS heated tobacco offerings are geared towards smokers of traditional cigarettes and the product was designed to replicate the conventional smoking experience. While Philip Morris International has other heated tobacco offerings, IQOS is its biggest bet on the future of tobacco. Global cigarette volumes are in secular decline while heated tobacco units ('HTUs') are experiencing strong sales growth, providing Philip Morris International a way to maintain and potentially grow its enormous cash flows going forward.

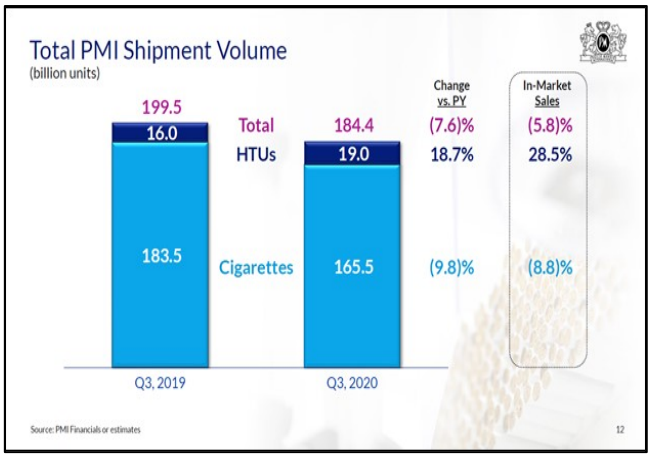


Image Shown: *Philip Morris International is utilizing growing sales of its IQOS and other heated tobacco offerings to offset declines at its traditional cigarette business.* ***Image Source:*** *Philip Morris International – Third Quarter of 2020 IR Earnings Presentation*

Management sees Philip Morris International's IQOS user base now sitting at 16.4 million, with 72% of those users being former smokers of traditional tobacco products and the remainder are in what the company views as a transitional phase. Looking ahead, these users are a source of recurring revenues for Philip Morris International just as traditional cigarette smokers are. The company launched IQOS in nine new markets so far in 2020 and is currently available in over 60 markets worldwide. Upside in the future will come from the firm launching new HTU products and expanding into new markets, along with growing the user base of its existing products.

By 2021, Philip Morris International aims to sell 90 billion – 100 billion in HTUs. For reference, the firm sold just over 54 billion HTUs in 2020 through the end of September. Additionally, the company sold just under 60 billion HTUs in 2019, **highlighting the rapid growth rate Philip Morris International is experiencing on this front.** This momentum is expected to continue going forward.

During the first nine months of 2020, Philip Morris International generated almost one quarter of its net revenues from reduced risk products ('RRPs'), up sharply from 2015 levels when RRPs were the source of less than 1% of the company's net revenues. IQOS is considering an RRP. Additionally, RRPs are now the source of over 10% of the firm's total shipment volumes (as of the first three quarters of 2020). During the company's latest earnings call, management noted that "the positive effect of the shift in our sales mix towards RRPs can be seen in the 6.5% organic increase in net revenue per unit" and that should help support the firm's margins going forward.

Financial Update

Additionally, cost containment efforts are expected to improve the tobacco giant's margins in the coming years. During the company's second quarter earnings call, management noted that the company was "on track to deliver our target of over $1 billion in efficiency by 2021 through both manufacturing productivity and SG&A savings."

Furthermore, Philip Morris International sees "additional opportunities" on this front which could be unlocked through "the acceleration of digital activities." In its third quarter earnings presentation, the company noted that marketing, administration, and research costs as a percentage of its total net revenues were shifting lower. We appreciate Philip Morris International's efforts to improve its cost structure.

At the end of September 2020, Philip Morris International had $4.8 billion in cash and cash equivalents on hand versus $2.1 billion in short-term debt and $27.3 billion in long-term debt. Though the company has a net debt load, we see Philip Morris International having a good handle on that burden given its ability to generate meaningful free cash flows in any environment.

Management forecasts that Philip Morris International will generate at least $9.0 billion in net operating cash flow and that the firm will spend $0.6 billion on its capital expenditures this year (keeping working capital movements and foreign currency fluctuations in mind). Please note the company moderately reduced its capital expenditure expectations for 2020 during its latest earnings report.

Concluding Thoughts

Though shares of PM sold off initially on the report, we view Philip Morris International's latest update as validating our long-term income generating thesis. Its margins are improving, the company remains incredibly free cash flow positive, management recently pushed through another dividend increase, and Philip Morris International boosted its full-year outlook for 2020.

We expect Philip Morris International will be able to maintain its generous payout policy throughout the pandemic. Longer term, management's focus on innovation is paying off given the success seen at Philip Morris International's IQOS offering.

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

Crown Castle Continues to Shine

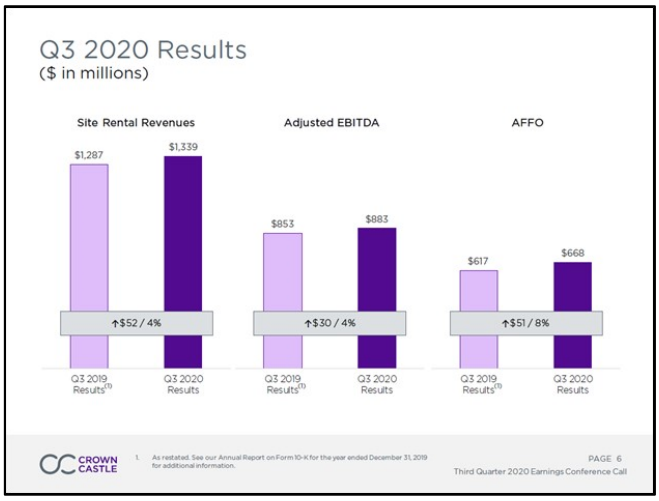


Image Shown: *Crown Castle International Corp.'s growth trajectory continued in the third quarter of 2020.* ***Image Source:*** *Crown Castle International Corp. – Third Quarter of 2020 IR Earnings Presentation*

By Callum Turcan

Crown Castle International Corp. (CCI)--**3.4% yield**--is a real estate investment trust ('REIT') that owns 40,000+ cell towers, ~70,000 small cell nodes (on air or under contract) and ~80,000 route miles of fiber that support numerous networking operations all across the US. We include shares of Crown Castle as a holding in our High Yield Dividend Newsletter **given its ability to generate sizable free cash flows even after investing heavily in expanding its asset base.**

From 2017 to 2019, Crown Castle generated ~$0.75 billion in annual free cash flows, though the firm had to tap capital markets to cover its annual common dividend obligations which averaged ~$1.75 billion during this period (its annual preferred dividend obligations averaged just under $0.1 billion during this period).

While the REIT is capital market dependent, given the importance of its asset base which is primarily made up of essential infrastructure that supports telecommunications services in the US (including 5G services) and its ability to generate consistent free cash flows (rare in the REIT industry), we see Crown Castle maintaining access to both debt and equity markets at attractive rates going forward.

When the REIT reported third quarter 2020 earnings on October 21, management had enough confidence in Crown Castle's outlook to boost the firm's quarterly dividend by 11% on a sequential basis.

Though management has had to adjust Crown Castle's 2020 guidance several times (including to the downside), largely due to headwinds created by the ongoing coronavirus ('COVID-19') pandemic, **the REIT still expects to generate meaningful revenue and adjusted funds from operations ('AFFO') growth this year.**

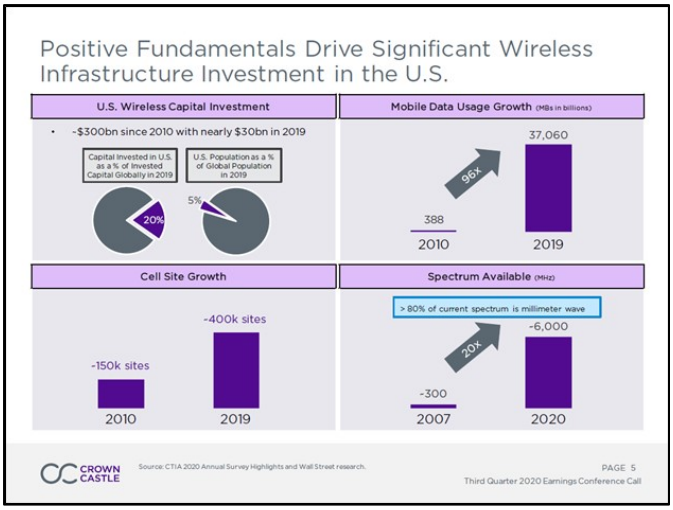


Image Shown: *A snapshot of the market Crown Castle operates in and why its asset base is essential to supporting US networking operations.* ***Image Source:*** *Crown Castle – Third Quarter of 2020 IR Earnings Presentation*

Looking Ahead

In 2019, Crown Castle generated $5.1 billion in 'site rental' revenue, and please note this does not include 'services and other' revenue. In 2020, the REIT's current guidance calls for $5.3 billion in site rental revenue for the full-year. Additionally, Crown Castle expects to generate $5.6 billion in site rental revenue in 2021, indicating the REIT expects its core sales will continue to grow.

Pivoting to AFFO, though an imperfect non-GAAP measure, this metric is useful for gauging a REIT's ability (or lack thereof) to maintain and grow its dividend. In 2019, Crown Castle generated $5.69 per share in AFFO, which management's current forecast indicates will grow to $6.09 per share in 2020 (at the midpoint of guidance). Next year, management sees Crown Castle generating $6.69 per share in AFFO (at the midpoint of guidance).

Looking at its current annualized dividend of $5.32 per share and its expected AFFO in 2021, Crown Castle is targeting a payout ratio just under 80% next year (expected dividends per share divided by expected AFFO per share in 2021). We appreciate payout ratios south of 80% as that indicates the REIT has a solid handle on its dividend obligations, keeping their refinancing needs in mind.

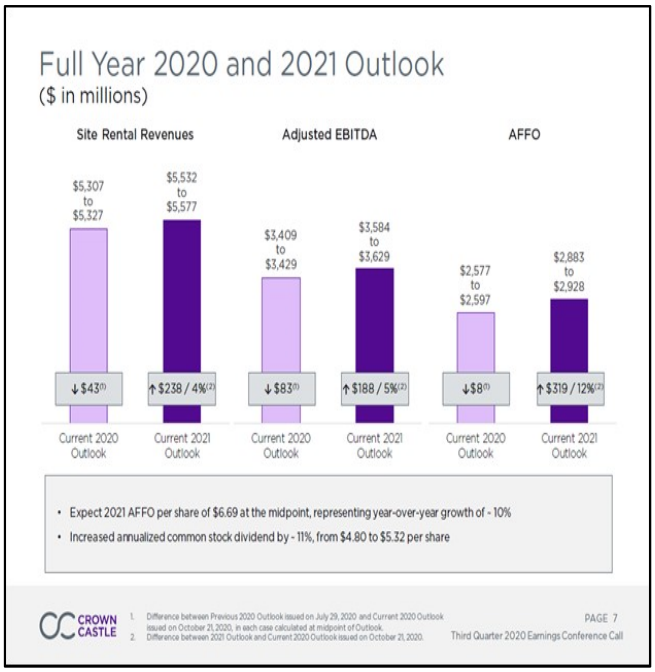


Image Shown: *An overview of Crown Castle's outlook for 2020 and 2021.* ***Image Source:*** *Crown Castle – Third Quarter of 2020 IR Earnings Presentation*

Financial Update

Crown Castle ended September 2020 with a little over $0.2 billion in cash and cash equivalents on hand along with a little under $0.2 billion in restricted cash on the books, versus $0.1 billion in short-term debt and $19.2 billion in 'debt and other long-term obligations' and please note the REIT also has sizable operating lease liabilities as well. To manage its liquidity needs, Crown Castle has a revolving credit line with $5.0 billion in total borrowing capacity that matures June 2024.

During Crown Castle's latest earnings call, management noted that the REIT had ~$4.5 billion in remaining borrowing capacity under that credit facility. Here is what management had to say during Crown Castle's latest earnings call regarding the REIT's financial position (slightly edited, emphasis added):

> *"As… discussed earlier, we expect discretionary capital expenditures in 2021 to be approximately $400 million lower when compared to 2019, totaling approximately $1.5 billion as we apply a rigorous analytical approach to each capital investment decision.* ***We anticipate the combination of lower capital expenditures and higher cash flow growth will allow us to fund our discretionary capital budget next year with free cash flow and incremental debt capacity consistent with our investment grade credit risk profile.*** *[Continued on next page]*

[Continued from previous page] As it relates to the balance sheet, we finished the quarter with 5.4 times debt to EBITDA, a weighted average maturity of 9 years, ***no maturities until 2022*** *and approximately $4.5 billion of undrawn capacity on our revolving credit facility. Our debt maturity profile is a result of a deliberate approach to minimize financing risk and more closely match our debt maturities for the long-term nature of our asset base, while focusing on driving down our overall cost of capital." --- Dan Schlanger, CFO of Crown Castle*

Looking ahead, management sees Crown Castle being able to fund its 2021 capital expenditure needs without needing to tap equity markets. Effectively, that allows Crown Castle to fund its growth ambitions without diluting existing shareholders (the REIT's outstanding diluted share count grew by 1% year-over-year during the first nine months of 2020, a relatively modest figure). Fitch Ratings upgraded Crown Castle's credit rating (long-term issuer rating, unsecured rating, and revolving credit rating) to BBB+ from BBB with a staple outlook in May 2020. Moody's Corporation (MCO) gives Crown Castle an investment grade credit rating of Baa3, specifically for its senior unsecured credit rating.

Concluding Thoughts

We continue to be big fans of Crown Castle and view the REIT's long-term outlook quite favorably. Its cash flow profile is impressive, its growth runway is promising, and we appreciate its investment grade credit ratings and lack of near-term debt maturities. Crown Castle is well-positioned to capitalize on the rollout of 5G telecommunications services in the US and should be able to maintain its dividend growth trajectory going forward, keeping headwinds stemming from the ongoing COVID-19 pandemic in mind (which the REIT has been able to adeptly navigate so far, in our view).

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

[Please see next page for a summary of portfolio activity during 2019.]

Tracking the High Yield Dividend Newsletter	Price -- 12/31/2018 or at open*	Interim Dividends	Price -- 12/31/2019 or at close**
CORE			
Alerian MLP ETF (AMLP) -- *removed* November 18	8.73	0.78	7.83
Added 2.5pts of AT&T (T) -- November 18	*39.21*	-	39.08
Added 2.5pts of Philip Morris (PM) -- November 18	*84.57*	1.17	85.09
Global X SuperDividend ETF (SDIV)	17.10	1.54	17.69
Global X SuperIncome Preferred ETF (SPFF)	11.03	0.71	11.74
iShares International Select Dividend ETF (IDV)	28.71	1.73	33.57
iShares MSCI Australia ETF (EWA)	19.25	0.90	22.64
iShares U.S. Preferred Stock ETF (PFF)	34.23	2.00	37.59
Invesco Senior Loan Portfolio (BKLN)	21.78	1.11	22.82
ProShares High Yield -- Interest Rate Hedged (HYHG)	62.09	3.97	65.44
Utilities Select Sector SPDR (XLU) -- *added August 22*	*61.61*	0.99	64.62
Vanguard Real Estate ETF (VNQ) - *added April 1*	*85.91*	2.53	92.79
EQUITY			
AT&T (T)	28.54	2.04	39.08
BP PLC (BP)	37.92	2.46	37.74
CubeSmart (CUBE) -- *added August 22*	*35.13*	0.65	31.48
Digital Realty Trust (DLR)	106.55	4.32	119.74
Enterprise Products Partners (EPD)	24.59	1.76	28.16
Iron Mountain (IRM) -- *removed August 1*	32.41	1.22	29.97
Magellan Midstram Partners (MMP)	57.06	4.04	62.87
Omega Healthcare Investors (OHI) -- *removed March 1*	35.15	0.66	34.72
Philip Morris (PM) -- *added August 1*	*82.41*	2.34	85.09
Public Storage (PSA)	202.41	8.00	212.96
Schlumberger*, added January 18, removed August 1*	*43.00*	1.00	38.07
Realty Income Corporation (O) -- *removed April 1*	63.04	0.68	72.03
Tallgrass Energy LP (TGE) -- *removed August 1*	24.34	1.59	18.25

* As shown in the January 2019 edition of the High Yield Dividend Newsletter, or price at entry point

** Price as of December 31, 2019, or price at close

-- THE HIGH YIELD DIVIDEND SPOTLIGHT IS ON THE NEXT PAGE --

HIGH YIELD SPOTLIGHT

High-Yield Dow Inc Making Major Changes to Its Business Model

Our **High Yield Spotlight for November 2020** is the commodity chemical company Dow Inc (DOW)--**6.2% yield**--which manufacturers plastics, coatings, silicones, and industrial intermediates. The company caters to a wide range of end-markets and has a sizable global presence with 100+ manufacturing sites spread out across 30+ countries. In 2019, Dow's revenues were broadly split bet ween three geographic markets (in terms of the location of its customers); US/Canada (36% of its annual sales), Europe/Middle East/Africa/India (34% of its annual sales), and Asia Pacific/Latin America (30% of its annual sales). Looking ahead, Dow sees ample room for upside in the consumer care, infrastructure, and packaging markets which management views as high-growth opportunities.

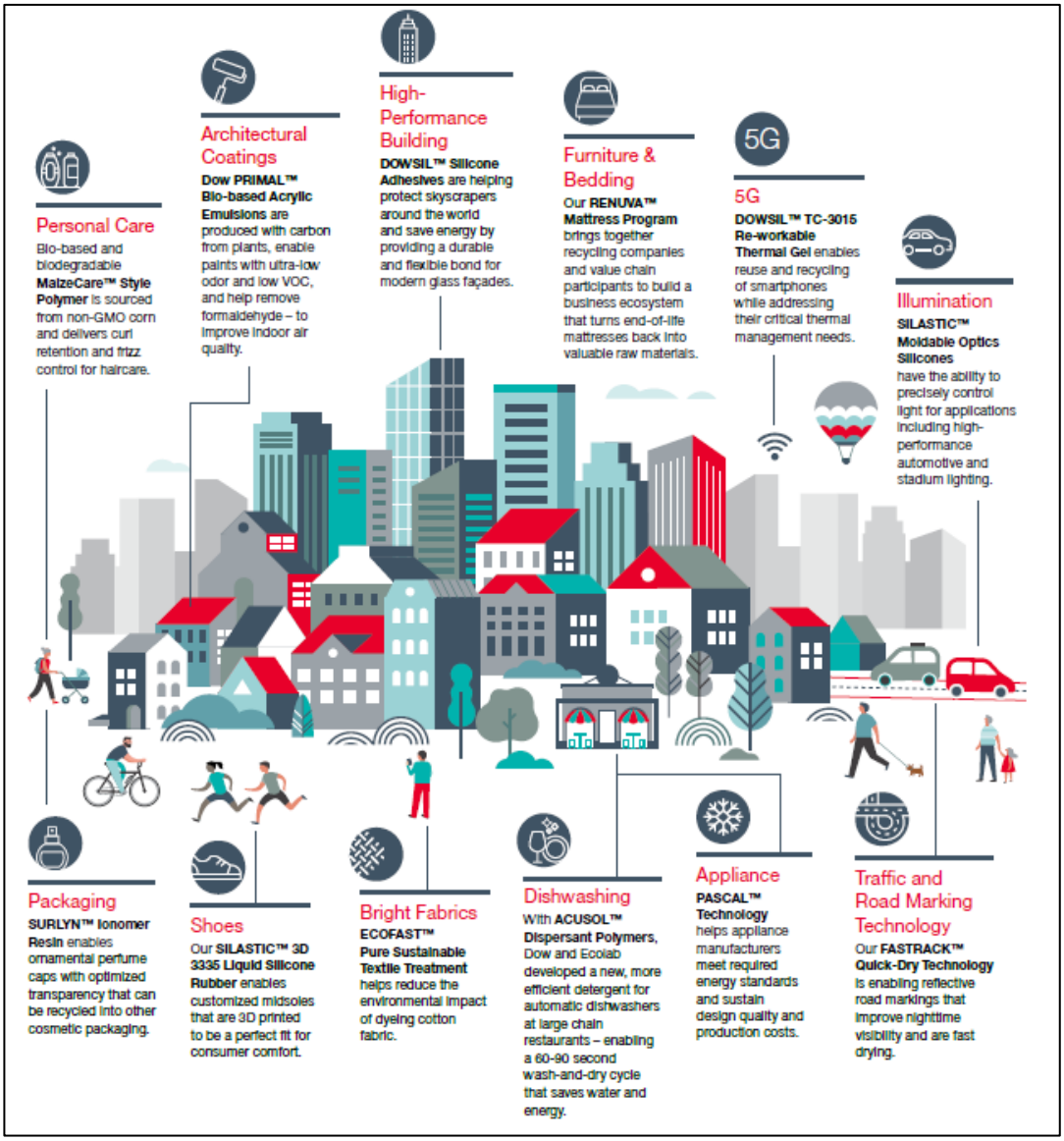


Image Shown: *An overview of some of Dow's various offerings.* ***Image Source:*** *Dow – 2019 Annual Report*

Dow is one of the successor companies to DowDuPont, which split its operations into three publicly-traded entities. The other successor companies are now known as DuPont de Nemours Inc (DU) and Corteva Inc (CTVA). As part of this separation, Dow was formed as a holding company of The Dow Chemical Company ('TDCC') and its consolidated subsidiaries, with TDCC now being a wholly owned subsidiary of Dow. In April 2019, the separation of Dow from DowDuPont was completed.

To improve its cost structure, Dow launched a restructuring program in 2020 that is forecasted to deliver $300 million in annualize cost savings by the end of 2021. Part of this strategy involves rationalizing its workforce and asset base while also divesting non-core assets. Management is focusing on shutting down smaller manufacturing facilities in Canada, the US, and Europe which lack the scale to generate meaningful returns.

Shifting gears to its divestment strategy, Dow completed the sale of its North American rail assets earlier this year and recently entered into an agreement to sell off select marine terminals in the US Gulf Coast region which is expected to close by the end of 2020. The rail assets were sold for ~$310 million and the pending sale of its marine terminal assets is expected to raise ~$620 million. We appreciate the targeted improvements in Dow's cost structure as that should go a long way in enhancing its cash flow profile.

Please note that its targeted cost savings from the aforementioned restructuring program are in addition to another cost savings initiative Dow launched. By the end of 2020, Dow aims to reduce its operating expenses by $500 million (up from its previous guidance of $350 million). According to past management commentary given during the firm's first quarter of 2020 earnings call earnings call, those savings are being generated by idling some of its production capacity and curtailing discretionary spending (such as travel-related expenses). Management stressed that these particular cost savings are not primarily headcount-related during the call, but it does appear that there is a good chance a chunk of these savings are not "sticky." By that we mean once Dow resumes production activities at its idled operations its expenses would rise in turn, though keeping a lid on discretionary spending would improve Dow's cost structure in the long run.

During the first nine months of 2020, Dow generated $4.6 billion in net operating cash flow and spent $1.0 billion on its capital expenditures, allowing for $3.6 billion in free cash flows. That easily covered $1.6 billion in dividend payments and $0.1 billion in share repurchases made during this period. **Management has made deleveraging a priority, which we really appreciate.** From the end of 2019 to the end of September 2020, **Dow's net debt load (inclusive of short-term debt) fell by $1.8 billion.** However, we caution that Dow still had a $12.8 billion net debt load (inclusive of short-term debt) as of the end of September, though its $4.6 billion cash, cash equivalents, and marketable securities (included in its 'other current assets' line-item) position provides the firm with ample liquidity.

RECONCILIATION OF NET DEBT

Reconciliation of Net Debt In millions (Unaudited)	Sep 30, 2020	Dec 31, 2019
Notes payable	$ 329	$ 586
Long-term debt due within one year	347	435
Long-term debt	16,698	15,975
Gross debt (GAAP)	$ 17,374	$ 16,996
- Cash and cash equivalents	4,549	2,367
- Marketable securities	30	21
Net debt (non-GAAP)	$ 12,795	$ 14,608

Image Shown: *Dow continues to delever which we really appreciate.* ***Image Source:*** *Dow – Third Quarter of 2020 IR Earnings Presentation*

Expected divestment proceeds and future free cash flows will help Dow bring its leverage ratio further under control. Management noted during Dow's third quarter earnings call that the company does not have a "substantive debt maturity" until mid-2024 after recent refinancing activities. Additionally, management reiterated that Dow would continue to delever going forward, which will improve Dow's dividend coverage strength on a forward-looking basis.

The ongoing coronavirus ('COVID-19') pandemic has weighed negatively on Dow's financial performance of late, though the company is taking the necessary measures to better position itself to ride out the storm. Its GAAP revenues fell by 15% year-over-year during the first nine months of 2020 as the global economy slowed to a crawl in various regions. However, **we would like to stress here Dow's ability to generate meaningful cash flows in this tough operating environment.**

Dow's income from continuing operations is a messy read because of sizable 'restructuring and asset related charges – net' and 'integration and separation costs' which combined came in at $0.9 billion during the first nine months of 2020 (and were also material in the same period in 2019). Going forward, restructuring charges will likely remain elevated as Dow completes its cost improvement strategies, though those expenses should roll off in the medium-term. Dow sees the market for commodity chemical products beginning to improve in earnest, and furthermore, that the company is well-positioned to meet a return in global demand.

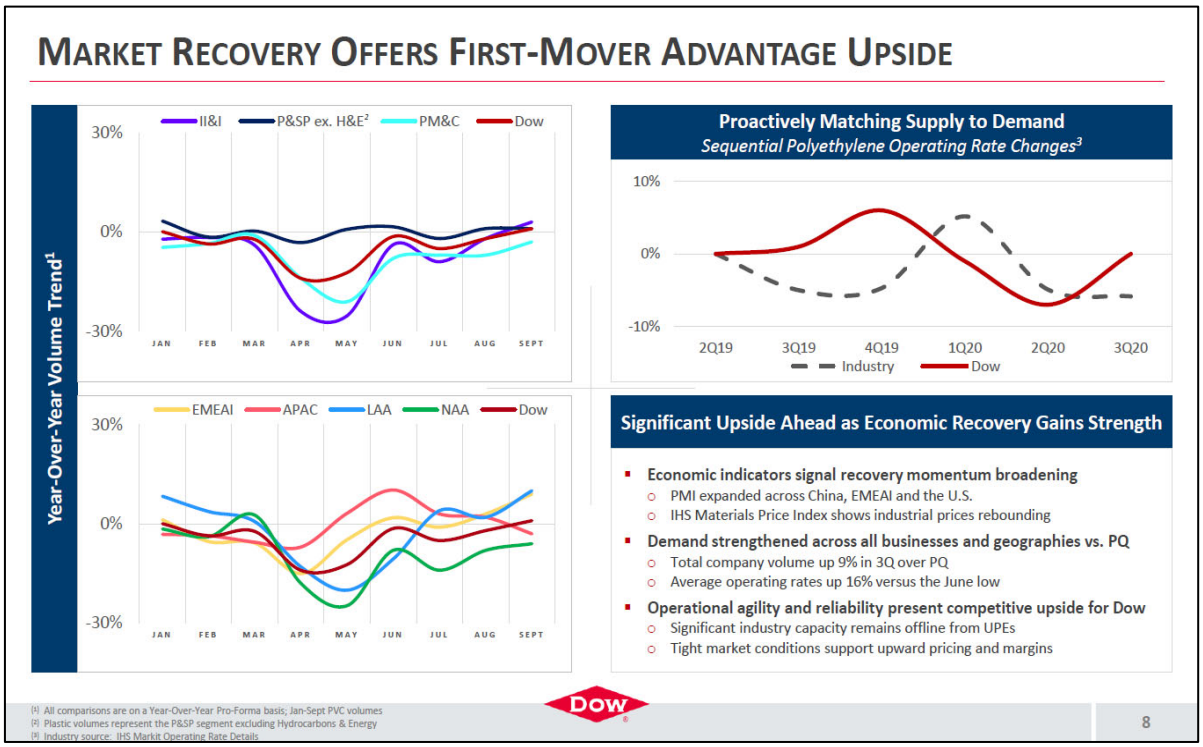


Image Shown: *The outlook for the commodity chemicals market is beginning to improve after demand slowed down sharply due to the COVID-19 pandemic earlier on in 2020.* ***Image Source:*** *Dow – Third Quarter of 2020 IR Earnings Presentation*

Management also responded to the COVID-19 pandemic by reducing Dow's capital expenditure budget, bringing it down to ~$1.25 billion in 2020 versus the $2.0 billion the company spent in 2019. **Reduced capital expenditure expectations and limited share repurchases supports Dow's ability to generate sizable free cash flows and puts the firm in a better position to keep making good on its dividend obligations.** The company's management team reiterated their support for Dow's current dividend policy during the firm's latest earnings call.

Dow is highly levered to the state of the global economy. The company attempts to invest in projects with cost-advantaged feedstock options and endeavors where meaningful economies of scale can be realized. While that has proven effective in the past, there are limits to what Dow can do when faced with sizable exogenous headwinds. We will caution here that beyond Dow's net debt load, the biggest threat to its ability to keep making good on its dividend obligations is a weak global economy for a sustained period of time.

In 2017, Dow brought a new ethylene production facility and 'Enhanced Polyethylene' production facility online in Freeport, Texas, which gives these facilities access to low-cost ethane supplies and overseas markets (Freeport is situated along the US Gulf Coast). Ethane is a natural gas liquid ('NGL') that is abundant in the US due to the rise of "fracking" and the related midstream investments that allow vast supplies to travel across the country from various shale plays. By integrating these operations, Dow aims to capture the benefits from scale, cost-advantaged feedstocks, and access to international markets where demand growth for polyethylene (a plastics product) is expected to be quite strong in the long-run. A growing global middle class is expected to drive up demand for plastics products and packaging offerings.

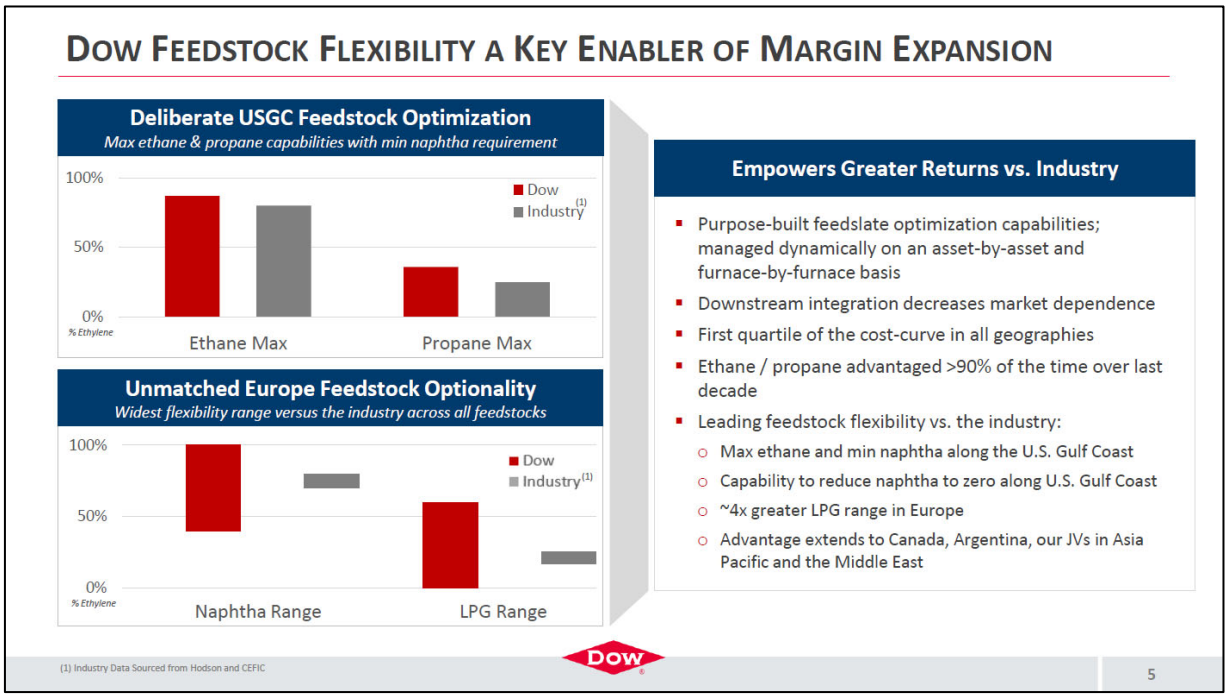


Image Shown: *An overview of how Dow views its feedstock advantages over its peers.* ***Image Source:*** *Dow – Third Quarter of 2020 IR Earnings Presentation*

We view Dow's long-term outlook favorably and though 2020 has been a rocky year for the year, management has adjusted accordingly. **Deleveraging efforts will put downward pressure on Dow's annual financing expenses (cheaper cost of debt, and the potential to reduce its total debt load) while rationalizing its asset base and pivoting its focus to its core competencies should go a long way in improving its cost structure and ultimately Dow's ability to generate free cash flows.** As long as Dow stays the course, its dividend coverage strength on a forward-looking basis should continue to improve. We expect Dow will continue to make good on its dividend obligations going forward.

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

JPMorgan, Citigroup Third Quarters Not Terrible, But Still No Reason to Own Financials

Please note a version of this article was emailed out to members on September 17.

S&P 500 Sector Return (%)	2/19/2020-3/23/2020	S&P 500 Sector Return (%)	3/23/2020-5/14/2020
Consumer Staples	-24.3	Energy	50.8
Healthcare	-28.1	Healthcare	33.1
Communication Services	-28.6	Information Technology	31.8
Information Technology	-31.2	Materials	31.2
Consumer Discretionary	-31.9	Consumer Discretionary	30.6
Utilities	-35.9	Utilities	23.5
Materials	-36.4	Communication Services	23.4
Real Estate	-38.0	Industrials	22.1
Industrials	-41.8	Real Estate	21.4
Financials	-43.0	Financials	19.6
Energy	-56.0	Consumer Staples	16.2

Image: *Banks and financials were among the most aggressively beaten down groups during the COVID-19 crash, and the sector failed to participate meaningfully in the bounce back. The leveraged and arbitrary nature of banking business models makes them much less attractive than entities with strong net cash positions on the balance sheet and solid expected future free cash flows. Source: Kastner, David, Charles Schwab. "Schwab Sector Views: Changes Are Coming." 18 June 2020.*

By Brian Nelson, CFA

Better-than-feared third-quarter reports are not going to change our minds on the banking and financials sector. The group has been among the worst performing sectors amid the COVID-19 market crash and failed to bounce back meaningfully since the March bottom. Banks are being used as extensions of government fiscal intervention via myriad stimulus programs, while oversight puts a limit on just how much capital they can return to shareholders.

Returns on equity remain subpar for many, and systemic risk remains present with most books opaque and intertwined within the global financial system. Cash flows for the group are largely arbitrary, and most remain leveraged by the very nature of their business models. We see no reason to own most banks and financials and point to fintech via PayPal (PYPL) and credit card processor Visa (V) as our favorite ideas for indirect exposure to the global financial system.

Just how hard is it to manage a bank these days? Earlier this month, Citigroup (C) was hit with a $400 million civil penalty from the Office of the Comptroller of the Currency, and the Fed recently ordered Citigroup to improve its risk control measures citing ongoing deficiencies *from years ago*. It's been over a decade since the worst of the Great Financial Crisis, and Citigroup is still working to get its house in order:

> We are disappointed that we have fallen short of our regulators' expectations, and we are fully committed to thoroughly addressing the issues identified in the Consent Orders.
>
> Citi has significant remediation projects underway to strengthen our controls, infrastructure and governance.
>
> These projects are each multi-year and have received significant investment. However, while we have made progress in each of these areas, we recognize that substantial improvement is still required to meet the standards we have set for ourselves and that our regulators expect of us.

Third quarter results released October 13 from Citigroup and JPMorgan (JPM) were not terrible, but the group will be facing a period of elevated loan losses and tighter net interest margins. The COVID-19 pandemic and the Fed's response have put many of the money center banks in a bind, and while markets-related revenue may help offset some pressure, it's hard to own a bank when one can instead gain exposure to transparent, net cash rich, strong free cash flow generating, moaty business models in the Best Ideas Newsletter portfolio.

Revenue during the third quarter at Citigroup dropped 7% from the prior-year period, while net income fell 34% due to higher expenses and increased credit costs. Return on average common equity was paltry at 6.7% in the period even though it did migrate upward from the weak 2.4% showing during the second quarter of 2020. Citigroup's tangible book value sits at $71.95 per share, but economic value destruction (ROE<COE) means the company should trade well below tangible book; shares are exchanging hands at $44.35 at the time of this writing.

Celebrity JPMorgan CEO Jamie Dimon catches a lot of media attention these days, but JPMorgan's stock is out of favor, down over 26% year-to-date, while a representative ETF for the Best Ideas Newsletter portfolio—generally large cap growth—has advanced more than 30% so far this year. Net revenue fell on a year-over-year basis during JPMorgan's third quarter, but the bank still managed to generate net income expansion and a very respectable 15% ROE. Credit loss provisioning came in lower than expected at JPMorgan in the period.

With so many other good ideas out there, we just don't like exposure to the traditional banking industry in the Best Ideas Newsletter portfolio and Dividend Growth Newsletter portfolio. This view has served many a member well, as the financials sector has performed terribly through the course of 2020; we don't expect this to change anytime soon, as we expect large cap growth, big cap tech, and the NASDAQ to continue to lead. The upcoming graphic down below highlights our valuation analysis for PayPal.

Valuation Analysis

Valuation Assumptions

In Millions of USD (except for per share items)	5-year Projections	
Revenue CAGR %	14.7%	
Avg. EBIT Margin %	25.9%	
Avg. Cash Tax Rate %	15.0%	
Earnings Before Interest CAGR %	24.7%	
Earnings Per Share CAGR %	32.2%	
Free Cash Flow to the Firm CAGR %	24.3%	
Earnings before interest = Net operating profits less adjusted taxes	Long-term Projections	
Phase II --> III FCFF CAGR %	5.8% (II)	3% (III)
Cost of Equity %	8.9%	
After-tax Cost of Debt %	4.8%	
Discount Rate (WACC) %	8.8%	
Synthetic credit spread = 1.29%	Results	
Phase I Present Value	33,402	
Phase II Present Value	104,056	
Phase III Present Value	93,964	
Total Firm Value	231,422	
Net Balance Sheet Impact	5,796	
Total Equity Value	237,218	
Diluted Shares Outstanding	1,188.0	
Fair Value per Share	$200.00	

Valuation Breakdown

In the chart below, we show the build up to our estimate of total enterprise value for PayPal and the break down to the firm's total equity value, which we estimate to be about 237.22USD billion. The present value of the enterprise free cash flows generated during each phase of our model and the net balance sheet impact is displayed. We divide total equity value by diluted shares outstanding to arrive at our $200 per share fair value estimate.

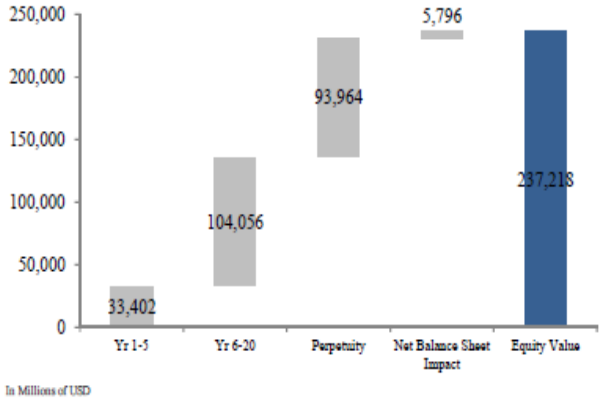


Image Shown: *A look at our valuation analysis covering PayPal, our favorite financial company. PayPal has significant exposure to numerous secular growth tailwinds, such as e-commerce and peer-to-peer money transfers, and we appreciate the firm's high quality cash flow profile.*

Disclosure: *Brian Nelson owns shares in SPY, SCHG, DIA, VOT, and QQQ.*

Global Net Lease's Yield is Flashing Signs of Trouble

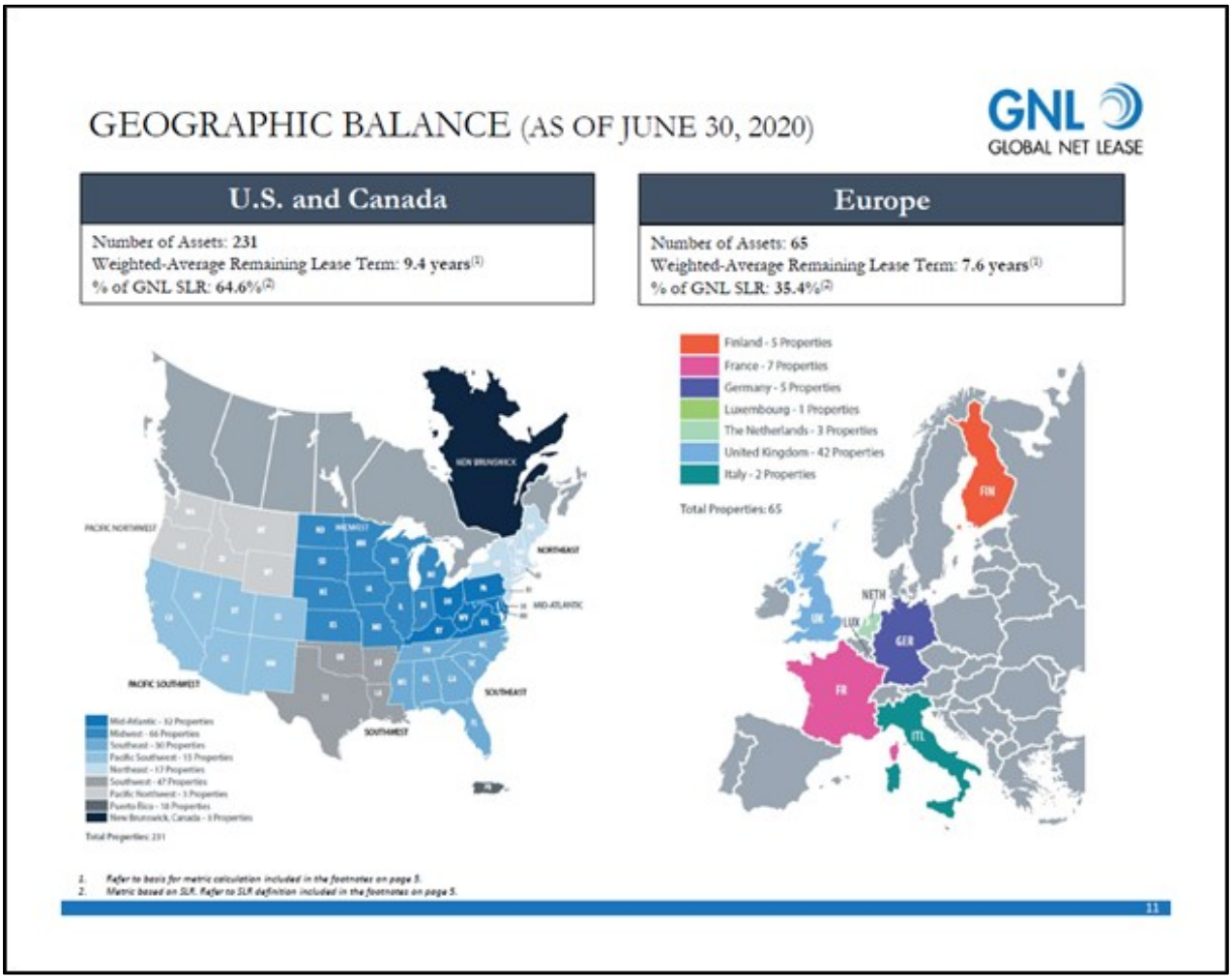


Image Shown: *An overview of Global Net Lease's asset base.* ***Image Source:*** *Global Net Lease – Second Quarter of 2020 IR Earnings Presentation IR*

By Callum Turcan

Global Net Lease (GNL) is a real estate investment trust ('REIT') focused on single tenant net-leased commercial properties in the US, Canada, and Europe. Sale and leaseback transactions are a common way the REIT grows its business. At the end of June 2020, a little less than two thirds of its annualized rental income came from properties in the US and Canada. Global Net Lease generated a little less than half of its annualized rental income from both office properties and industrial/distribution properties, with the remainder coming from retail properties. **Shares of GNL yield ~11.2%** on a forward-looking basis as of this writing after the REIT cut its quarterly payout in early 2020.

Financial Overview

Like most REITs, Global Net Lease carries a significant net debt load which we will get into later. From 2017 to 2019, Global Net Lease generated ~$141 million in annual net operating cash flows on average while spending just ~$7 million per year on average covering its capital expenditures during this period. However, the REIT also spent ~$380 million per year on average on activities classified as 'investment in real estate and real estate related assets' and another ~$147 million per year on average covering its dividend obligations (including preferred and common dividend obligations) during this period. There are also modest 'distributions to non-controlling interest holders' to consider as well.

Its dividend obligations are primarily funded by its ability to tap capital markets for funds, ideally at attractive rates. Historically, Global Net Lease has preferred to tap both debt and equity markets for funds. The REIT has an at-the-market ('ATM') equity issuance program and a revolving credit facility. **As a capital market dependent entity, should Global Net Lease lose access to debt and/or equity markets, not only would the REIT have to seriously consider suspending its payout but its core operations would also likely be severely impacted** given that only a portion of its growth-related expenditures have historically been covered by internally generated funds (i.e. net operating cash flow).

Elevated Payout Ratio

With that in mind, the ongoing coronavirus ('COVID-19') pandemic has weakened investor confidence in Global Net Lease's ability to keep making good on its dividend obligations going forward. That is reflected in the relatively high yield shares of GNL have as of this writing. Part of that comes from its adjusted funds from operations ('AFFO') slipping in 2020 versus last year's levels.

In the second quarter of 2020, Global Net Lease's AFFO per share dropped by 6% year-over-year hitting $0.44 per share. Though an imperfect industry-specific metric, AFFO is a useful tool for getting an idea of the REIT's ability to maintain its payout. Currently, the firm's quarterly payout sits at $0.40 per share, indicating its AFFO payout ratio (dividends per share divided by AFFO per share) is quite high at 91% based on its second quarter performance. **Payout ratios below 80% are preferred, and ratios over 85% are a red flag.**

Rent Collection Efforts

On October 8, Global Net Lease put out a press release that noted it had collected "97% of the original cash rent due for the third quarter of 2020 has been received as of October 2, 2020" including 99% of the rent due concerning its properties in the UK and other European countries. For reference, Global Net Lease collected "over 98%" of the rent it was due in the second quarter of 2020 according to management commentary during its second quarter earnings call. The REIT may receive additional rent payments before announcing its third quarter earnings, **but it is worth noting that its rent collection performance likely stagnated from the second to the third quarter of this year.**

Investors may also be concerned that Global Net Lease's ability to push through organic rental rate increases in the future will be diminished by the acceleration of certain trends. If the working from home trend continues, and there are plenty of signs it will for workers in certain sectors/industries (especially tech), it may become tough to push through rental rate increases if occupancies rise down the road. Global Net Lease has deferred rent payments for a portion of its tenants in light of the headwinds created by the COVID-19 pandemic.

At the end of June 2020, 99.6% of Global Net Lease's portfolio by square leasable feet was leased, and contractual rent increases are built into the vast majority of those agreements, though these are extenuating times. As contracts come up for renewal, Global Net Lease may find it hard to continue including meaningful rental rate increases at some of its properties, specifically office properties.

Highly Levered

Global Net Lease had $0.3 billion in cash and cash equivalents on hand at the end of June 2020. Though dwarfed by $1.3 billion in net mortgage notes payable, $0.3 billion drawn on its revolving credit facility, and $0.4 billion in net term loans at the end of this period, Global Net Lease has a decent amount of liquidity to meet its near-term needs.

Its revolving credit facility and term loan combined have $1.235 billion is total borrowing capacity (according to its second quarter of 2020 10-Q SEC filing), with the revolving credit facility maturing in August 2023 (there is the option for two six-month extensions) and its term loan maturing in August 2024. However, its borrowing capacity under the revolving credit facility "is based on the value of a pool of eligible unencumbered real estate assets" owned by Global Net Lease along with the borrowing capacity limit. The firm had just $14 *million* in available borrowing capacity under its revolving credit line as of the end of June 2020.

As of the second quarter of 2020, Global Net Lease's annualized net debt to adjusted EBITDA ratio stood at a whopping ~7.2x, which is incredibly high. The company does not have a significant amount of debt coming due until 2023, which gives the REIT some time to adjust, but we are not fans of its balance sheet. Even for a REIT, that leverage ratio is simply far too high.

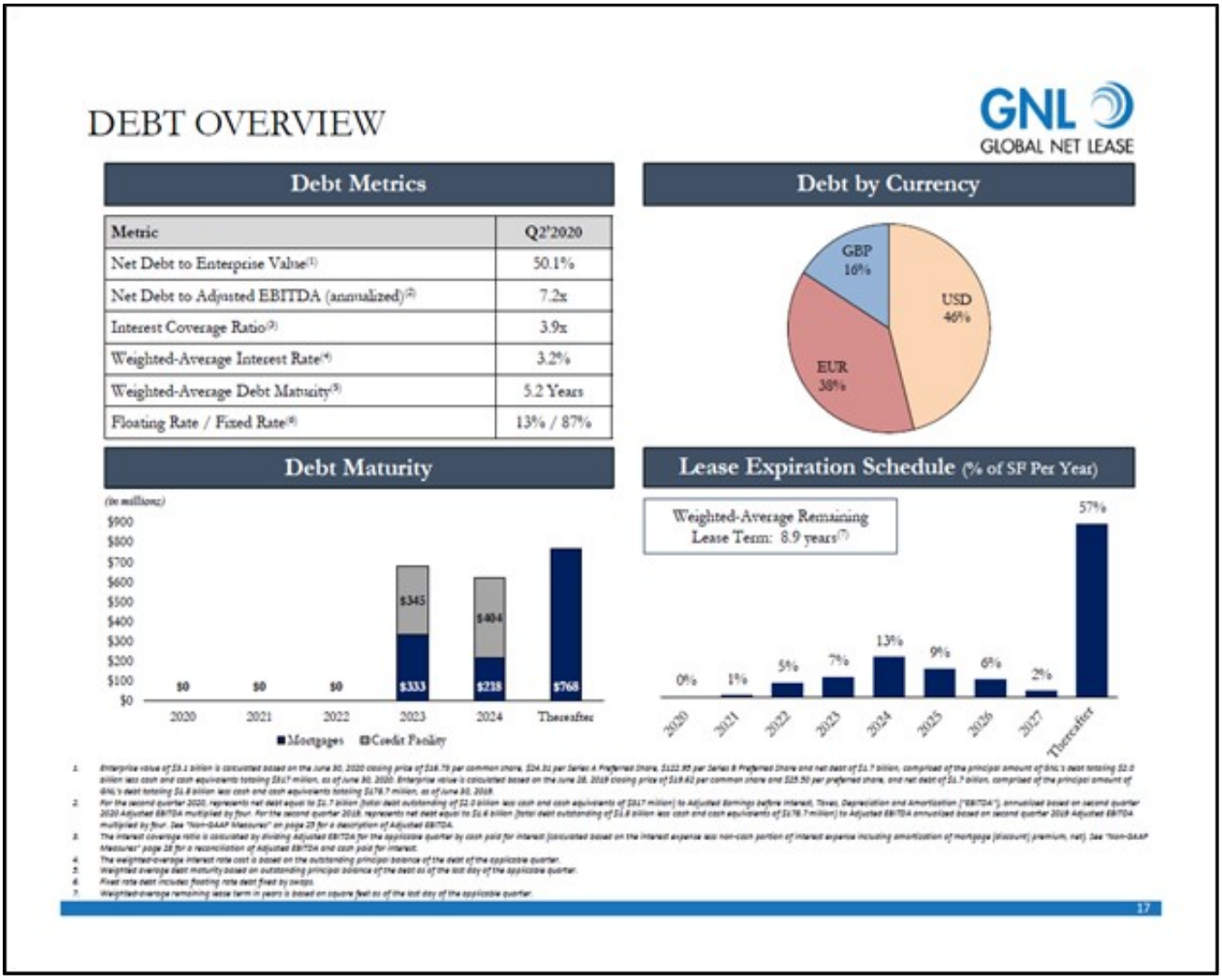


Image Shown: *Global Net Lease's balance sheet is highly levered.* ***Image Source:*** *Global Net Lease – Second Quarter of 2020 IR Earnings Presentation IR*

Concluding Thoughts

Global Net Lease's AFFO payout ratio is rather high, and its balance sheet is highly levered. The REIT's rent collection performance appears to be stagnating as the fallout from the ongoing COVID-19 pandemic continues. **We think there is a good chance Global Net Lease will be forced to cut its dividend again, and that is at least partially why shares of the REIT carry a lofty yield as investors appear to be pricing in a potential payout cut as likely.** We prefer REITs that operate in the self-storage and data center space.

Disclosure: *Callum Turcan does not own shares in any of the securities mentioned above.*

Key Contributors

- Brian Nelson, CFA
President, Investment Research
brian@valuentum.com

- Callum Turcan
Associate Investment Analyst
info@valuentum.com

Disclosure: *Brian Nelson and Callum Turcan do not own any shares of any securities mentioned in their authored articles. Please contact info@valuentum.com for more information regarding Valuentum's editorial policies.*

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We think the High Yield Dividend Newsletter portfolio positions us fairly well for whatever the market may throw at us, whether it's COVID-19 or another calamity. The newsletter portfolio is pretty well-diversified, and we've started to identify some pretty good individual equity ideas of late. That said, **high yield investing is inherently risky.**

In many respects, the high yield dividend equity arena trades a lot like junk bonds, meaning that interest rates play a key role in how equities will perform. As interest rates fall, high yield stays in vogue, but as interest rates rise, many look elsewhere. This impacts pricing greatly.

We're laser focused on identifying high yielding stocks that have sustainable yields, and if the income stream becomes threatened, we won't hesitate to say goodbye to a name. The High Yield Dividend Newsletter portfolio is presented each month in similar fashion (list and weightings) as that of the first edition.

If you have any questions, comments, or concerns, please be sure to let us know at info@valuentum.com.

Idea	Symbol	Weighting	Est Div Yield
CORE			
PowerShares Senior Loan Portfolio	BKLN	5.0%	3.91%
iShares MSCI Australia ETF	EWA	5.0%	3.74%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	5.68%
iShares International Select Dividend ETF	IDV	5.0%	7.34%
iShares U.S. Preferred Stock ETF	PFF	5.0%	5.44%
Global X SuperDividend ETF	SDIV*	5.0%	9.03%
Global X SuperIncome Preferred ETF	SPFF	10.0%	6.12%
Vanguard Consumer Staples ETF	VDC	5.0%	3.09%
Vanguard Real Estate ETF	VNQ	10.0%	3.85%
Utilities Select Sector SPDR	XLU	5.0%	3.13%
EQUITY			
AT&T	T	5.0%	7.70%
Crown Castle	CCI	5.0%	3.41%
CyrusOne Inc.	CONE	5.0%	2.87%
CubeSmart	CUBE	5.0%	3.89%
Digital Realty Trust	DLR	5.0%	3.10%
Enterprise Products Partners	EPD	2.5%	10.74%
Magellan Midstream Partners	MMP	2.5%	11.56%
Philip Morris	PM	5.0%	6.76%
Public Storage	PSA	5.0%	3.49%
Cash**	-	0.0%	0.00%
		100.0%	**5.18%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 11/1/2020. Est. Div. Yield information retrieved from SeekingAlpha.

*** Reflects federal funds target rate range*

DIVIDEND REPORT PAGE 2 – EXXON MOBIL (XOM)

Exxon Mobil XOM FAIRLY VALUED

Buying Index™ 3 Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$27.00 - $41.00	HEALTHY	POOR / 0.1	VERY POOR	10.19%

Assessment of Company Dividend Strategy

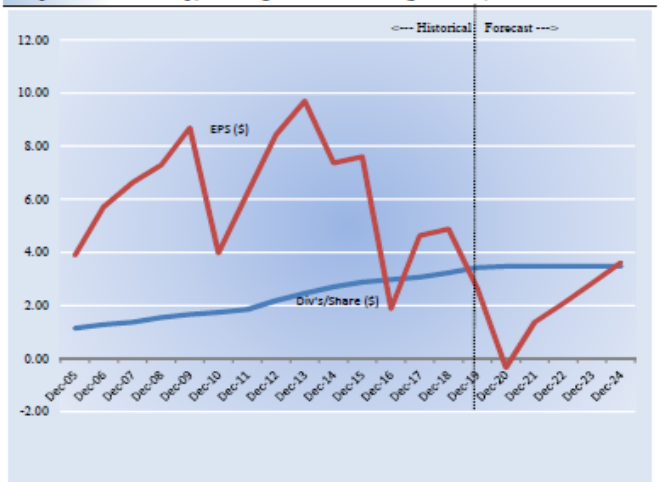
Key Strengths

We are huge fans of Exxon Mobil's integrated model as its refining and petrochemicals operations can offset some of the headwinds low raw energy resources pricing creates for its upstream operations. However, the COVID-19 pandemic has decimated demand for petroleum products and petrochemicals, which in turn weighs negatively on Exxon Mobil's outlook. Management has maintained Exxon Mobil's quarterly dividend so far, but its large net debt load is concerning given the headwinds facing its cash flow generation abilities. Exxon Mobil cut its long-term capital expenditure expectations to improve its ability to generate free cash flows going forward.

Potential Weaknesses

Exxon Mobil has seen its upstream production base dwindle over the past decade, largely due to meaningful natural decline rates. In 2012, Exxon Mobil produced ~4.2 million barrels of oil equivalent net per day. By 2019, that had fallen to less than 4.0 million barrels of oil equivalent net per day, even after the firm invested billions upon billions in new upstream developments. Exxon Mobil carries a large net debt load, and its near-term outlook is dour. Low raw energy resources pricing makes generating sizable free cash flows a difficult task, as does its shrinking upstream production base. We caution that should crude oil prices remain subdued, the company may have to cut its dividend.

Graphical Relationship, Earnings and Dividends (per share)



The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. Exxon Mobil's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is less than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

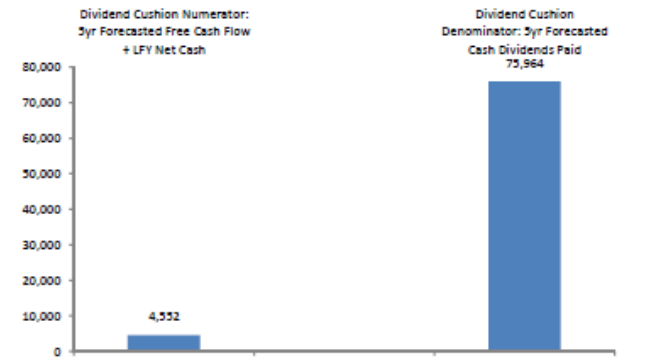
Dividend Cushion Cash Flow Bridge

Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

The Dividend Cushion Ratio Deconstruction, shown in the image to the right, reveals the numerator and denominator of the Dividend Cushion ratio. At the core, the larger the numerator, or the healthier a company's balance sheet and future free cash flow generation, relative to the denominator, or a company's cash dividend obligations, the more durable the dividend. In the context of the Dividend Cushion ratio, Exxon Mobil's numerator is smaller than its denominator suggesting weak dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.

Dividend Cushion Ratio Deconstruction



DEFINITIONS

ValueCreation. This is a proprietary Valuentum measure. ValueCreation indicates the firm's historical track record in creating economic value for shareholders, taking the average difference between ROIC (without goodwill) and the firm's estimated WACC during the past three years. The firm's performance is measured along the scale of EXCELLENT, GOOD, POOR, and VERY POOR. Those firms with EXCELLENT ratings have a demonstrated track record of creating economic value, while those that register a VERY POOR mark have been destroying economic value.

ValueRisk. This is a proprietary Valuentum measure. ValueRisk indicates the historical volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow. The standard deviation of each measure is calculated and scaled against last year's measure to arrive at a percentage deviation for each item. These percentage deviations are weighted equally to arrive at the corresponding fair value range for each stock, measured in percentage terms. The firm's performance is measured along the scale of LOW, MEDIUM, HIGH, and VERY HIGH. The ValueRisk™ rating for each firm also determines the fundamental beta of each firm along the following scale: LOW (0.85), MEDIUM (1), HIGH (1.15), VERY HIGH (1.3).

ValueTrend. This is a proprietary Valuentum measure. ValueTrend indicates the trajectory of the firm's return on invested capital (ROIC). Firms that earned an ROIC last year that was greater than the 3-year average of the measure earn a POSITIVE rating. Firms that earned an ROIC last year that was less than the 3-year average of the measure earn a NEGATIVE rating.

Copyright © 2020 by Valuentum, Inc. All rights reserved. No part of this publication may be reproduced in any form or by any means.

The information contained in the High Yield Dividend Newsletter or any report from Valuentum is not represented or warranted to be accurate, correct, complete, or timely. This newsletter is for informational purposes only and should not be considered a solicitation to buy or sell any security. No warranty or guarantee may be created or extended by sales or promotional materials, whether by email or in any other format. The securities or strategies mentioned herein may not be suitable for all types of investors. The information contained in this report does not constitute any advice, especially on the tax consequences of making any particular investment decision. This material is not intended for any specific type of investor and does not take into account an investor's particular investment objectives, financial situation or needs. This report is not intended as a recommendation of the security highlighted or any particular investment strategy. Before acting on any information found in this report, readers should consider whether such an investment is suitable for their particular circumstances, perform their own due diligence, and if necessary, seek professional advice. The sources of the data used in this report are believed by Valuentum to be reliable, but the data's accuracy, completeness or interpretation cannot be guaranteed. Assumptions, opinions, and estimates are based on our judgment as of the date of the report and are subject to change without notice. Valuentum is not responsible for any errors or omissions or for results obtained from the use of this report and accepts no liability for how readers may choose to utilize the content. In no event shall Valuentum be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained in this document. Investors should consider this report as only a single factor in making their investment decision. Valuentum is not a money manager, is not a registered investment advisor, and does not offer brokerage or investment banking services. Valuentum has not received any compensation from the company or companies highlighted in this report. Valuentum, its employees, independent contractors and affiliates may have long, short or derivative positions in the securities mentioned herein. Information and data in Valuentum's valuation models and analysis may not capture all subjective, qualitative influences such as changes in management, business and political trends, or legal and regulatory developments. Redistribution is prohibited without written permission. Readers should be aware that information in this work may have changed between when this work was written or created and when it is read. There is risk of substantial loss associated with investing in financial instruments. Valuentum's company-specific forecasts used in its discounted cash flow model are rules-based. These rules reflect the experience and opinions of Valuentum's analyst team. Historical data used in our valuation model is provided by Xignite and from other publicly available sources including annual and quarterly regulatory filings. Stock price and volume data is provided by Xignite. No warranty is made regarding the accuracy of any data or any opinions. Valuentum's valuation model is based on sound academic principles, and other forecasts in the model such as inflation and the equity risk premium are based on long-term averages. The Valuentum proprietary automated text-generation system creates text that will vary by company and may often change for the same company upon subsequent updates. Valuentum uses its own proprietary stock investment style and industry classification systems. Peer companies are selected based on the opinions of the Valuentum analyst team. Research reports and data are updated periodically, though Valuentum assumes no obligation to update its reports, opinions, or data following publication in any form or format. Performance assessment of Valuentum metrics, including the Valuentum Buying Index, is ongoing, and we intend to update investors periodically, though Valuentum assumes no obligation to do so. Not all information is available on all companies. There may be a lag before reports and data are updated for stock splits and stock dividends. The portfolio in the High Yield Dividend Newsletter is hypothetical and does not represent real money. Past simulated performance, whether backtested or walk-forward or other, is not a guarantee of future results. Actual results may differ from simulated portfolio information being presented in this newsletter. For general information about Valuentum's products and services, please contact us at valuentum@valuentum.com or visit our website at www.valuentum.com.