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HIGH YIELD DIVIDEND NEWSLETTER

MORTGAGE REITS HAVE UNDERPERFORMED SIGNIFICANTLY THE PAST SEVERAL YEARS

Latest Changes to High Yield Dividend Newsletter
Removed: EWA – April 27 Added: SPYD – April 27

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"LOCATING HIGH-QUALITY COMPANIES WITH STRONG FUTURE FREE CASH FLOW GENERATING PROSPECTS AND AMPLE PRICING POWER IS ESSENTIAL WHEN SEEKING TO AVOID VALUE TRAPS, ESPECIALLY IN THE CURRENT LOW INTEREST RATE ENVIRONMENT. THE GLOBAL ECONOMY CONTINUES TO IMPROVE IN THE WAKE OF COVID-19 VACCINE DISTRIBUTION EFFORTS AND THE RELATED EASING OF LOCKDOWN MEASURES IN CERTAIN REGIONS WORLDWIDE, THOUGH SERIOUS HURDLES REMAIN."

– CALLUM TURCAN

Image: *An ETF that tracks the mortgage REIT industry has fallen more than 31% on a price-only basis, while an ETF that tracks the S&P 500 has advanced more than 160% on a price-only basis, as measured from May 2013.*

By Brian Nelson, CFA

Mortgage REITs (REM) are popular vehicles because of their deceptively enticing dividend yields, but **we've never been bullish on the group.** We're reiterating our take hat these instruments are not for the individual investor or even prudent financial advisor and are more complicated vehicles than many investors believe.

In May 2013, we first starting warning about the group, and the performance, as shown in the image above, hasn't been pretty. On a price-only basis, the iShares Mortgage Real Estate ETF is trailing the simpleton S&P 500 index by roughly 190 percentage points since we first laid out our thesis on the group years ago.

Not much has changed from an analytical perspective since 2013 either. Mortgage market dynamics remain inherently difficult to predict, many mortgage REITs

have eye-popping leverage, and their book values tend to be more impacted by changes in 'other comprehensive income' (unrealized gains or losses that are marked to market) than net interest spread income.

Annaly Capital (NLY) and AGNC Investment REIT (AGNC) remain the two main mortgage REIT considerations for investors, and while both have advanced in the high-single-digits on a price-only percentage basis thus far in 2021, it's hard for us to get excited about the move in light of their massive historical underperformance and hard-to-predict business models.

The yields on mortgage REIT instruments are certainly very tempting, but the payouts just haven't been high enough to offset their price weakness as book values continue to whipsaw around along with interest rates. We thought it time to take a victory lap on our call made years ago, and we think avoiding mortgage REITs continues to make a lot of sense for most long-term investors.

Energy: A Small Part of the S&P 500 but Making a Comeback

Image Source: Bureau of Land Management

By Callum Turcan and Brian Nelson, CFA

The energy sector remains a small part of the S&P 500 (SPY), coming in at just ~3% nowadays. Collapsing energy resource prices, overspending on capital projects, and a fallout in the pipeline MLP space have been primary causes for the sector's ever-shrinking representation in the S&P 500 over the past five years or so, but we still think some exposure is warranted. During the past several months, raw energy resource pricing, from crude oil (USO) to natural gas (UNG), has staged an impressive recovery with room for upside.

This recovery has been aided by optimism regarding coronavirus ('COVID-19') vaccine distribution efforts and expectations that the global economy will stage a sharp, though uneven, recovery from the pandemic. Additionally, the OPEC+ oil cartel has held substantial volumes of crude oil supplies off the market since 2020 and continues to do so in a bid to prop up prices while production in non-OPEC nations such as the US took a beating during the worst of the pandemic and have not fully recovered.

OPEC+ is steadily easing supply curtailments but that has not stopped the rally in WTI and Brent as demand continues to recover in earnest. Domestic air travel is rebounding in China, the US, and elsewhere which supports the demand outlook for kerosene (jet fuel). The resumption of "normal" daily activities such as commuting to work is also helping to drive up demand for gasoline and diesel, as is strong demand for home delivery services such as Uber (UBER) Eats and DoorDash (DASH) and physical goods. We expect spending on such services to continue to improve going forward as the economy opens back up.

Looking to Exxon Mobil, Chevron for Dividend Growth and Potential Income

Without a doubt, the rise in energy resource prices the past several months has helped the future expected free cash flow profiles at many of the oil and gas majors, and we continue to keep a close eye on a few of them as we look to "allocate" some new capital. ExxonMobil (XOM) and Chevron (CVX) currently boast dividend yields of ~5.4% and 5%, respectively, and both of their Dividend Cushion ratios have improved of late to 0.6 and 1.2, respectively.

During the first quarter of 2021, Chevron generated $2.45 billion in free cash flow, and ~$3.4 billion in free cash flow when excluding working capital, sufficient to cover its cash dividends paid in the period. Capital spending was down 43% from the year-ago period, and we think Chevron will continue to be mindful of where it is investing shareholder money. The average sale price for crude oil was $56 per barrel in the first quarter of 2021, and with the price of crude oil now at its highest in two years in the mid-$70s, Chevron's dividend strength is even stronger than it was last quarter.

We think Chevron's free cash flow will have an upward bias from higher energy resource prices alone, but a more normalized working capital consideration could make for a much better-than-expected showing in the back half of 2021. The potential for stronger downstream (refineries) and petrochemical performance is key here as well.

Chevron last raised its payout nearly 4% recently, to $5.36 per share (we plan to update our dividend report shortly), and we think it is setting up for another raise come 2022 following a nice year in 2021. The company is a Dividend Aristocrat, having raised its dividend in each of the past 30+ years.

ExxonMobil's free cash flow generation is even more impressive than Chevron's. During the first quarter of 2021, the company hauled in $6.86 billion, while it paid out roughly $3.7 billion to shareholders in the form of a dividend, showcasing tremendous free cash flow coverage of the payout. Stronger average sale prices for energy resources during the current quarter and potentially during the back half of 2021 may make the free cash flow coverage at Exxon even stronger.

Though perhaps not to worry about too much, Exxon does hold a rather large net debt position of $59.8 billion at the end of March. Chevron's net debt position at the end of the first quarter was $38.4 billion, which helps explain why its Dividend Cushion ratio comes out a bit better, despite tighter free cash flow coverage of the payout. ExxonMobil has failed to raise its payout for a couple years now, too, last doing so in early 2019, but the oil and gas giant's free cash flow performance of late means its dividend growth may resume in the not-too-distant future, in our view.

Concluding Thoughts

The energy sector is now a small part of the S&P 500, but improving energy resource pricing has enhanced the merits of many in the space, namely the dividend growth and income prospects at ExxonMobil and Chevron. Both companies offer investors dividend yields north of 5%, and both have experienced tremendous improvements in free cash flow generation thanks in part to more prudent capital spending.

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS. Callum Turcan does not own shares in any of the securities mentioned above.*

High Yielding PPL Corp Simplifying Business Profile and Reducing Debt

Our **High Yield Spotlight for July 2021** is the regulated natural gas and electric utility PPL Corporation (PPL)---**6.0% yield**---as we are big fans of its transformative arrangement with National Grid plc (NGG). This two-part deal will see PPL Corp exit the UK in return for significantly greater scale in the US utility space while also raising substantial net cash proceeds in the process.

PPL Corp announced that it had completed the sale of its UK utility business, Western Power Distribution ('WPD'), to National Grid on June 14. National Grid paid PPL Corp approximately GBP£7.8 billion which resulted in PPL Corp receiving roughly USD$10.4 billion net in cash after taking taxes and fees into consideration. Now PPL Corp is working towards acquiring National Grid's Rhode Island gas and electric utility, Narragansett Electric Company, for roughly $3.8 billion and that deal remains on-track to close by March 2022. Here is what PPL Corp had to say regarding the remaining cash proceeds in a recent press release:

> PPL intends to use the $6.6 billion in net cash proceeds from the transactions to further strengthen its balance sheet and enhance opportunities for growth. The company plans to reduce outstanding debt by approximately $3 billion to $3.5 billion and will continue to evaluate the best use of the remaining proceeds to maximize shareowner value. This includes potentially investing incremental capital at PPL's utilities or in renewables, and repurchasing shares.

No time was wasted when PPL Corp announced a tender offer to retire certain debt tranches on the same day of the announcement that the first part of its deal with National Grid was complete. **We appreciate PPL Corp's debt reduction efforts as that will be key to preserving its financial strength going forward.**

PPL Corp owns several regulated utilities in the US that primarily provide electric and gas utility services in Pennsylvania, Kentucky, and parts of Virginia. That includes PPL Electric Utilities Corporation (provides distribution and transmission electric utility services to customers in eastern and central Pennsylvania) and Louisville Gas and Electric Company (provides distribution, generation, and transmission electric utility services along with natural gas distribution utility services to customers in Kentucky), among others. **Its pending acquisition of Narragansett Electric Company will see PPL Corp become the primary gas and electric utility company in Rhode Island.**

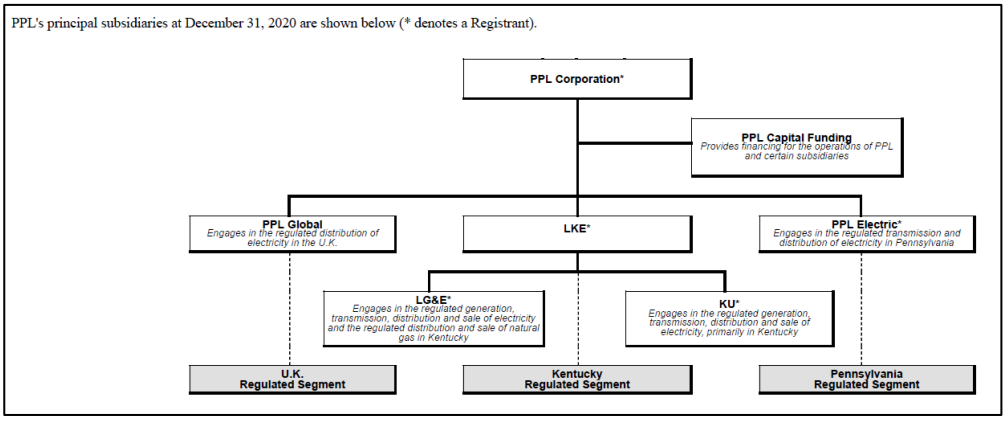


Image Shown: *An overview of PPL Corp's corporate structure at the end of 2020, keeping in mind its UK operations have since been divested.* ***Image Source:*** *PPL Corp – 2020 Annual Report*

In the graphic at the bottom of the previous page, PPL Corp provides an overview of its corporate structure at the end of 2020, keeping in mind the firm has since divested its UK operations. Back in 2018, PPL Corp acquired Safari Energy which provides solar energy solutions to domestic commercial customers, as part of PPL Corp's push into the green energy space. Its pending acquisition of Narragansett Electric Company will further support PPL Corp's efforts on this front.

PPL Corp's promising growth outlook is underpinned by its robust investment pipeline. From 2021-2025, the company plans to spend $7.8 billion towards capital expenditures to grow its regulated utility businesses that are focused on Kentucky and Pennsylvania. During this period, the firm's capital expenditures on its coal-related utility operations in Kentucky is expected to wind down significantly as PPL Corp prioritizes green energy projects and investments in its electricity grid (transmission and distribution operations). **The addition of Narragansett Electric Company and its ~510,000 electric customers and ~270,000 gas customers to PPL Corp's portfolio should further strength its investment pipeline.**

Before factoring in planned acquisition activity, PPL Corp's investment pipeline is forecasted to grow its rate base from $19.1 billion in 2020 to $20.9 billion in 2025. With the net cash infusion from its two-part deal with National Grid, PPL Corp could significantly step up its capital expenditure expectations (assuming regulators give their approval) to further bolster its growth outlook.

Narragansett Electric Company posted annual rate base growth north of 9% over the past five years through fiscal 2020 and the utility's capital expenditures have been rising in the recent past as there are ample growth opportunities available to the firm. **Green energy investments and grid reliability are two main sources of upside.** PPL Corp has the financial capacity to make substantial capital investments while maintaining its financial strength. **Rhode Island has statewide green energy mandates that should create substantial growth opportunities for PPL Corp.**

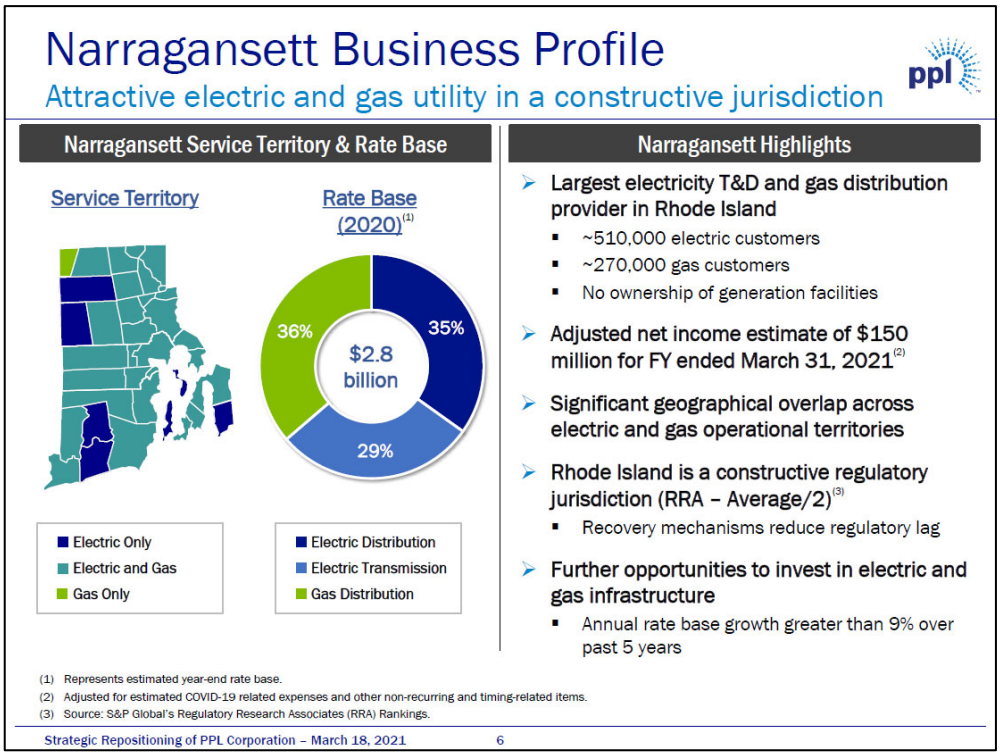
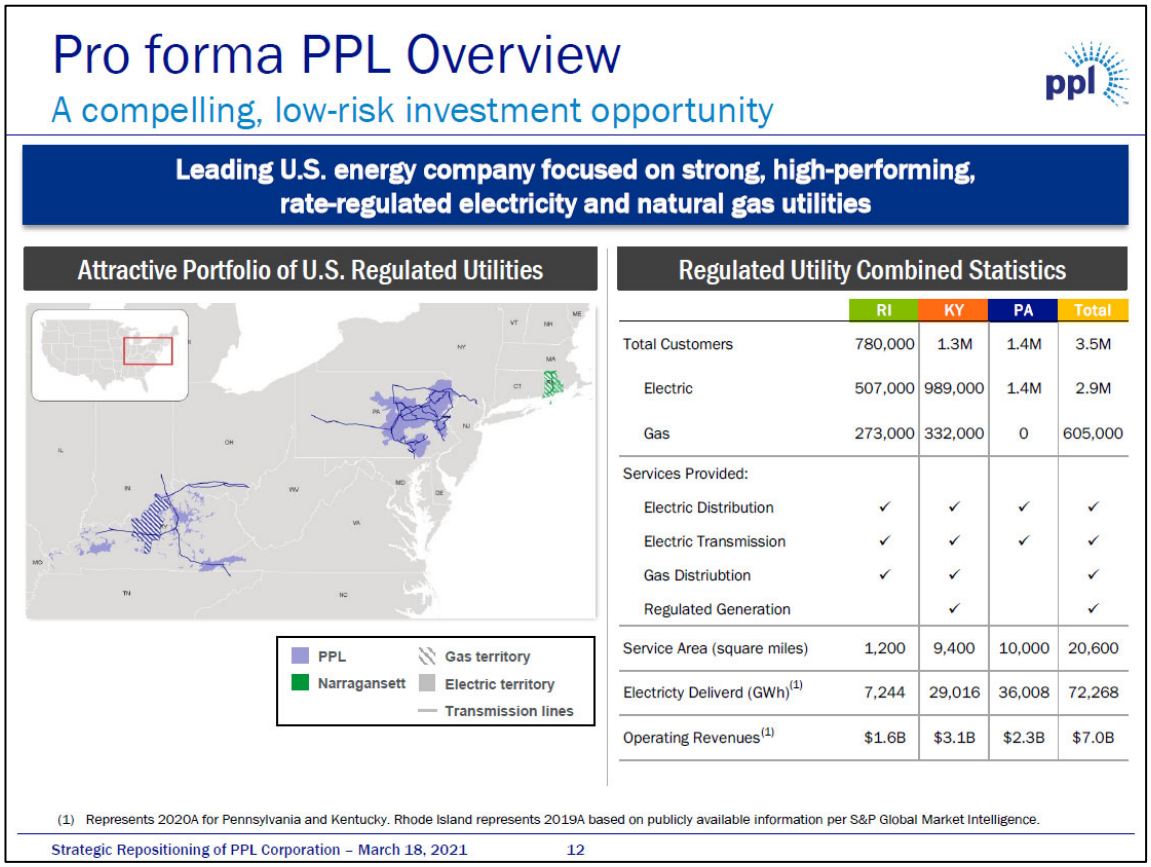


***Image Shown**: An overview of the Narragansett Electric Company. **Image Source**: PPL Corp – March 2021 IR Presentation*

On a pro forma basis, PPL Corp's rate base (as of 2020) would grow to $20.9 billion once the Narragansett Electric Company acquisition is complete. **When the deal closes, PPL Corp's business profile will have ample geographical diversity along with more meaningful scale in the US, which supports the company's outlook.** The company did not have the financial capacity to make major investments in both its US and UK utility operations, while National Grid does considering it is a much larger enterprise, so having PPL Corp simplify its business model is the right call, in our view.



Pro forma PPL Overview

A compelling, low-risk investment opportunity

ppl

Leading U.S. energy company focused on strong, high-performing, rate-regulated electricity and natural gas utilities

Attractive Portfolio of U.S. Regulated Utilities

PPL
Narragansett
Gas territory
Electric territory
Transmission lines

Regulated Utility Combined Statistics

	RI	KY	PA	Total
Total Customers	780,000	1.3M	1.4M	3.5M
Electric	507,000	989,000	1.4M	2.9M
Gas	273,000	332,000	0	605,000
Services Provided:				
Electric Distribution	✓	✓	✓	✓
Electric Transmission	✓	✓	✓	✓
Gas Distriubtion	✓	✓		✓
Regulated Generation		✓		✓
Service Area (square miles)	1,200	9,400	10,000	20,600
Electricty Deliverd (GWh)(1)	7,244	29,016	36,008	72,268
Operating Revenues(1)	$1.6B	$3.1B	$2.3B	$7.0B

(1) Represents 2020A for Pennsylvania and Kentucky. Rhode Island represents 2019A based on publicly available information per S&P Global Market Intelligence.

Strategic Repositioning of PPL Corporation – March 18, 2021 12

Image Shown: *An overview of PPL Corp's pro forma asset base.* ***Image Source:*** *PPL Corp – March 2021 IR Presentation*

As PPL Corp has a hefty total debt load (~$16.2 billion at the end of March 2021 when including short-term debt, though this does not factor in the aforementioned debt reduction activity), **maintaining access to capital markets at attractive rates is a key part of its business model. We expect that will continue to be the case going forward.**

The company's long-term issuer credit rating remains rock-solid at A- (stable outlook) from S&P Global Inc's (SPGI) S&P Ratings and Baa2 (positive outlook) from Moody's Corporation (MCO). When combined with its recent debt reduction efforts, PPL Corp should maintain access to debt markets at attractive rates going forward. Its utility subsidiaries also all have solid investment grade credit ratings. At the end of March 2021, PPL Corp had a well-staggered debt maturity schedule which will assist the firm in its future refinancing activities. **When factoring in its recent cash infusion, PPL Corp has ample liquidity on hand to manage its upcoming debt maturities.**

Debt Maturities[1]

($ in Millions)	2021	2022	2023	2024	2025	2026 and Beyond	Total
PPL Capital Funding	$0	$900	$600	$350	$0	$3,780	$5,630
PPL Electric Utilities[2]	$400	$474	$340	$0	$0	$3,075	$4,289
LG&E and KU Energy	$250	$0	$0	$0	$0	$0	$250
Louisville Gas & Electric[2]	$292[3]	$0	$0	$0	$300	$1,432	$2,024
Kentucky Utilities[2]	$132	$0	$13	$0	$250	$2,247	$2,642
Total Debt Maturities[4]	$1,074	$1,374	$953	$350	$550	$10,534	$14,835

Note: As of March 31, 2021.

(1) Excludes PPL's U.K. utility business due to the pending sale announced on March 18, 2021.
(2) Amounts reflect the timing of any put option on municipal bonds that may be put by the holders before the bonds' final maturities.
(3) In April 2021, $128 million of these bonds were remarketed at a long-term rate through their final maturity date in 2033. In May 2021, an additional $70 million of these bonds were remarketed at a long-term rate through their final maturity date in 2027.
(4) Does not reflect unamortized debt issuance costs, unamortized premiums (discounts), and fair market valuation adjustments totaling ($146 million).

PPL 1st Quarter Earnings Call – May 6, 2021 16

Image Shown: *PPL Corp had a well-staggered debt maturity schedule as of the end of March 2021.* ***Image Source:*** *PPL Corp – March 2021 IR Presentation*

Shares of PPL have recovered significant ground from the coronavirus ('COVID-19) pandemic-induced downturn in 2020 though there is room for further improvement, in our view. **Our fair value estimate for PPL Corp, based on its normalized cash flow generating abilities forecasted into perpetuity, sits at $45 per share** with the low end of our fair value estimate range sitting at $36 per share. **PPL Corp scores a 9 on the Valuentum Buying Index** and shares of PPL have started to perk up recently, potentially due to excitement beginning to build regarding its transformation strategy.

In the upcoming graphic at the top of the following page, PPL Corp highlights its key objectives once the second part of its transformative strategy is complete. That includes maintaining a dividend payout ratio of 60%-65% of its earnings, committing to grow its dividend alongside its expected earnings growth going forward, and targeting a debt-to-capitalization ratio of 45%-55%. **Management sees PPL Corp's transformation improving the firm's rate base growth outlook and credit profile while offering room for further upside via operational efficiencies.** PPL Corp does not plan to pursue any significant equity issuances for the foreseeable future and could potentially buy back some of its stock with a portion of its net cash infusion.

Whether PPL Corp intends to right-size its payout after its pending acquisition is complete is not clear (the firm noted it would not change its quarterly dividend prior to the acquisition closing but has not indicated what the specific goal is after the deal closes). However, reduced annual financing expenses (via debt reduction and an improved credit profile)

Pro forma Financial Outlook

Strong earnings growth and credit metrics

- **Expect earnings growth rate to be competitive with U.S. utility peers post transactions**
  - Underpinned by rate base growth prospects, improved credit profile, and proven track record of delivering operational efficiencies
- **Lower parent leverage combined with Narragansett's strong credit profile is expected to support strong investment grade credit ratings**
  - Targeting CFO(FFO) to debt ratio of 16% - 18%
  - Expected to reduce Holding Company debt to Total debt ratio to below 25%
  - Targeting Debt-to-Total Capitalization ratio of 45% - 55%
- **No planned equity issuances** (1)
- **Dividend considerations** (2)
  - Payout projected to be 60% - 65% of earnings per share post closing of transactions
  - Dividend growth aligned with earnings per share growth post closing of transactions
  - No change expected in quarterly dividends prior to Narragansett transaction closing

(1) Excluding immaterial equity issuances for DRIP and compensation programs.
(2) Actual dividends to be determined by Board of Directors.

Strategic Repositioning of PPL Corporation – March 18, 2021 14

Image Shown: *A look at PPL Corp's main objectives after its pending acquisition of Rhode Island's main electric and gas utility is complete.* ***Image Source:*** *PPL Corp – March 2021 IR Presentation*

and potential savings from the simplification of its corporate structure along with the cash flows from Narragansett Electric Company should help offset a large chunk of the loss in cash flows from its UK business. Share buybacks would both be a good use of capital given shares of PPL are trading at a steep discount to their intrinsic value, in our view, and would also put downward pressure on PPL Corp's future dividend obligations.

There are downside risks to be aware of here, primarily that PPL Corp's pending acquisition does not receive the necessary regulatory approvals. Additionally, the chance that PPL Corp will right-size its payout is another, though the yield on shares of the PPL would likely remain quite competitive should such an event occur given management's stated dividend payout policy.

Over the long haul, we expect PPL Corp will remain a solid high yielding income generation idea for investors and its growth outlook is quite bright. **Upside from greater scale, an improved credit profile, a larger growth runway, operational synergies, and a smaller net debt load should enable PPL Corp to stay on top of its dividend obligations over the long haul.** In the near-term, PPL Corp should benefit from recent rate case proceedings in Kentucky that are expected to grow the firm's annualized revenues by over $0.2 billion starting July 1, 2021. **We like PPL Corp as our High Yield Spotlight for July 2021.**

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

CubeSmart Outperforms and Boosts Its Full Year Guidance

Image Source: *CubeSmart – June 2021 IR Presentation*

By Callum Turcan

We are big fans of the self-storage real estate investment trust ('REIT') industry given the ability for firms operating in this arena to generate meaningful free cash flows, a difficult task for most REITs considering their hefty capital expenditure requirements. CubeSmart (CUBE) is one of our favorites in the space and **we include shares of CUBE as an idea in the High Yield Dividend Newsletter portfolio.**

Shares of CUBE are up 39% year-to-date as of the end of normal trading hours on June 29 according to *Yahoo Finance* data, easily outpacing the 14% gain seen in the S&P 500 (SPY) during this period before taking dividend considerations into account. **As of this writing, shares of CUBE yield ~2.9%.**

Earnings Update

In late April, CubeSmart published its first quarter 2021 earnings and we liked what we saw. Its same-store occupancy rate stood at 94.4% at the end of March 2021, up from 93.4% at the end of December 2020. **Meaningful rental rate increases enabled CubeSmart to grow its same-store net operating income ('NOI') by 9% year-over-year in the first quarter of 2021 as strong revenue growth offset modest operating expense increases.** CubeSmart added 31 stores to its third-party self-storage management platform in the first quarter and we appreciate its sustained strength on this front given how the REIT can use this platform to identify potential acquisitions and other growth opportunities (on top of the management fees it receives in the meantime).

The company raised its full-year guidance for 2021 during its first quarter earnings report. Now CubeSmart is guiding to generate $0.75-$0.81 in diluted EPS, up from $0.71-$0.77 previously, and $1.80-$1.83 in diluted funds from operations ('FFO') per share, which is up from $1.77-$1.83 previously. Please note that FFO is an imperfect industry metric used to gauge the trajectory of a REIT's cash flow performance. This guidance boost was primarily made possible by CubeSmart revising its expected same-store NOI growth up to 5.25%-6.25% in 2021, from 3.75%-5.00% previously.

As of its latest guidance, CubeSmart forecasts that its same-store revenue growth (in percentage terms) will come in stronger than previously expected this year at the midpoint, while its same-store operating expense growth (in percentage terms) is expected to come in a bit lighter than previously expected at the midpoint. **We appreciate CubeSmart's confidence in its near-term performance and continue to view the REIT's long-term cash flow growth outlook quite favorably.**

CubeSmart exited March 2021 with a large net debt load, highlighting its dependence on capital markets. Historically, CubeSmart has been able to tap debt and equity markets at attractive rates for funds and we expect that will continue being the case going forward. **The REIT has an investment grade credit rating (Baa2/BBB).** Its revolving credit line due June 2024 provides it with ample access to liquidity to meet its near-term funding needs. **CubeSmart generated $79 million in free cash flow in the first quarter of this year while spending $68 million covering its payout obligations during this period** as you can see in the upcoming graphic down below.

CUBESMART AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended March 31, 2021	Three Months Ended March 31, 2020
Operating Activities		
Net income	$ 43,315	$ 38,317
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	54,845	41,592
Non-cash portion of interest expense related to finance leases	111	—
Equity in (earnings) losses of real estate ventures	(20)	5
Equity compensation expense	2,042	1,871
Accretion of fair market value adjustment of debt	(607)	(176)
Changes in other operating accounts:		
Other assets	(1,718)	2,743
Accounts payable and accrued expenses	(1,675)	(3,743)
Other liabilities	1,889	340
Net cash provided by operating activities	$ 98,182	$ 80,949
Investing Activities		
Acquisitions of storage properties	—	(9,090)
Additions and improvements to storage properties	(7,894)	(11,923)
Development costs	(10,932)	(9,709)
Investment in real estate ventures	(6,664)	(5,877)
Cash distributed from real estate ventures	4,958	1,815
Net cash used in investing activities	$ (20,532)	$ (34,784)
Financing Activities		
Proceeds from:		
Revolving credit facility	268,111	5,127
Principal payments on:		
Revolving credit facility	(333,111)	(5,127)
Mortgage loans and notes payable	(44,649)	(633)
Proceeds from issuance of common shares, net	99,688	(118)
Cash paid upon vesting of restricted shares	(728)	(631)
Exercise of stock options	1,172	—
Distributions paid to noncontrolling interests in subsidiaries	(69)	(59)
Distributions paid to common shareholders	(67,368)	(64,036)
Distributions paid to noncontrolling interests in Operating Partnership	(933)	(650)
Net cash used in financing activities	$ (77,887)	$ (66,127)
Change in cash, cash equivalents and restricted cash	(237)	(19,962)
Cash, cash equivalents and restricted cash at beginning of period	6,229	58,441
Cash, cash equivalents and restricted cash at end of period	$ 5,992	$ 38,479
Supplemental Cash Flow and Noncash Information		
Cash paid for interest, net of interest capitalized	$ 23,534	$ 23,652
Supplemental disclosure of noncash activities:		
Accretion of put liability	$ 2,823	$ 896
Derivative valuation adjustment	$ 20	$ 20

Image Shown: *Line-items concerning CubeSmart's free cash flow performance are underlined in blue and line-items concerning the REIT's payout obligations are underlined in red.* ***Image Source:*** *CubeSmart – 10-Q SEC filing covering the first quarter of 2021*

Concluding Thoughts

We continue to be huge fans of CubeSmart and like the self-storage REIT as an idea in the High Yield Dividend Newsletter portfolio. A greater percentage of US households have been turning to self-storage offerings over the past several decades in order to maximize their living space in an economical manner according to data cited by Public Storage (PSA), another idea included in the High Yield Dividend Newsletter portfolio, and Extra Space Storage Inc (EXR). **Secular tailwinds support CubeSmart's promising growth outlook.**

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

Public Storage and Philip Morris are Stellar High-Yielding Opportunities

Image Shown: *Shares of Public Storage (depicted by the orange line) and Philip Morris International Inc (depicted by the blue line) have outperformed the S&P 500 (depicted by the yellow line) year-to-date as of the end of normal trading hours on June 29, before taking dividend considerations into account. We continue to be huge fans of Public Storage and Philip Morris and include both firms as ideas in our High Yield Dividend Newsletter portfolio.*

By Callum Turcan

Public Storage (PSA)---**2.6% yield**---, the self-storage real estate investment trust ('REIT') primarily focused on the US, and Philip Morris International Inc (PM)---**4.9% yield**---, the global tobacco giant behind the Marlboro brand and the IQOS offering, are two of our favorite high-yielding ideas. As one can see in the graphic at the top of this article, shares of PSA and PM have outperformed the S&P 500 (SPY) year-to-date as of the end of normal trading hours on June 29, before taking dividend considerations into account. **We include both Public Storage and Philip Morris as ideas in the High Yield Dividend Newsletter portfolio.**

Public Storage

At the end of March 2021, Public Storage had an equity stake in over 2,500 self-storage properties across 38 US states along with a ~35% equity stake in Shurgard Self Storage. Please note Public Storage's asset base has since expanded due to acquisition activity and organic investments. Shurgard trades on the Brussels Euronext and owns economic interests in self-storage properties in Western Europe. Additionally, Public Storage had a ~42% equity stake in PS Business Parks Inc (PSB) at the end of March 2021. PS Business Parks owns economic interests in commercial properties in the US with a focus on multi-tenant industrial, flex, and office space properties.

We are huge fans of the self-storage space given the ability for REITs operating in this industry to generate positive free cash flows *after dividends paid.* Public Storage generated roughly $1.6 billion in annual free cash flows on average from 2018-2020, an impressive feat. Please note Public Storage remains a capital market dependent entity given its sizable net debt load. This means the REIT needs to retain access to debt and equity markets (ideally at attractive rates) to keep refinancing its debt position and making good on its dividend obligations while funding its capital expenditure requirements. Recent capital market activity indicates that is the case.

In April 2021, Public Storage announced it was acquiring ezStorage for $1.8 billion, strengthening its position in the Mid-Atlantic region (specifically Maryland, Virginia, and Washington DC). Public Storage closed the acquisition of ezStorage later that month. Public Storage closed the first phase of a different acquisition in December 2020, when the firm paid $0.5 billion for three dozen self-storage properties (the second phase is expected to be completed sometime this year and involves additional self-storage properties).

On June 7, **Public Storage reported that its square foot occupancy rate stood at 96.5% as of May 31, 2021.** For comparison, Public Storage's square foot occupancy rate stood at 92.7% as of March 31, 2020, and at 94.2% as of December 31, 2020. We appreciate the apparent strong demand for Public Storage's offerings and see room for additional upside. Secular tailwinds support Public Storage's outlook as an increasing number of US households are turning to self-storage offerings to maximize their living spaces in an economical manner. **Having healthy occupancy rates speaks favorably towards Public Storage's ability to push through rental increases and grow its same-store net operating income ('NOI') over time.**

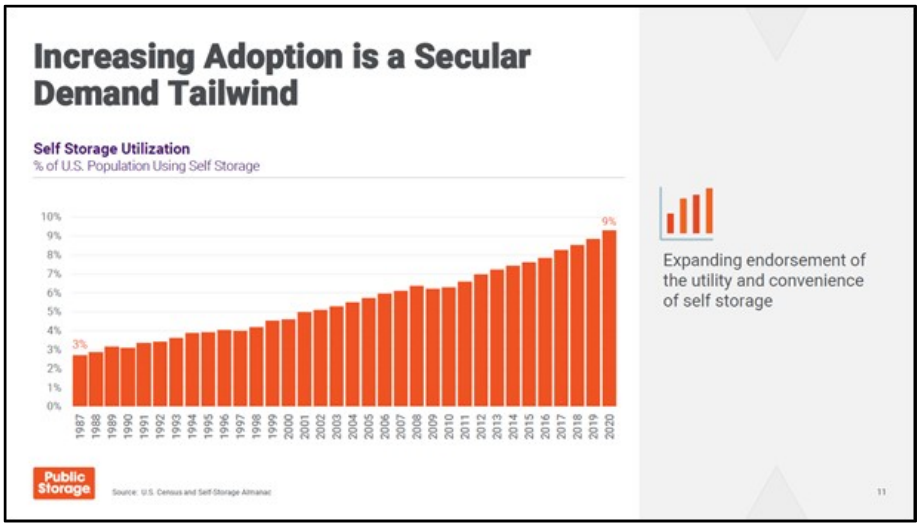
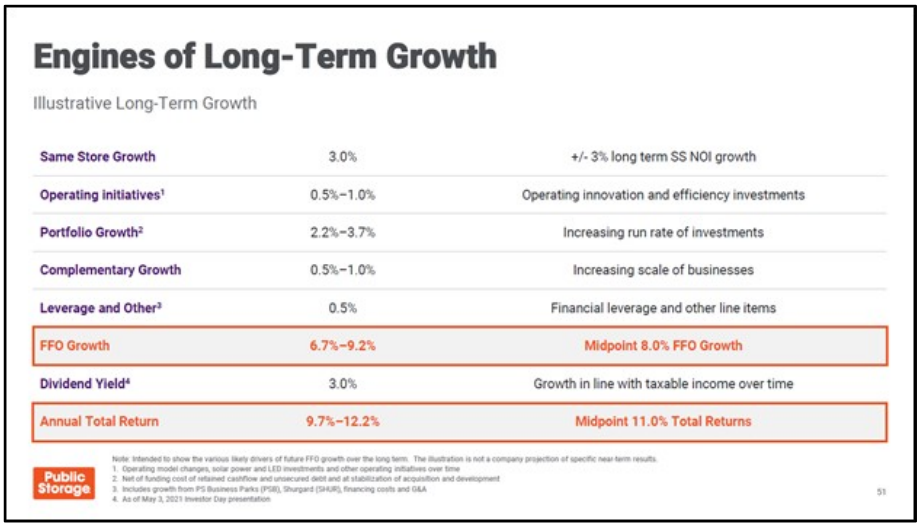


Image Shown: *Demand for self-storage offerings in the US has grown at a steady clip since the late-1980s with room for additional upside.* ***Image Source:*** *Public Storage – May 2021 Investor Day Presentation*

Public Storage has received some attention from activist investors recently with Elliott Associates, led by Paul Singer, pushing for the company to invest more in its business while also better engaging with its shareholders. The REIT's recent acquisition activity and its $0.5 billion "Property of Tomorrow" investment program highlight how Public Storage is responding to these pressures. Though a combination of rental rate increases, asset base growth, a revamp of some of its properties, and efficiency initiatives, Public Storage aims to reward shareholders over the long haul via cash flow and ultimately dividend growth.



Engines of Long-Term Growth

Illustrative Long-Term Growth

Same Store Growth	3.0%	+/- 3% long term SS NOI growth
Operating initiatives[1]	0.5%–1.0%	Operating innovation and efficiency investments
Portfolio Growth[2]	2.2%–3.7%	Increasing run rate of investments
Complementary Growth	0.5%–1.0%	Increasing scale of businesses
Leverage and Other[3]	0.5%	Financial leverage and other line items
FFO Growth	6.7%–9.2%	Midpoint 8.0% FFO Growth
Dividend Yield[4]	3.0%	Growth in line with taxable income over time
Annual Total Return	9.7%–12.2%	Midpoint 11.0% Total Returns

Public Storage

Note: Intended to show the various likely drivers of future FFO growth over the long term. The illustration is not a company projection of specific near-term results.
1. Operating model changes, solar power and LED investments and other operating initiatives over time
2. Net of funding cost of retained cashflow and unsecured debt and at stabilization of acquisition and development
3. Includes growth from PS Business Parks (PSB), Shurgard (SHUR), financing costs and G&A
4. As of May 3, 2021 Investor Day presentation

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Image Shown: *Public Storage's long-term financial growth and shareholder return targets.* ***Image Source:*** *Public Storage – May 2021 Investor Day Presentation*

We continue to be huge fans of Public Storage and view the REIT as well-positioned to capitalize on the reopening of the US economy in the wake of coronavirus ('COVID-19') vaccine distribution efforts. **Public Storage's forward-**

looking dividend coverage is strong as it has an adjusted Dividend Cushion ratio of 1.6, which takes its ability to tap capital markets into account. Public Storage's unadjusted Dividend Cushion ratio is near parity (~1.0). We are also big fans of CubeSmart (CUBE), another self-storage REIT focused on the US, and include shares of CUBE as an idea in our High Yield Dividend Newsletter portfolio.

Philip Morris

On June 8, **Philip Morris reiterated its full-year 2021 guidance** that among other things calls for 5%-7% net organic revenue growth, ~$11.0 billion in operating cash flow, and ~$0.8 billion in capital expenditures. While the news disappointed some investors that were hoping for a guidance boost, **we appreciate the resilience of Philip Morris' free cash flow generating abilities.** The COVID-19 pandemic weighed on the company's performance in 2020, **though its outlook indicates that Philip Morris is on the rebound.**

As we have covered in the past, Philip Morris owns the popular IQOS heat-not-burn ('HTU') tobacco offering, and sales of these products have grown at a brisk pace over the past few years. Going forward, growth at its IQOS offering combined with pricing strength at its traditional cigarette businesses underpins Philip Morris' promising outlook.

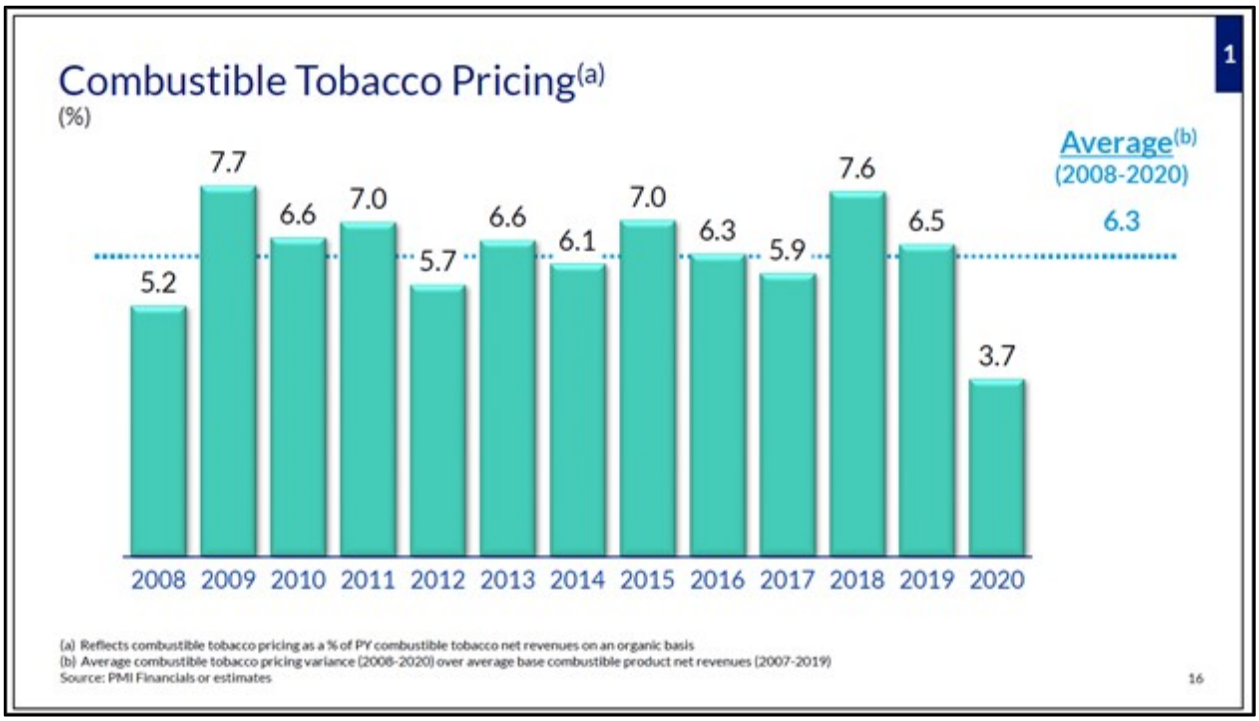

Image Shown: *Philip Morris utilizes its brand power to push through continuous price increases at its traditional cigarette offerings, such as those sold under its Marlboro brand. This enables the firm to maintain and even grow its cash flows, even though unit volumes of its traditional cigarette offerings are in secular decline.* ***Image Source:*** *Philip Morris – April 2021 IR Presentation*

In terms of unit volumes, IQOS and its other HTU offerings now represent a low double-digit percentage of the firm's company-wide volumes (up from virtually nothing in 2015). **By 2025, Philip Morris estimates that HTU offerings will represent over half of its unit volumes.** Philip Morris's HTU operations better positions the firm for the future as unit volumes of its traditional cigarette offerings are in secular decline.

Philip Morris recently lost its challenge in Saudi Arabia regarding customs duties that are allegedly owed from the 2014-2018 period which is expected to weigh on the company's near-term financial performance. However, this news does not materially impact Philip Morris' longer term outlook.

We are monitoring the ongoing legal battle regarding Philip Morris' popular IQOS offering and a challenge from British American Tobacco Plc (BTI) over patents covering HTU devices. In the UK, Philip Morris received a nice legal win after the UK High Court revoked two of British American Tobacco's patents covering HTU offerings in March 2021.

However, Philip Morris and Altria Group Inc (MO), its partner in the US, suffered a legal setback in May 2021 after an initial determination by a judge at the US International Trade Commission ('ITC') ruled that the IQOS device infringed on patents owned by British American Tobacco. Now the legal battle goes before the full ITC tribunal.

Philip Morris remains a stellar high-yielding income generation idea. From 2018-2020, Philip Morris generated roughly $8.8 billion in annual free cash flows on average which fully covered its run-rate dividend obligations of $7.4 billion as of 2020. This year, Philip Morris is guiding to generate around $10.2 billion in free cash flow (before taking working capital movements and other considerations into account). **The company's forward-looking dividend coverage is quite strong as Philip Morris has a Dividend Cushion ratio near parity (~1.0).** Through 2023, Philip Morris aims to realize material cost savings while steadily growing its organic revenues, which supports its cash flow growth outlook.

Image Shown: *Philip Morris' revenue growth trajectory is underpinned by expected sales growth at its IQOS offering. Beyond expected revenue growth, Philip Morris' cash flow growth trajectory is further supported by its ongoing cost structure improvement initiatives.* ***Image Source:*** *Philip Morris – April 2021 IR Presentation*

Concluding Thoughts

In the current low interest rate environment, locating high-quality companies with strong cash flow generating abilities and promising outlooks is essential to avoiding *Value Traps* when searching for high-yielding opportunities. **We continue to be huge fans of Public Storage and Philip Morris.**

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

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Disclosure: *Unless otherwise noted, 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%	3.20%
SPDR Portfolio S&P 500 High Dividend ETF	SPYD	5.0%	4.75%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	4.83%
iShares International Select Dividend ETF	IDV	5.0%	4.34%
iShares U.S. Preferred Stock ETF	PFF	5.0%	4.51%
Global X SuperDividend ETF	SDIV	5.0%	6.82%
Global X SuperIncome Preferred ETF	SPFF	10.0%	5.62%
Vanguard Consumer Staples ETF	VDC	5.0%	2.43%
Vanguard Real Estate ETF	VNQ	10.0%	3.13%
Utilities Select Sector SPDR	XLU	5.0%	3.12%
EQUITY			
AT&T	T	5.0%	7.23%
Crown Castle	CCI	5.0%	2.73%
CyrusOne Inc.	CONE	5.0%	2.85%
CubeSmart	CUBE	5.0%	2.94%
Digital Realty Trust	DLR	5.0%	3.08%
Philip Morris	PM	5.0%	4.84%
Public Storage	PSA	5.0%	2.66%
Enterprise Products Partners	EPD	2.5%	7.46%
Magellan Midstream Partners	MMP	2.5%	8.40%
Cash*	-	0.0%	0.00%
		100.0%	**4.29%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 7/1/2021. Est. Forward Div. Yield information retrieved from SeekingAlpha, YF.

** Reflects federal funds target rate range*

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 27-Jun-2021 | Data as of 25-Jun-2021

Exxon Mobil XOM FAIRLY VALUED

Buying Index™ 6 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$56.00 - $110.00	HEALTHY	POOR / 0.9	VERY POOR	5.38%

Assessment of Company Dividend Strategy

Key Strengths

Exxon Mobil is focused on improving its cost structure through work process simplification initiatives, the optimization of its logistics and supply chain operations, and through workforce reductions. While Exxon Mobil operates in a capital-intensive business and must contend with sizable capital expenditure requirements, management has placed a greater emphasis on better managing the company's capital investment programs in recent years. The integrated nature of Exxon Mobil's business model supports its cash flow outlook, as weakness at its upstream business can at times be offset by strength at its chemical and downstream businesses.

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 over 4.2 million barrels of oil equivalent net per day. By 2020, that had fallen to less than 3.8 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. While the outlook for energy markets and raw energy resources pricing has improved considerably since 2020, the outlook for energy markets can change quickly. Exxon Mobil's financial and operational flexibility is limited.

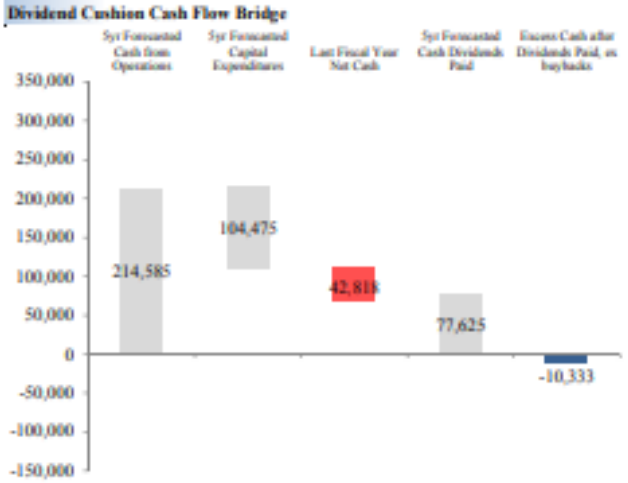
Graphical Relationship, Earnings and Dividends (per share)

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

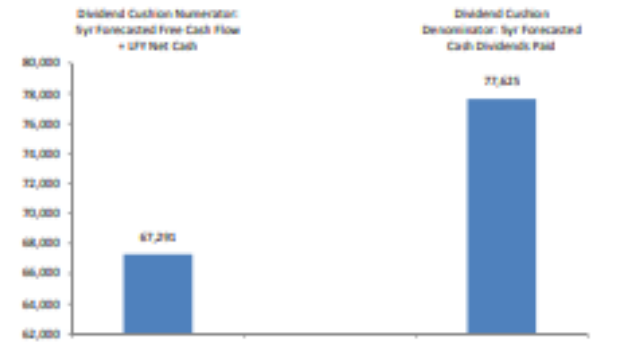


Source: Company Filings, Valuentum Projections

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



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VALUENTUM

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.

Disclosure: *Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS.*

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Amended June 1, 2021.