Valuentum Securities, Inc. 2/1/2022 Edition 5, Volume 2

HIGH YIELD DIVIDEND NEWSLETTER

NEW: PORTFOLIO CHANGES: CONE IS BOUGHT OUT; LSI AND AMT ARE IN!

CAPITAL SPENDING A KEY HEADWIND TO BROADER MARKETS IN 2022

Prior Changes to High Yield Dividend Newsletter

Removed: T – November 8 Added: CVX, XOM – November 8 Changed Weighting: EPD, MMP, SPFF, VNQ – November 8

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"TODAY, ON FEBRUARY 1, WE ARE MAKING SOME CHANGES TO OUR HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO. SPECIFICALLY, WE ARE REMOVING CYRUSONE (CONE) AFTER THE DATA CENTER REIT AGREED TO SELL ITSELF BACK IN NOVEMBER 2021. WE ARE ADDING LIFE STORAGE (LSI) AND AMERICAN TOWER (AMT) IN ITS STEAD. WE CONTINUE TO LIKE EXPOSURE TO LARGE CAP ENERGY FIRMS AS THE GLOBAL ENERGY COMPLEX STEADILY RECOVERS."

– CALLUM TURCAN

The undercurrents of the market in 2022 aren't as strong as we would like, with the Federal Reserve expected to tighten soon and capital spending expected to increase materially, but we continue to like stocks for the long run and don't see any reason to make any changes to the High Yield Dividend Newsletter portfolio at this time in light of these observations.

By Brian Nelson, CFA

Before we cover the recent changes in our High Yield Dividend Newsletter portfolio, let us first look at the trend of capital expenditures across some key sectors and industries. One of the biggest themes in 2022 is the amount of money companies will spend in capex ("capital expenditures"). A key reduction to net cash flow from operations to arrive at traditional free cash flow is capital expenditures, and we're seeing some of the largest companies spend aggressively to the detriment of internal free cash flow generation. Though such spending may be necessary, in most cases, to enhance long-term revenue and earnings growth, the higher spending this year is a notable trend that we think may be posing a headwind to the broader equity markets so far in 2022.

The markets the past few years have been driven in part by high economic-return, asset-light entities. These companies are able to drive strong traditional free cash flow growth with little incremental net new investment as their operations become more efficient (scale) or become more digital in nature via traditional earnings/operating leverage. But this tailwind may be losing some momentum. According to a report from the *Wall Street Journal*, "companies in the S&P 500 allocated $528.4 billion toward capital projects during the first nine months of 2021, or 11% more than during the comparable months of 2020. According to S&P Global Ratings, in 2022, "capital expenditures by big companies worldwide are expected to increase 6.1% from 2021 levels."

Big Spenders

For one, Amazon's (AMZN) capital spending is simply out of control, and it is one of the biggest companies on the market. Intel (INTC), which reported fourth-quarter 2021 results January 26, noted in its prior quarterly report that it would spend as much as $25-$28 billion in 2022 when compared to just $18.7 billion in the most recently completed 2021, nearly a 50% increase in spending, and almost all of the operating cash flow generated during 2021. Intel's $20 billion investment to build two chip factories in Ohio is quite the capital outlay, for example.

Though we believe the metaverse may live up to the hype, Facebook's (FB) $10 billion investment in its metaverse division this year isn't small potatoes and won't translate into any meaningful returns for years. In total, the level of investment at Facebook to take a chance on the metaverse could be in the tens of billions, with considerable capital investment year after year. Look at the delta in capex spending as revealed in Facebook's most recent quarterly report, for example: "We expect 2021 capital expenditures to be approximately $19 billion, updated from our prior estimate of $19-21 billion. For 2022, we expect capital expenditures to be in the range of $29-34 billion, driven by our investments in data centers, servers, network infrastructure, and office facilities." That's a huge jump.

Prudent Allocators

On the other hand, **we've written extensively about how some of the largest companies in the energy sector** (XLE) **have scaled back their capital investments in recent years.**

Significantly lower energy resource pricing seen over the past few years is the primary culprit here, leading to a much more benign environment both with respect to their cash-based sources of intrinsic value (i.e. free cash flow), but also in keeping excess energy resource supplies from flooding the market.

For example, our favorite large cap energy firms, Chevron (CVX)--**4.3% yield**---and Exxon Mobil (XOM)---**4.6% yield**---are both keeping a lid on their capital expenditures. This has enabled both firms to boost their per share dividends, resume share repurchases, and announce sizable share repurchases in recent quarters. **We include both Chevron and Exxon Mobil as ideas our High Yield Dividend Newsletter portfolio** and cover the companies extensively in our article *Valuentum's Theses on Best Ideas Chevron and Exxon Mobil Playing Out* which can be viewed on page 11 of this newsletter.

Lower Economic Returns

Broad market economic returns on invested capital will likely take a hit, and while all eyes remain on the Federal Reserve and the 10-year Treasury rate, and perhaps rightly so, pressure on economic value added (EVA) or economic profit (returns), the difference between return on invested capital [ROIC] and a company's cost of capital [WACC], may be starting to emerge.

The dichotomy between those exhibiting capital discipline and those that aren't is starting to become clearer and clearer as 2022 progresses. Technology, for example, is among the worst-performing sectors this year while energy is among the best-performing ones. **Early last decade, the energy sector learned the importance of capital discipline the hard way--that overspending could be a recipe for disaster.** The largest technology companies may be taking on that risk today, and it remains to be seen whether the same lesson will be taught.

That said, it's far too early to say whether the broader markets will start to feel the weight of increased capital spending in 2022 as the year progresses, but many other research outfits are also starting to see what we're seeing -- signs of a new capex cycle ahead, with the consumer discretionary (XLY) and information technology (XLK) sectors leading the spending increases and the energy and mining (XME) sectors being as prudent as ever, revealing capital discipline late into the economic cycle.

The undercurrents of the market in 2022 aren't as strong as we would like, with the Federal Reserve expected to tighten soon and capital spending expected to increase materially, but we continue to like stocks for the long run and don't see any reason to make any changes to the newsletter portfolios at this time in light of these observations.

With all this said, we wanted to make note of a couple changes. We've talked extensively about how much we like the self-storage arena and the tower stocks in the past, with Public Storage (PSA) and Crown Castle (CCI) as key holdings in the High Yield Dividend Newsletter portfolio. **With CyrusOne (CONE) being taken out, we're replacing it with storage play Life Storage (LSI) and tower stock American Tower (AMT) in the High Yield Dividend Newsletter portfolio effective today, February 1, 2022.**

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

High Yielding Philips 66 Has a Solid Plan in Place to Reward Its Shareholders

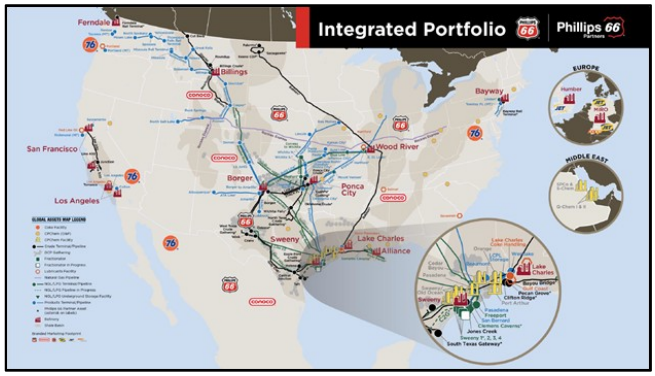

Image Shown: *An overview of Phillip 66's expansive asset base.* ***Image Source:*** *Phillips 66 – November 2021 IR Presentation*

By Callum Turcan

Demand for diesel and gasoline has largely recovered from the worst of the coronavirus ('COVID-19') pandemic, though kerosene demand (jet fuel) has a way to go given depressed levels of international travel. The petrochemical, midstream, and refining giant Phillips 66 (PSX)---**4.3% yield**---**took advantage of the rebound seen over the past year to pare down its debt levels on a consolidated basis.**

At the end of December 2020, Phillips 66 had $13.4 billion in net debt (inclusive of short-term debt) on a consolidated basis, which fell down to ~$11.3 billion in net debt (inclusive of short-term debt) on a consolidated basis at the end of December 2021. Now the firm wants to focus on returning cash to shareholders as communicated during a January 2022 investor conference.

We appreciate the recent improvements in Phillips 66's balance sheet strength as puts the firm in a better position to reward income seeking investors in a sustainable manner.

Corporate Structure and Pending Changes

First, some quick housekeeping items. Note that Phillips 66 owns a large economic interest in Phillips 66 Partners LP (PSXP) which is its main midstream master limited partnership ('MLP') spinoff. Furthermore, the financial performance of Phillips 66 Partners is consolidated with Phillips 66's financial performance. **Phillips 66 is getting ready to acquire Phillips 66 Partners through an all-stock deal that is expected to close in the first quarter of 2022**, which was announced back in October 2021. When the deal was first announced, the transaction value was pegged at ~$3.4 billion. **When the deal closes, Phillips 66 Partners will become a wholly-owned subsidiary of Phillips 66.**

Image Shown: *Phillips 66 is acquiring the remaining economic interests in Phillips 66 Partners that it does not already own through an all-stock deal that is set to close in the first quarter of 2022.* ***Image Source:*** *Phillips 66 – November 2021 IR Presentation*

Additionally, Phillips 66 owns 50% the equity of DCP Midstream which in turn owns the general partner ('GP') of the publicly traded DCP Midstream LP (DCP), another publicly traded midstream MLP (DCP Midstream also owns a sizable economic stake in the publicly traded midstream MLP). Furthermore,

Phillips 66 owns half of the Chevron Phillips Chemical Company ('CPChem') joint-venture, with its partner Chevron Corporation (CVX) owning the remaining stake.

Phillips 66 is a giant in the refining, petrochemical, and midstream industries and is well-positioned to capitalize on the ongoing recovery in the global energy complex.

Capital Allocation Priorities

Pivoting back to Phillips 66's plan to return more cash to shareholders, the firm aims to spend $1.9 billion on its capital expenditures in 2022 versus $2.9 billion in capital expenditures in 2020 and ~$1.9 billion in adjusted capital expenditures in 2021 (its adjusted and actual capital expenditures are roughly the same). **The company is keeping a lid on its capital investments to maximize its free cash flow generating abilities.** Phillips 66 is targeting mid-cycle annual operating cash flows of ~$6.0-$7.0 billion.

Though Phillips 66 notes that its sustaining level of capital expenditures is estimated to be roughly $1.0 billion on an annual basis (both in 2022 and over the long haul), we are always cautious with that type of commentary given the eventual need to replace aging assets with new operations (especially in the rapidly changing global energy complex).

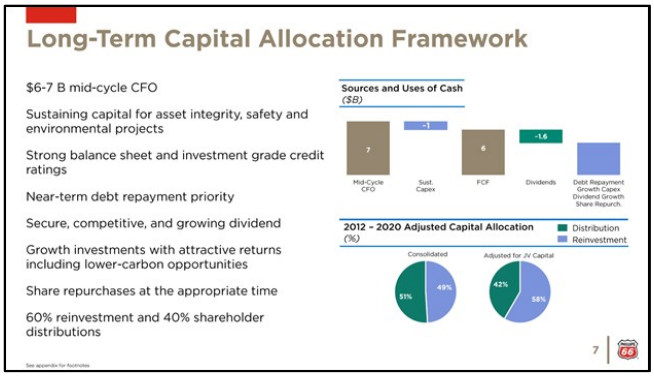

Image Shown: *Phillips 66 lays out plans for its capital allocation priorities over the long haul, with debt repayment being a near term priority as it repairs its balance sheet from the damage sustained during the worst of the COVID-19 pandemic.* ***Image Source:*** *Phillips 66 – November 2021 IR Presentation*

Management noted during the January 2022 investor event that the goal would be to bring Phillips 66's debt load down to pre-pandemic levels of roughly $12.0 billion before resuming share buybacks in earnest. That appeared to be a reference to total debt, which stood at ~$14.4 billion at the end of December 2021 when including short-term debt.

In the eyes of management, Phillips 66 should be able to pare down its total debt load quickly given the firm's improving outlook, relatively modest capital expenditure budget, and strong cash flow generating abilities. That, in turn, will allow Phillips 66 to resume share repurchases this year, a move management is "anxious" to begin doing.

Our fair value estimate sits at $79 per share of Phillips 66, roughly where the company is trading at as of this writing, though the high end of our fair value estimate range stands at $99 per share. **We appreciate Phillips 66's plan to further pare down its debt load in the near term before resuming share buybacks considering shares of PSX are fairly valued as of this writing, in our view.**

Phillips 66's run-rate payout obligations stood at ~$1.9 billion in 2021 (dividends to common shareholders plus distributions to noncontrolling interests), though its pending deal to acquire Phillips 66 Partners may change the total figure modestly. In October 2021, Phillips 66 announced a modest sequential increase in its quarterly payout of ~2%. Looking ahead, Phillips 66's annualized dividend now sits at $3.68 per share.

Green Growth

Though Phillips 66 is a powerhouse in the fossil fuel industry, management is pushing aggressively into new arenas. For instance, Phillips 66 is working towards converting its San Francisco Refinery in Rodeo, California (which is right next to San Francisco), to one that produces renewable fuels through its Rodeo Renewal project.

For reference, the Rodeo Refinery has 120,000 barrels of daily crude throughput capacity (140,000 barrels of total throughput capacity per day) and the facility dates back to the 1890s (though the current refinery is much more modern). The renewable fuels project would see the refinery no longer process crude oil.

By 2024, the goal is to enable the refinery "to produce 800 million gallons per year of renewable diesel, renewable gasoline and sustainable jet fuel from used cooking oils, fats, greases and soybean oils" which includes output from a previous endeavor along with the 680 million gallons of annual renewable fuel capacity the Rodeo Renewal endeavor would bring

online. **Phillips 66 is already producing a modest amount of renewable biodiesel at the Rodeo Refinery** as it recently completed a small renewable fuel conversion project at the refinery that commenced operations in July 2021.

Here we must stress that the Rodeo Refinery was recently defined as a "perennial underperformer" by Phillips 66's management team.

While this upgrade is considered a growth endeavor, it really is all about ensuring that the refinery does not become a stranded asset due to its unappealing economics. There is a lot of existing infrastructure at the facility along with a dedicated workforce, but the asset does not have the kind of economic profile that refineries in the US Gulf Coast and Midwest regions have.

Refineries in these aforementioned regions have ample access to cost-advantage crude oil and other supplies from major shale plays and Canada's oil sands patch. **Phillips 66 is making the right call by upgrading the Rodeo Refinery instead of simply letting the asset fade into irrelevancy, in our view.**

By utilizing existing infrastructure at the refinery, and the feedstock operations already set up via its recently completed hydrotreater conversion project, Phillips 66 aims to bring down development costs while ensuring that ongoing operating expenses will be tame.

Having access to global bio-feedstocks due to the Rodeo Refinery's proximity to various Pacific Coast ports along with ample domestic bio-feedstock supplies should support the project's economics over the long haul. Additionally, please note that boosting its domestic biofuel production capacity will help Phillips 66 comply with the Renewable Fuels Standard Program that is run by the US Environmental Protection Agency ('EPA').

Phillip 66 announced its new Emerging Energy group back in January 2021. While a small part of its business profile currently, the goal is to aggressively grow this unit going forward, albeit off a very low base.

Management noted during the January 2022 investor presentation that Phillip 66 was considering "everything from soybean oil to corn oil, canola, oil, use cooking all animal fats, anything that that we can get our hands on across the planet to process." Furthermore, Phillips 66's management team noted that "Rodeo Renewed is the cornerstone of our renewables efforts" and that the firm's recently established Emerging Energy unit will support Phillips 66's future efforts in this space.

Looking ahead, its Emerging Energy group will focus on renewable fuels, batteries, carbon capture and storage, and hydrogen technologies. **By 2030, Phillips 66 aims to have this part of its business generate $2 billion in EBITDA.**

In our view, **its growing renewable fuels operations will likely be the main way the company achieves its longer term goals.**

While Phillips 66's renewable fuels business is currently rather small, once the Rodeo Renewed endeavor is fully operational, its Emerging Energy group will start to become a meaningful (albeit still small) part of its business profile. The company is focusing on new energy opportunities where it already has a solid understanding of market dynamics.

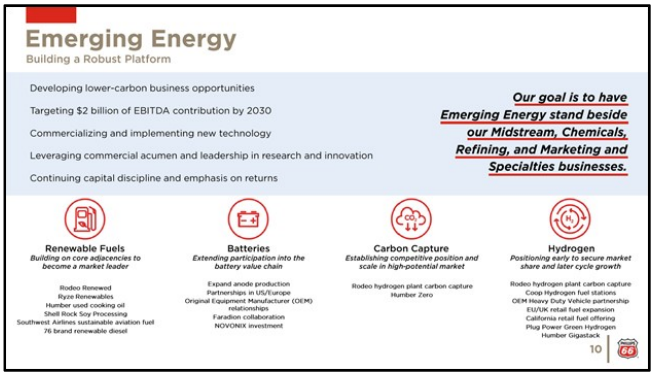

Image Shown: *An overview of the various new energy technologies Phillips 66 intends to invest in via its nascent Emerging Energy unit.* ***Image Source:*** *Phillips 66 – November 2021 IR Presentation*

Phillips 66 is more committed to green ambitions than its long and storied history may have some believe. For instance, the company publishes annual sustainability reports, focuses and reports on ESG (environmental, social, and governance) issues, and has its aforementioned renewable biofuel growth ambitions. Over time, Phillips 66 will likely continue to expand its ability to produce renewable gasoline, diesel, and jet fuel using bio-feedstocks.

Image Shown: *Phillips 66 is adapting to the changing investing landscape by placing a greater emphasis on ESG issues and sustainability practices, as best as it can considering the firm is a juggernaut in the fossil fuels industry.* ***Image Source:*** *Phillips 66 – November 2021 IR Presentation*

Concluding Thoughts

The oil and gas industry represents an attractive space right now as the global energy complex continues to recover. **Large cap energy majors offer ample capital appreciation and dividend growth opportunities.** Rising geopolitical tensions combined with ongoing efforts by the OPEC+ cartel to keep a lid on crude oil supplies supports the outlook for the broader global energy complex.

Phillips 66 has laid out a sound long-term capital allocation strategy. **We appreciate the company's plan to continue deleveraging in the near term.** Farther out, keeping its capital expenditures contained will better enable Phillips 66 to generate substantial free cash flows throughout the business cycle. Its renewable fuels project in California is intriguing, though what matters most is the ongoing recovery in the global energy complex, particularly as it concerns refined petroleum products demand.

The recovery in the global energy complex seen over the past year is what enabled Phillips 66 to boost its dividend and reduce its net debt load in recent quarters. As the recovery is expected to continue, management had the confidence to communicate that Phillips 66 will soon resume share repurchases after bringing its debt load down further. Things are looking up for Phillips 66.

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

HIGH YIELD SPOTLIGHT

Energy Select Sector SPDR Fund ETF Offers Investors Diversified Exposure to High-Yielding Energy Firms

Our **High Yield Spotlight for February 2022** is the Energy Select Sector SPDR Fund ETF (XLE) **which had a 30-day SEC yield of ~3.3% in late-January 2022** and a gross expense ratio of ~0.1%. We are incredibly optimistic that the ongoing recovery in the global energy complex has long legs. **The XLE ETF is a great way to gain diversified exposure to the upside that the energy space provides.**

Demand destruction for refined petroleum products due to the coronavirus ('COVID-19') pandemic weighed negatively on raw energy resources pricing in 2020, particularly for crude oil. Back in April 2020, in the wake of the pandemic, the OPEC+ cartel agreed on a massive collective production curtailment agreement as it concerns global crude oil supplies. Subdued raw energy resources pricing saw government revenues relating to oil & gas activities dry up overnight, which negatively impacted the outlook for national budgets of major energy producing nations. The OPEC+ cartel needed to respond to shore up their national finances and the cartel continues to limit global crude oil supplies to this day.

Upstream operations, activities involved in the extraction of raw energy resources from the ground, are the cash flow cows of the oil & gas industry. When upstream operations are performing poorly, that decimates the national finances of major energy producing nations and weighs quite negatively on the financial performance of energy firms. Downstream operations, activities involved in refining oil and producing petrochemical products, take a beating when forced to operate at subdued utilization rates. Economies of scale are essential in enabling refineries and petrochemical plants to produce meaningful profits. Midstream operations, activities involved in transporting and storing raw energy resources and refined petroleum/petrochemical products, also require high utilization rates to produce decent profits.

In 2020 and parts of 2021, the global energy complex was contending with major headwinds, though more recently, the space has been benefiting from massive tailwinds.

Russia and Saudi Arabia were key to making the agreement reached in April 2020 possible, which came into force May 2020. While OPEC+ has since scaled back the size of the supply curtailments and will likely continued to do so going forward, adherence to the agreement has been quite strong. Furthermore, demand for refined petroleum products has swiftly recovered from the worst of the COVID-19 pandemic as households returned to the office, started taking vacations again, and resumed outdoor activities. These two forces have gone a long way in improving the outlook for the global energy complex. **Crude oil prices have been on a powerful upswing of late, with near term Brent and WTI futures trading near ~$90 per barrel as of this writing.**

Prices for natural gas, liquified natural gas ('LNG'), and natural gas liquids have also boomed higher over the past year or so. Demand for electricity and petrochemical products is quite strong as the global industrial economy recovered quickly from the worst of the COVID-19 pandemic. Rising geopolitical tensions are further driving up raw energy resources pricing. **The equities included in the XLE ETF stand to gain immensely from the recovering global energy complex.**

In short, the XLE ETF "seeks to provide investment results that, before expenses, correspond generally to the price and yield performance of the Energy Select Sector Index" according to its website. Furthermore, the index is "an effective representation of the energy sector" within the S&P 500 (SPY) and "includes companies from the following industries: oil, gas and consumable fuels; and energy equipment and services." State Street Global Advisors Funds Management is the administrator and SSGA Funds Management is the investment manager of the XLE ETF.

At the end of December 2021, the top two holdings in the XLE ETF were Exxon Mobil Corporation (XOM)---**4.6% yield**---and Chevron Corporation (CVX)---**4.3% yield**---which together represented ~44% of the XLE ETF's total holdings at the end of this period. We are huge fans of both Exxon Mobil and Chevron and include both companies as ideas in our High Yield Dividend Newsletter portfolio. **The integrated nature of their business models represents key competitive advantages, especially during turbulent times such as these.** The upcoming graphic down below highlights the XLE ETF's top ten holdings at the end of December 2021.

Top 10 Holdings‡	Weight (%)
Exxon Mobil Corporation	22.71
Chevron Corporation	21.30
EOG Resources Inc.	4.89
ConocoPhillips	4.49
Schlumberger NV	4.37
Pioneer Natural Resources Company	4.30
Marathon Petroleum Corporation	4.10
Phillips 66	3.31
Williams Companies Inc.	3.29
Kinder Morgan Inc Class P	3.22

‡Subject to Change.
Totals may not equal 100 due to rounding.

Image Shown: *We appreciate the diversified exposure to the energy complex that the XLE ETF provides as its top holdings include large cap integrated energy firms along with major upstream, midstream, and oil field services providers.* ***Image Source:*** *XLE ETF Website – Fact Sheet*

The XLE ETF also has sizable exposure to high-quality upstream focused names such as EOG Resources Inc (EOG)---**2.7% yield**---Pioneer Natural Resources Company (PXD)---**1.1% yield**---and the "super-independent" ConocoPhillips (COP)---**2.1% yield**. All three of these three firms have enormous positions in the prolific Permian Basin in West Texas and Southeastern New Mexico. Additionally, **the XLE ETF has exposure to large US midstream companies** including Williams Companies Inc (WMB)---**5.5% yield**---and Kinder Morgan Inc (KMI)---**6.2% yield.** The XLE ETF also has **exposure to major downstream firms** with sizable international footprints such as Phillips 66 (PSX)---**4.3% yield**---and **exposure to major international oil field services providers** such as Schlumberger NV (SLB)---**1.3% yield**. Recovering upstream capital expenditure budgets supports the outlook for firms like Schlumberger.

In recent quarters, Exxon Mobil and Chevron have taken advantage of the recovery in the global energy complex to repair their respective balance sheets. Both firms aggressively reduced their net debt loads in 2021, primarily by using their "excess" free cash flows (free cash flows after covering dividend obligations) as these large cap energy giants kept their capital expenditures contained to better enable free cash flow generation. **Going forward, both firms intend to keep their spending levels contained over the long haul.** Exxon Mobil reduced its net debt load (inclusive of short-term debt) by $11.4 billion from the end of December 2020 to the end of September 2021.

EXXON MOBIL CORPORATION CONDENSED CONSOLIDATED BALANCE SHEET *(millions of dollars)*	September 30, 2021	December 31, 2020
Assets		
Current assets		
Cash and cash equivalents	4,768	4,364
Notes and accounts receivable – net	29,516	20,581
Inventories		
Crude oil, products and merchandise	15,087	14,169
Materials and supplies	4,520	4,681
Other current assets	1,664	1,098
Total current assets	55,555	44,893
Investments, advances and long-term receivables	45,641	43,515
Property, plant and equipment – net	218,795	227,553
Other assets, including intangibles – net	16,697	16,789
Total assets	336,688	332,750
Liabilities		
Current liabilities		
Notes and loans payable	12,966	20,458
Accounts payable and accrued liabilities	47,257	35,221
Income taxes payable	1,633	684
Total current liabilities	61,856	56,363
Long-term debt	43,639	47,182
Postretirement benefits reserves	21,060	22,415
Deferred income tax liabilities	19,008	18,165
Long-term obligations to equity companies	3,060	3,253
Other long-term obligations	20,559	21,242
Total liabilities	169,182	168,620
Commitments and contingencies (Note 3)		
Equity		
Common stock without par value		
(9,000 million shares authorized, 8,019 million shares issued)	16,104	15,688
Earnings reinvested	386,952	383,943
Accumulated other comprehensive income	(16,696)	(16,705)
Common stock held in treasury		
(3,785 million shares at September 30, 2021 and 3,786 million shares at December 31, 2020)	(225,771)	(225,776)
ExxonMobil share of equity	160,589	157,150
Noncontrolling interests	6,917	6,980
Total equity	167,506	164,130
Total liabilities and equity	336,688	332,750

Image Shown: *Exxon Mobil reduced its net debt load, inclusive of short-term debt, by over $11 billion from the end of December 2020 to the end of September 2021. The large cap energy giant primarily utilized its strong excess free cash flow generating abilities to do so.* ***Image Source:*** *Exxon Mobil – 10-Q SEC filing covering the third quarter of 2021*

Pivoting to Chevron, this energy giant reduced its net debt load (inclusive of short-term debt) by ~$13.0 billion from the end of December 2020 to the end of December 2021. Its impressive excess free cash flow generating abilities made its deleveraging push possible.

SELECTED BALANCE SHEET ACCOUNT DATA (Preliminary)	Dec. 31, 2021	Dec. 31, 2020
Cash and Cash Equivalents	**$ 5,640**	$ 5,596
Marketable Securities	**$ 35**	$ 31
Total Assets	**$ 239,535**	$ 239,790
Total Debt	**$ 31,369**	$ 44,315
Total Chevron Corporation Stockholders' Equity	**$ 139,067**	$ 131,688

Image Shown: *Chevron substantially reduced its net debt load in 2021, which we really appreciate.* ***Image Source:*** *Chevron – Fourth Quarter of 2021 Earnings Press Release*

Exxon Mobil announced last year that it intended to resume share repurchases in 2022 and Chevron started buying back its stock again in the third quarter of 2021. During the worst of the COVID-19 pandemic, both Exxon Mobil and Chevron halted their share buyback programs to conserve cash to continuing meeting their dividend obligations. **We appreciate their commitment to income seeking shareholders.** Shares of both XOM and CVX are trading well below their intrinsic values as of this writing (Exxon Mobil has a fair value estimate of $92 per share and Chevron has a fair value estimate of $140 per share). We view share buybacks at both Exxon Mobil and Chevron as solid uses of shareholder capital, if these programs are done in moderation to preserve their respective balance sheet improvements seen over the past year or so.

CHEVRON CORPORATION - FINANCIAL REVIEW **Attachment 3**
(Billions of Dollars)
(unaudited)

SUMMARIZED STATEMENT OF CASH FLOWS (Preliminary)[1]	Three Months Ended Dec. 31	Year Ended Dec. 31	
OPERATING ACTIVITIES	**2021**	**2021**	**2020**
Net Income (Loss)	**$ 5.1**	**$ 15.7**	$ (5.6)
Adjustments			
Depreciation, depletion and amortization	**4.8**	**17.9**	19.5
Distributions more (less) than income from equity affiliates	**0.2**	**(2.0)**	2.0
Loss (gain) on asset retirements and sales	**(0.6)**	**(1.0)**	(0.8)
Net foreign currency effects	**—**	**—**	0.6
Deferred income tax provision	**0.2**	**0.7**	(3.6)
Net decrease (increase) in operating working capital	**0.1**	**(1.4)**	(1.7)
Other operating activity	**(0.3)**	**(0.7)**	—
Net Cash Provided by Operating Activities	**$ 9.5**	**$ 29.2**	$ 10.6
INVESTING ACTIVITIES			
Capital expenditures	**(2.6)**	**(8.1)**	(8.9)
Proceeds and deposits related to asset sales and returns of investment	**1.2**	**1.8**	3.0
Other investing activity[2]	**—**	**0.4**	(1.0)
Net Cash Used for Investing Activities	**$ (1.4)**	**$ (5.9)**	$ (7.0)
FINANCING ACTIVITIES			
Net change in debt	**(6.0)**	**(12.9)**	7.5
Cash dividends — common stock	**(2.6)**	**(10.2)**	(9.7)
Net sales (purchases) of treasury shares	**0.3**	**—**	(1.5)
Distributions to noncontrolling interests	**—**	**—**	—
Net Cash Provided by (Used for) Financing Activities	**$ (8.3)**	**$ (23.1)**	$ (3.7)
EFFECT OF EXCHANGE RATE CHANGES ON CASH, CASH EQUIVALENTS AND RESTRICTED CASH	**—**	**(0.2)**	(0.1)
NET CHANGE IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH	**$ (0.2)**	**$ 0.1**	$ (0.2)

Image Shown: *Chevron was a free cash flow generating powerhouse in 2021.* ***Image Source:*** *Chevron – Fourth Quarter of 2021 Earnings Press Release*

Investors are clearly warming up to the energy sector. **Shares of Chevron hit an all-time high in late-January 2022 and shares of Exxon Mobil are on a nice upward climb in recent months.** Both Chevron and Exxon Mobil are taking advantage of their swelling free cash flows and stronger balance sheets to reward income seeking investors, which highlights why we are big fans of both firms. **Chevron announced it was increasing its quarterly payout by 6% sequentially in January 2022**, bringing it up to $1.42 per share or $5.68 per share on an annualized basis, after previously boosting its payout in April 2020. **This latest increase makes 2022 the 35th consecutive year that Chevron has increased its annual per share dividend.** Back in October 2021, Exxon Mobil raised its quarterly dividend by 1% sequentially to $0.88 per share or $3.52 per share on an annualized basis, which represented its first dividend hike since April 2019.

There are some downside risks to be aware of here. For starters, the XLE ETF is full of firms with large net debt loads that operate in an incredibly volatile industry prone to large swings. The direction of raw energy resources pricing, refined petroleum products pricing, and petrochemical products pricing will all have an outsized impact on the future financial performance of virtually all of the companies included in the XLE ETF. Additionally, **the companies included in the XLE ETF have asset-heavy business models that require sizable capital expenditures to maintain, which can eat away at their free cash flow generating abilities even in the best of times.**

Keeping these risks in mind, the outlook for the global energy complex is incredibly promising. **We like having exposure to large cap energy firms in our High Yield Dividend Newsletter portfolio**. The XLE ETF provides investors a nice way to gain diversified exposure to high-quality large cap energy firms, including our favorites Chevron and Exxon Mobil. **We like the XLE ETF as our High Yield Spotlight for February 2022.**

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

Our Theses on Best Ideas Chevron and Exxon Mobil Playing Out

Image Shown: *Shares of Chevron Corporation (blue line) and Exxon Mobil Corporation (orange line) have surged higher in recent months. We continue to like both large cap energy firms as ideas in our High Yield Dividend Newsletter portfolio.* ***Image Source:*** *TradingView*

By Callum Turcan

Raw energy resources pricing has surged higher during the past year with room to run. The global energy complex is on the rebound as demand for crude oil and refined petroleum products is steadily recovering from the worst of the coronavirus ('COVID-19') pandemic. As demand for electricity and heating needs held up well during the pandemic, liquified natural gas prices ('LNG') put up a strong year in 2021 and remain elevated. The OPEC+ cartel is committed to slowly phasing out its crude oil supply curtailment agreement first enacted in 2020, effectively limiting growth in global oil supplies at a time when demand is rebounding at a brisk pace.

We view the near-term outlook for the global energy complex quite favorably and have been pounding the table on this issue for some time. Shares of Chevron Corporation (CVX)---**4.3% yield**---and Exxon Mobil Corporation (XOM)---**4.6% yield**---are both included in our High Yield Dividend Newsletter portfolio. **Recently, shares of both CVX and XOM have started shifting higher, and in our view, this is just the beginning of a strong cyclical recovery.**

Our fair value estimate for Chevron sits at $140 per share and the high end of our fair value estimate range sits at $175 per share, while CVX is trading at ~$131 as of this writing. Our fair value estimate for Exxon Mobil sits at $92 per share and the high end of our fair value estimate range sits at $122 per share, while XOM is trading at ~$76 as of this writing. As investors continue to rotate into energy firms, we expect that the stock prices of Chevron and Exxon Mobil will continue converging towards our estimate of their respective intrinsic values.

Importantly, however, **we view our energy exposure as near- to medium-term in nature** and generally prefer over the long run the strong net cash rich, free-cash-flow generating profiles of moaty secular-growth powerhouses in the area of large cap growth, where many of our best ideas reside. We still think big cap tech and large cap growth remain very attractive, even near all-time highs.

Chevron

In recent years, Chevron has placed a greater emphasis on controlling the trajectory of its capital expenditures and not chasing raw energy resources pricing higher by aggressively increasing its capital investment plans. We are huge fans of this strategy as it better enables Chevron to generate traditional free cash flows and return cash to shareholders.

For 2022, Chevron aims to spend approximately $15.0 billion on its "organic capital and exploratory spending program" which is a proxy for its capital expenditure plans. While up from its 2021 budget, please note Chevron aggressively reduced its capital investment levels in the face of the COVID-19 pandemic to conserve cash, so a moderate recovery in spending does not mean it has abandoned its fiscal discipline (for reference, Chevron spent $14.1 billion on capital expenditures in 2019).

Back during previous boom years when raw energy resources pricing was elevated, Chevron found it quite difficult to generate free cash flow as it was pouring tens of billions of dollars towards its capital investments each year. For example, Chevron spent an average of ~$34.8 billion per year on its capital expenditures during the 2012-2014 period and generated just ~$0.3 billion in free cash flow per year on average during this period as capital expenditures consumed virtually all its net operating cash flows.

Share buybacks and dividend payouts from 2012-2014 were funded by Chevron's ability to tap capital markets for funds and by its balance sheet. This strategy created major headwinds for the company as Chevron entered the prolonged bust in oil prices (from 2015-2020) with a large net debt load on the books while contending with relatively low raw energy resources pricing.

A lot has changed since then, and Chevron's fiscal discipline should better enable the firm to reward shareholders in the current environment. In 2021, **Chevron generated ~$21.1 billion in free cash flow** as the company capitalized on the recovery in global energy markets. The company spent ~$10.2 billion covering its dividend obligations, allowing for sizable "excess" free cash flows (free cash flows after covering its dividend obligations). On a net basis, Chevron's share repurchases were offset by equity issuances in 2021.

Chevron used its improving financial performance to pay down debt, reducing its net debt load (inclusive of short-term debt and current marketable securities) from $38.7 billion at the end of December 2020 to ~$25.7 billion at the end of December 2021. Proceeds from asset sales helped here to a degree, which raised ~$1.8 billion in cash in 2021, though for the most part it was Chevron's ability to generate sizable free cash flows that enabled the firm to clean up its balance sheet.

During its second quarter of 2021 earnings update, Chevron announced it would resume share buybacks at a pace of ~$2.0-$3.0 billion per year (repurchases resumed in the third quarter of 2021). We view Chevron's share repurchases as a good use of its capital in moderation given that its shares are trading below our estimate of their intrinsic value as of this writing (and have been for some time).

In October 2020, Chevron completed its all-stock acquisition of Noble Energy through a deal with an enterprise value of ~$13 billion. **The combination is already generating meaningful synergies which are coming in stronger than initially expected.** Ongoing cost structure improvements represent a big reason why we are huge fans of Chevron.

Most importantly, this acquisition gave Chevron a substantial position in the Eastern Mediterranean's booming natural gas industry. Chevron acquired sizable economic interests in large producing natural gas fields off the coast of Israel (the Leviathan and Tamar gas fields) along with stakes in offshore exploration opportunities in Israel, Cyprus, and Egypt. The company's upside in this region is quite extensive and comes from a combination of expanding the production capacity of producing fields and bringing new fields online. **We like Chevron's exposure to the natural gas industry in the Eastern Mediterranean region as this is an area with attractive project economics that offers private operators the abilities to secure contracts with relatively favorable pricing mechanisms.**

Chevron's peers have also had a lot of success discovering large offshore natural gas resources in the Eastern Mediterranean region in recent years, beyond the major discoveries Noble Energy located in Israel. For instance, the Italian energy firm Eni SpA (E) located the massive Zohr field off the coast of Egypt in 2015 and BP plc (BP) announced the Atoll discovery in 2015, another offshore gas field in Egypt.

On January 28, Chevron reported a solid fourth quarter 2021 earnings update that beat top-line consensus estimates but missed bottom-line estimate estimates. During the related earnings conference call, management noted that "we reaffirm our prior long-term guidance of a 3% production CAGR through 2025" as it concerns Chevron's upstream production trajectory (activities involved in the extraction of raw energy resources from the ground). However, Chevron's near term production was expected to be either down 3% or flat in 2022 versus 2021 levels "due to expiration of contracts in Indonesia and Thailand" though when removing those concerns, Chevron expects its upstream production will grow by 2%-5% in 2022 versus 2021 levels.

Here is what Chevron had to say regarding its improving cash structure and broader shareholder return strategy during its fourth quarter 2021 earnings call (emphasis added, lightly edited):

> *"**I expect 2022 will be even better for cash returns to shareholders with another dividend increase announced [in January 2022] and first quarter buybacks projected at the top of our guidance range.** We're optimistic about the future, focused on continuing to reward our shareholders while investing to grow our businesses and maintaining a strong balance sheet. We made the most of this challenging period, transforming Chevron through a well-timed acquisition and an enterprise-wide restructuring into a leaner and more productive company. **In just 2 years, [Chevron's capital expenditures were] reduced by almost half from Chevron and Noble's pre-COVID total. And operating expenses for the combined company in 2021 were lower than for Chevron on a standalone basis in 2019.**" --- Michael Wirth, Chairman and CEO of Chevron*

Pivoting here, Chevron also owns a 50% stake in Tengizchevroil ('TCO'), which operates two large oilfields in Kazakhstan (the onshore Tengiz oil field is the most important, though the onshore Korolev oil field is still sizable). TCO represents another major growth lever for Chevron as the TCO venture is actively working on expanding the production capabilities of the Tengiz oil field in a big way. We are keeping an eye on the situation in Kazakhstan as the country is currently facing a political crisis that unfortunately has turned quite deadly. Output at the TCO venture has been negatively impacted by the unrest, though Chevron and its partners are actively working towards restoring production activities to normal levels.

Exxon Mobil

We covered why we are big fans of Exxon Mobil in our December 2021 note *Exxon Mobil's Bright Growth Outlook*. Here is a key excerpt from that piece:

> Exxon Mobil's stated strategy is to not chase raw energy resources pricing higher by perpetually raising its capital expenditure expectations. **This strategy will better enable Exxon Mobil to generate substantial free cash flows going forward as it invests in its most promising assets while paying down debt, buying back its stock, and continuing to make good on its sizable dividend obligations going forward.**
>
> During its third-quarter 2021 earnings update, Exxon Mobil announced that starting in 2022, it would begin repurchasing sizable amounts its stock (buybacks were subdued during the 2018-2020 period). Its new stock buyback program will see the firm repurchase up to $10.0 billion of its shares over the 12-24 months starting in 2022. The company continued to make good on its dividend obligations during the pandemic which we appreciate.
>
> Recently, **Exxon Mobil has been taking advantage of its stellar free cash flows during the first three quarters of 2021 to pare back its net debt load.** Inclusive of short-term debt, Exxon Mobil's net debt load dropped by $11.4 billion from the end of December 2020 to the end of September 2021. During the first nine months of 2021, Exxon Mobil generated $23.0 billion in free cash flow and spent $11.3 billion covering its total dividend obligations. Cash raised via asset sales and its "excess" free cash flows (after paying out its total dividends) enabled the firm to improve its balance sheet strength. Exxon Mobil has a lot going for it.

Furthermore, we had this to say in our December 2021 note covering Exxon Mobil:

> The company noted in its early-December update that its capital expenditures would come in around ~$20-$25 billion from 2022-2027. Its investments are focused on its operations in the Permian Basin, Guyana, Brazil, its liquefied natural gas ('LNG') business, and its petrochemical businesses. While up from ~$16-$19 billion versus expected 2021 capital expenditure levels (during Exxon Mobil's third quarter of 2021 update, the firm noted that it would spend at the lower end of that range), please note that its 2022-2027 capital expenditure target is well below levels seen during previous periods of strong raw energy resources pricing. From 2010-2014, ExxonMobil's annual capital expenditures averaged ~$33 billion.

We appreciate that Exxon Mobil is keeping a lid on its capital expenditures as that will go a long way in bolstering its free cash flow generating abilities and ultimately its ability to reward income seeking investors. Exxon Mobil is also targeting major improvements in its cost structure. **By 2023, Exxon Mobil aims to realize ~$6 billion in annual cost reductions versus 2019 levels.** Workforce rationalization efforts, productivity gains, and ongoing efforts to optimize its asset base are part of its process here. Exxon Mobil noted it had realized ~$4.5 billion of those targeted annualized cost savings by the third quarter of 2021, which we really appreciate. These efforts are forecasted to improve the company's return on capital employed ('ROCE') to 14% by 2025 and 17% by 2027, versus 6.5% in 2019 and negative 9.3% in 2020.

In January 2022, Exxon Mobil had some positive updates to provide on its venture in Guyana, a small South American country in the northern part of the continent. The company recently announced two additional offshore discoveries in Guyana in the offshore 6.6 million acre Stabroek block, which will add to the 10 billion barrels of recoverable oil equivalent the venture has already discovered in the region. To commercialize these discoveries, the venture is currently working on developing the Liza and Payara oil fields (the Liza oil field is already producing raw energy resources). Exxon Mobil has a 45% interest in the Stabroek block and acts as the operator, Hess Corporation (HES) owns 30% of venture, and China's state-run CNOOC energy firm owns the remaining 25% stake.

First-oil at the Stabroek block was achieved in December 2019 when the Liza Destiny floating production storage offloading ('FPSO') vessel commenced operations. That FPSO has the capacity to produce 120,000 barrels of crude oil per day at its peak. Going forward, the goal is to roll out numerous production facilities across the Stabroek block over the next decade to aggressively boost the region's oil production capacity. The Liza Unity FPSO arrived in Guyana back in October 2021 and work is underway to begin production activities during the first quarter of 2022. At its peak, the Liza Unity FPSO will have the capacity to produce 220,000 barrels of crude oil per day.

By 2025, Exxon Mobil envisions having at least five FPSOs operating in the Stabroek block that combined will have the capacity to produce at least 750,000 barrels of crude oil per day. Construction of the Prosperity FPSO vessel is currently ongoing in Singapore, and by 2024, Exxon Mobil aims to have that FPSO pumping oil out of the Payara oil field. While the Liza oil field and related developments played an outsized role in getting Guyana's oil industry up and running, the Exxon Mobil-led venture has struck liquid gold multiple times in this region. This is about much more than just one field; it is about a wave of developments targeting economically attractive resources (due to the sheer size of these resources, which are heavily weighted towards crude oil, and the ability for the venture to leverage scale to generate meaningful synergies across this position).

Concluding Thoughts

The sharp rise in raw energy resources pricing seen over the past year speaks quite favorably towards the future financial performance of both Chevron and Exxon Mobil, however, these firms remain highly exposed to fluctuations in raw energy resources pricing. If these large cap energy companies stay the course and continue to practice fiscal discipline, namely by limiting their capital expenditures, **both firms should generate "gobs" of free cash flow going forward that can be used to repair their balance sheets and reward shareholders.**

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

Public Storage is Simply a Monster REIT Idea!

Investing Category	Return Last 5 Years (%) -- price only --	Return in 2021 (%) -- price only --
Bitcoin (GBTC)	2,462.1	7.0
Disruptive Innovation (ARKK)	371.8	-24.0
Technology (XLK)	259.5	33.7
U.S. Large-Cap Growth (SCHG)	193.3	27.5
Russell 1000 Growth (IWF)	191.3	26.7
Consumer Discretionary (XLY)	151.2	27.2
U.S. Momentum (MTUM)	139.7	12.7
ESG U.S. (ESGU)	119.8	25.4
Economic Moats (MOAT)	118.5	22.8
U.S. Stocks (SPY)	112.5	27.0
Healthcare (XLV)	105.7	24.2
Materials (XLB)	82.3	25.2
Biotech (IBB)	72.5	0.8
Industrials (XLI)	70.1	19.5
Financials (XLF)	68.0	32.5
60%/40% stock/bond (VBINX)	57.6	10.6
Gold (GLD)	56.0	-4.2
Dividend Growth (SDY)	50.9	21.9
Russell 1000 Value (IWD)	50.2	22.8
Consumer Staples (XLP)	49.1	14.3
Utilities (XLU)	47.4	14.2
Silver (SLV)	42.4	-12.5
European Stocks (VGK)	42.3	13.3
U.S REITs (VNQ)	40.6	36.6
U.S. Small-Cap Value (IWN)	39.6	26.0
Non-U.S. Stocks (VEU)	38.7	5.0
CBOE PutWriteStrategy (PUTW)	26.3	20.9
U.S. Treasuries (TIP)	14.2	1.2
Merger Arbitrage (MNA)	10.1	-3.2
U.S. Muni Bonds (MUB)	7.5	-0.8
U.S. IG Bonds (AGG)	5.6	-3.5
ChineseStocks (FXI)	5.4	-21.2
U.S. HY Bonds (JNK)	-0.7	-0.3
Managed Futures (WTMF)	-14.5	-4.5
Energy (XLE)	-24.1	46.4
Crude Oil (USO)	-42.0	64.7
U.S. MLPs (AMLP)	-48.0	27.6
Risk Parity (RPAR)	NA	5.4

Source: Seeking Alpha, retrieved January 1, 2022.

Image Shown: *REITs have struggled relative to other investing areas during the past 5 years. Absent the areas of crypto tokens, speculative disruptive innovators and technology, the most prudent area has been large cap growth the past five years, an area that we have been materially overweight in the newsletter portfolios.*

By Brian Nelson, CFA

REIT returns haven't been that great the past several years (as shown above), but that may be no reason to fret. Some of the top yielding REITs across our coverage include Arbor Realty Trust (ABR), Iron Mountain (IRM), LTC Properties (LTC) and Omega Healthcare (OHI). **These REITs come with significantly elevated risk, however.** There's one REIT that may not yield quite as much, but it really hits the ball out of the park with respect to all of the things we like to see in REIT idea considerations. That REIT is self-storage player Public Storage (PSA)---**2.2% yield**---which in our view is one of the best self-storage REITs out there. **We include shares of PSA as an idea in our High Yield Dividend Newsletter portfolio.**

Note also in the image below the attractive characteristics of American Tower (AMT) and Life Storage (LSI), the new additions to the High Yield Dividend Newsletter portfolio to replace CyrusOne (CONE), which was bought out.

Company Name	Symbol	Dividend Yield (%) (1/9/2022)	First Nine Months 2021 Cash Flow From Operations	First Nine Months 2021 Capital Expenditures *	First Nine Months Traditional Free Cash Flow (FCF)	First Nine Months 2021 Total Distributions	First Nine Months 2021 FCF Less Total Distributions	Net Cash (IFC) (negative is net debt)**	Net Debt / Annualized FCF***	Market Capitalization (1/9/2022)	Annualized FCF Yield (%)
(in millions, except ratios)											
American Tower	AMT	2.09	4,141.0	916.7	3,224.3	1,897.5	1,326.8	-29,846.1	6.9	121,400	3.54
Arbor Realty Trust	ABR	8.50	-0.4	0.0	-0.4	161.4	-161.8	-8,761.2	NMF	3,130	NMF
AvalonBay Communities	AVB	2.56	911.7	586.6	325.1	666.7	-341.6	-7,343.5	16.9	34,720	1.25
Boston Properties	BXP	3.12	786.9	484.9	301.9	579.0	-277.1	-12,254.9	HIGH	21,630	1.86
Crown Castle	CCI	3.02	2,055.0	892.0	1,163.0	1,738.0	-575.0	-19,828.0	12.8	84,160	1.84
CubeSmart	CUBE	3.36	342.9	88.7	254.2	210.6	43.7	-2,141.0	6.3	11,560	2.93
Digital Realty Trust	DLR	2.88	1,250.3	1,748.1	-497.8	1,369.3	-1,867.0	-13,971.5	NMF	46,750	NMF
Equinix	EQIX	1.48	1,655.1	1,934.1	-279.0	783.5	-1,062.5	-10,249.9	NMF	69,780	NMF
Extra Space Storage	EXR	2.40	729.3	66.6	662.7	462.2	200.5	-5,502.5	6.2	29,290	3.02
Federal Realty	FRT	3.19	366.0	331.5	34.5	257.3	-222.8	-3,986.8	VERY HIGH	10,453	0.44
Healthcare Realty Trust	HR	3.85	170.3	71.7	98.6	130.8	-32.2	-1,675.4	12.7	4,640	2.83
Healthpeak	PEAK	3.34	571.3	502.6	68.7	512.5	-443.8	-5,283.6	VERY HIGH	19,650	0.47
Iron Mountain	IRM	5.29	463.3	419.0	44.4	538.9	-494.5	-8,972.0	VERY HIGH	13,550	0.44
Kimco Realty	KIM	2.75	417.3	112.8	304.5	271.0	33.5	-5,784.1	14.2	15,270	2.66
Life Storage	LSI	2.88	308.1	54.3	253.8	171.4	82.4	-2,058.5	6.1	11,440	2.96
LTC Properties	LTC	6.37	69.6	4.8	64.7	68.3	-3.6	-616.4	7.1	1,410	6.12
Omega Healthcare	OHI	8.54	565.6	120.9	444.7	497.2	-52.4	-5,167.0	8.7	7,700	7.70
Prologis Inc.	PLD	1.64	2,280.0	1,869.2	410.7	1,404.4	-993.6	-16,550.6	HIGH	115,680	0.47
Public Storage	PSA	2.25	1,814.7	370.6	1,444.1	1,194.4	249.7	-4,814.9	2.5	62,490	3.08
Realty Income Corp	O	4.14	970.1	182.0	788.1	799.0	-10.9	-8,732.4	8.3	40,440	2.60
Regency Centers	REG	3.30	508.5	120.8	387.7	306.5	81.1	-3,386.6	6.6	12,990	3.98
SBA Communications	SBAC	0.67	891.3	90.4	800.9	190.5	610.5	-11,595.0	10.9	37,850	2.82
Simon Property	SPG	4.43	2,752.5	419.5	2,333.0	2,069.8	263.2	-25,145.9	8.1	60,620	5.13
SL Green Realty	SLG	4.56	191.0	208.4	-17.4	222.4	-239.8	-3,654.5	NMF	5,420	NMF
STORE Capital Corp	STOR	4.50	414.8	128.5	286.3	293.2	-6.9	-3,891.4	10.2	9,320	4.10
UMH Properties	UMH	3.04	46.3	65.7	-19.5	45.3	-64.8	-282.3	NMF	1,230	NMF
Universal Health Realty	UHT	4.68	36.2	11.5	24.7	28.8	-4.2	-324.9	9.9	830	3.96
Ventas	VTR	3.36	760.3	324.0	436.4	524.2	-87.8	-11,882.3	HIGH	21,590	2.69
Welltower	WELL	2.78	992.0	429.0	563.0	879.4	-316.4	-13,306.8	17.7	38,230	1.96
Weyerhaeuser Co.	WY	1.69	2,665.0	223.0	2,442.0	382.0	2,060.0	-2,924.0	0.9	30,220	10.77
WP Carey	WPC	5.23	625.4	88.0	537.4	567.3	-29.9	-6,543.2	9.1	15,030	4.77

* Capital Expenditures excludes cash paid for business combinations and acquisitions. It generally consists of additions to PP&E, development costs, improvements to investments in real estate, investments in construction in progress, etc. STOR ~5% of acquisition of and additions to real estate.

** Net Debt generally consists of the sum of cash and cash equivalents, restricted cash, marketable securities, and escrow deposits less the sum of bank lines, line of credit borrowings, term loans, unsecured notes, secured notes, mortgage debt payable, notes payable, and the like.

*** HIGH = 20-60; VERY HIGH = 50+; NMF = Negative

Data Sources: 10-Q filings. Market price and dividend yield data retrieved from Seeking Alpha, January 9, 2022.

Image Shown: *We examine the traditional operating metrics of the REITs with a focus on traditional free cash flow, dividends paid, and traditional balance sheet analysis where we assess net debt positions. Most REITs fail to cover their dividends with traditional free cash flow and boast huge net debt positions. Public Storage remains one of our very favorite REITs, however. Its free cash flow coverage of the payout and manageable financial leverage are exactly what we're looking for.*

Shares of Public Storage have advanced ~58% during the past year through January 31, excluding dividends, and we think the company has earned every bit of that return and more. For those that don't know Public Storage, the REIT is "the world's largest owner, operator and developer of self-storage facilities," with ~2,500 locations across the United States. Founded in 1972, the REIT has staying power, and with 1.6 million customers, the firm's operations speak to durability.

Aside from its long operating experience, Public Storage has a number of advantages, including consumer awareness and marketing cost advantages, and while these may not be as durable as other competitive advantages (i.e. the network effect), we do think the 'Public Storage' brand name is better known than some of its peers, though we also note that we like the fundamental economic profiles of its self-storage peers, too.

Public Storage pretty much dominates the 15 markets in which it operates, and we continue to be fans of the operating leverage inherent in a self-storage operator's business model. A few things that PSA has been working on to bolster profitability levels, too, include leveraging its unmatched scale while pursuing payroll cost savings as well as solar and LED light (utility) cost savings. Its operating (net operating income) margin is best-in-class and stands at ~76%.

Image Source: *Public Storage*

Public Storage's third-quarter 2021 results for the three months ending September 30, released November 1, were solid. Reported core funds from operations (FFO) advanced 30% in its third quarter of 2021 relative to the same period a year ago, while same store direct net operating income leapt nearly 21%. On a per share basis, core FFO came in at $3.42 per diluted common share, as compared to $2.63 in last year's quarter. Its core FFO numbers came in better than expected.

Most importantly, Public Storage hits on the key dynamics we like with respect to traditional operating, non-REIT equities, and this achievement is a rarity, as one can see per the comparable REIT statistical analysis table. For starters, Public Storage has been significantly traditional free cash flow positive (cash flow from operations less capital spending) *after* paying distributions through the first nine months of 2021, and as one can see, not every REIT can say that.

We also like that Public Storage's net debt is much more manageable than that of many of the other players across the REIT sector. For example, its net debt to annualized free cash flow is a modest 2.5, while others' are much higher than that--and some leverage measures from Dividend Aristocrat Federal Realty (FRT), Healthpeak (PEAK), Iron Mountain, Boston Properties (BXP), and Prologis (PLD) have been astronomical through the first nine months of 2021. Public Storage covers its dividends with traditional free cash flow, and it has significant borrowing capacity like no other, in our view.

As noted before, we're huge fans of the operating dynamics of the self-storage space, and Extra Space Storage (EXR), Life Storage (LSI), and CubeSmart (CUBE) have similar economic profiles, all with strong traditional free cash flow generation in excess of their cash dividend obligations and comparatively more attractive net debt burdens relative to some of the aforementioned leveraged players. The two REITs with the biggest net debt positions are tower REIT American Tower (AMT) and retail REIT Simon Property (SPG), but these two entities generate traditional free cash flow in excess of dividends paid, so leverage may not be their biggest concerns.

We're not too big of fans of the retail REITs, in general, given waning trends in brick-and-mortar retail and the proliferation of e-commerce, though we note that Simon Property and Regency Centers (REG) had healthy free cash flow coverage of the payout during the first nine months of 2021, while monthly dividend payer Realty Income (O) and Federal Realty remain much more capital-market dependent to keep growing their payouts as one might not have expected. **We define capital-market dependency risk with respect to REIT dividends as ones in which traditional free cash flow is not in excess of cash dividends paid.** Many REITs remain capital-market dependent, and players in the self-storage arena are the least capital-market dependent, in our view.

Two other strong REITs that we're keeping a close eye on are SBA Communications (SBAC) and Weyerhaeuser Co. (WY). Both of these REITs have slam-dunk economics with substantial traditional free cash flow generation in excess of cash dividends paid, and their net debt positions are very manageable, especially Weyerhaeuser's. These REITs also have low capital-market dependence risk. However, both have comparatively lower dividend yields than we'd prefer.

Concluding Thoughts

Image Shown: *Public Storage's shares rallied significantly in 2021.* ***Image Source:*** *TradingView*

There are a number of industry-specific metrics that REITs use including funds from operations (FFO) and adjusted funds from operations (AFFO), but we think more traditional analysis helps to offer incremental insights while adding considerable informational value when used in conjunction with industry-specific REIT analysis.

The REIT with the best combination of dividend yield, free cash flow generation in excess of cash dividends paid, and leverage (as measured by net debt divided by annualized traditional free cash flow) is Public Storage. The company's self-storage peers are runners up with respect to our favorites, followed by the tower stocks American Tower and SBA Communications, and then timber REIT Weyerhaeuser.

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

Our Two Favorite U.S. Banks

By Valuentum Analysts

In this note, sourced from our recently updated report covering the banking and money center industry, we highlight our two favorite ideas within the banking space. First, we will provide a brief primer on how banks operate, make money, and what the industry backdrop looks like before highlighting why we are big fans of Bank of America Corporation (BAC)---**1.8% yield**---and JPMorgan Chase & Co (JPM)---**2.7% yield**.

How Do Banks Make Money?

In order to understand where the big banks stand right now, it might be helpful to start at the very beginning. How do banks make money? Banks essentially make money on money. They collect money mostly in the form of deposits, often at a very low cost--such as zero interest checking accounts. Certificates of deposit ('CDs') and corporate deposits cost more than nothing, and borrowing in the bond market costs even more than that. Even when no interest is paid on transactional accounts, there remains a cost to these funds as services are being offered to those clients "for free."

While banks have a cost of funds, they then turn around and lend out some, all, or more than their deposits to the public whether in the form of credit cards or auto loans to retail clients, small business loans, construction finance loans, or loans to giant multi-national corporations. The spread between the revenue earned lending and the cost of those funds is called the net interest margin ('NIM'), which is often about 200-300 basis points for a large bank, depending on the mix of business.

Banks also earn non-interest revenue in the form of banking fees, commissions, and the like. Adding net interest income to the non-interest revenue arrives at the net revenue of the bank; subtracting non-interest expenses (starting with bad credit costs) from this, one gets down to the pre-tax income line.

Three Key Costs of Running a Bank

This quick introduction to banking makes it clear the three key areas where banks must control their costs, especially given that US banking is largely a commodified industry. In a commodified industry, it is the sustainable low-cost leaders that can eek out returns above the cost of capital.

One, the cost of deposits is the first key cost to control. Banks with large, low cost deposit bases such as JPMorgan Chase, Bank of America, and Wells Fargo (WFC) enjoy the leading US deposit franchises.

Two, the cost of credit is the next key cost to control. Over the course of time, banks that are lending in the exact same space such as auto lending can experience wildly different credit costs. While some of this can be due to the risk/reward tradeoff being pursued by management, it can also reflect the success or failure of underwriting each individual loan, which ultimately creates the aggregate loss experience.

Underwriting quality stems from the underwriting culture of the bank, which starts right at the top with the CEO steering the ship. Is risk or reward being emphasized to middle managers and the rank and file? What kind of targets are financial incentives and promotions based upon? How is risk versus reward talked about inside the bank? Underwriting culture is driven by all layers of management and embodied in and executed by front line employees and is not quick or easy to change on a dime. It is more like turning a large ship. It is individual human decisions that we are talking about after all, and old habits die hard.

Not only is there an underwriting culture that drives credit costs (bad debt expenses), but it is also a bank's culture that drives the third major cost center, which is operating costs, as measured by the all-important efficiency ratio--operating costs over net revenue. The efficiency ratio is also very much affected by business mix. Stock brokerage and investment banking come with very high efficiency ratios (more expensive to serve clients), while mass market retail banking comes with much lower efficiency ratios (less expensive to serve clients). That said, if business mixes are similar, the bank with the lower efficiency ratio is the one that is generating revenue at a lower cost on a per dollar basis.

Interest Rates, the Yield Curve, and Net Interest Margins

Some but not all bank loans are tied to benchmark interest rates plus a margin. Therefore, in the short run, the amount they can charge customers varies accordingly with short rates for credit card debt and longer rates for things like mortgages. Here, we would like to stress that the London Inter-Bank Offered Rate ('LIBOR') is being phased out after a series of scandals in the wake of the Great Financial Crisis made LIBOR unappealing in the eyes of key financial regulatory authorities (and various private enterprises as well).

One of the leading candidates to replace LIBOR is the Secured Overnight Financing Rate ('SOFR'). LIBOR and SOFR are important as they set the benchmark interest rates used to price numerous other forms of credit such as credit cards, auto loans, and more. **By the end of December 2021, the phase out of LIBOR was supposed to begin in earnest as LIBOR can no longer be used as the official reference rate. New reference rates, like SOFR, are taking its place.** Adoption of SOFR as a reference rate has picked up pace in recent quarters and the SOFR-related derivatives market has grown at a robust pace of late. The banking industry has been steadily preparing itself for a post-LIBOR world for some time, and we expect that the industry will be up to the challenge.

Another key factor is that zero rate deposits don't tend to move much when rates change (endowment effect). Therefore, higher rates mean higher net interest margins ('NIMs') on these deposits. These two factors mean that higher rates tend to mean higher NIMs and vice versa. The banks disclose how much higher and lower rates will affect revenues and the profit impact can be imputed. That said, we think these short-term impacts can be overblown by the media and even analysts and investors at times. The reality is that the margin or spread changes with competition over a longer period of time. So, if rates are lower for longer, the banks can mark up the margin they charge over these lower rates and cycle through the book to better economics.

Given that the overall banking industry tends to produce cost-of-capital returns on average over time, it suggests a competitive landscape and one that can adjust the levers of profitability to match the exogenous or uncontrollable factors like short-term rates and the shape of the yield curve. Therefore, beware when you hear oversimplifications in the media that banks borrow short and lend long and are simply price takers on both sides according to the whims of the yield curve. We would beg to differ, and we think the financial results of major banking entities will prove out over time. As the outlook for NIMs in the US has improved considerably of late as the Fed plans to tighten up its monetary policy, we view the domestic banking landscape quite favorably as 2022 gets underway.

Digitalization of Banking

The digitalization that is taking place across so many industries has certainly been taking place in banking over the past decade (especially in the US). Think about how advanced mobile banking apps are now compared to where things stood a decade ago, when most people were in the branch or at the ATM. For instance, the ability to cash checks via mobile apps has saved many households countless hours versus having to wait in line at a physical bank branch. Major banking entities with strong digital operations have been able to slim down their physical branch footprints and rationalize the size of their workforce over the past decade while improving their ability to meet customer demand due to the digitalization of the banking industry. **This has gone a long way in improving the industry's cost structure.**

The digitalization is also simplifying processes in the back office, taking out people, making things more scalable and repeatable. The biggest banks with the most scale have the largest revenue streams and can afford to stay on top of this trend most easily, while many small-scale banks and credit unions are stuck in the past shuffling paper around with unsophisticated or even no mobile app available. **This trend plays right into the hands of the biggest banks in the country and is encouraging consolidation in the industry.**

Having a digital competitive edge helps bigger banking entities hold onto clients, win new clients, and ultimately grow their market share. It helps them deliver a better customer experience and frees up branches for sales activities, all while streamlining their cost structure (which in turn frees up additional funds that can be used to invest in their digital operations and/or offer lower cost financials services and products). These trends will continue to help large banking entities and drive further consolidation of market share within the industry--especially in retail banking, but also in commercial banking.

Our Favorite Banks

Our favorite banks are Bank of America and JPMorgan Chase. These banking institutions have stellar deposit franchises, top-notch digital operations, and are well-managed. Both Bank of America and JPMorgan Chase benefit from cultures that encourage the right kind of risk/reward thinking, as seen through the resilience of their respective business models and financial performance during the worst of the COVID-19 pandemic. **As of late January 2022, shares of BAC are trading near their fair value estimate (of $47 per share) and shares of JPM are trading well below their fair value estimate (of $173 per share).**

Both Bank of America and JPMorgan Chase pay out nice dividends and have a history of being shareholder friendly. Additionally, both banking entities are steadily repurchasing their stock and are likely to push through meaningful dividend increases over the coming years as their financial performance rebounds from the worst of the COVID-19 pandemic, aided by the improving macroeconomic background and rising NIMs due to the Federal Reserve embarking on a period of tighter monetary policy. **The upcoming graphic down below highlights our fair value estimates for key banking enterprises and their respective dividend yields.**

Company Name	Ticker	Yield	Fair Value
American Express	AXP	1.0%	$ 172.00
Bank of America	**BAC**	**1.8%**	**$ 47.00**
Bank of NY Mellon	BK	2.3%	$ 57.00
Citigroup	C	3.1%	$ 60.00
Discover Financial	DFS	1.7%	$ 122.00
Fifth Third	FITB	2.7%	$ 46.00
Goldman Sachs	GS	2.3%	$ 399.00
Huntington Bancshares	HBAN	4.1%	$ 14.00
HSBC	HSBC	3.1%	$ 28.00
JPMorgan	**JPM**	**2.7%**	**$ 173.00**
KeyCorp	KEY	3.1%	$ 22.00
Morgan Stanley	MS	2.7%	$ 99.00
M&T Bank	MTB	2.8%	$ 158.00
Northern Trust	NTRS	2.4%	$ 110.00
PNC Financial	PNC	2.4%	$ 190.00
Regions Financial	RF	3.0%	$ 23.00
Truist Financial	TFC	3.1%	$ 63.00
US Bancorp	USB	3.2%	$ 59.00
Wells Fargo	WFC	1.9%	$ 46.00

Image Shown: *An overview of our fair value estimates across the banking and money center industry.*

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%	3.09%
SPDR Portfolio S&P 500 High Dividend ETF	SPYD	5.0%	3.62%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	4.61%
iShares International Select Dividend ETF	IDV	5.0%	5.62%
iShares U.S. Preferred Stock ETF*	PFF	5.0%	4.47%
Global X SuperDividend ETF*	SDIV	5.0%	6.83%
Global X SuperIncome Preferred ETF	SPFF	5.0%	5.94%
Vanguard Consumer Staples ETF	VDC	5.0%	2.19%
Vanguard Real Estate ETF	VNQ	5.0%	2.79%
Utilities Select Sector SPDR	XLU	5.0%	3.15%
EQUITY			
Chevron Corp.	CVX	5.0%	4.32%
Crown Castle	CCI	5.0%	3.22%
CubeSmart	CUBE	5.0%	3.39%
Digital Realty Trust	DLR	5.0%	3.11%
ExxonMobil Corp.	XOM	5.0%	4.63%
Philip Morris	PM	5.0%	4.86%
Public Storage	PSA	5.0%	2.23%
Enterprise Products Partners	EPD	5.0%	7.87%
Magellan Midstream Partners	MMP	5.0%	8.49%
American Tower ***NEW***	AMT	2.5%	2.21%
Life Storage ***NEW***	LSI	2.5%	2.96%
Cash**	-	0.0%	0.00%
		100.0%	**4.35%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 2/1/2022. Est. Forward Div. Yield information retrieved from SeekingAlpha, YF.

** Retrieved from YahooFinance. 30-Day SEC Yield, 12-Month Trailing Yield, and Distribution Yield approximate ~9%, per Global X website.*

*** Reflects federal funds target rate range*

NEW: PORTFOLIO CHANGES: CONE IS BOUGHT OUT; LSI AND AMT ARE IN!

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 5-Dec-2021 | Data as of 3-Dec-2021

Chevron CVX FAIRLY VALUED

Buying Index™ 6 Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$105.00 - $175.00	HEALTHY	GOOD / 1.6	GOOD	4.68%

Assessment of Company Dividend Strategy

Key Strengths

Chevron is a Dividend Aristocrat that has grown its annual payout over the past 30+ consecutive years. The recovery in raw energy resources pricing seen at the start of 2021 and the improving outlook for global energy markets underpins our expectations that Chevron's cash flow generating abilities will improve considerably going forward versus 2020 levels. Chevron has committed to keeping its capital expenditure budgets contained in the medium-term, enhancing the company's future free cash flow potential. Targeted cost synergies from Chevron's acquisition of Noble Energy (the deal closed in October 2020) supports Chevron's outlook.

Potential Weaknesses

Chevron's financial performance is tied to volatile energy markets. The company has a large net debt load, large capital expenditure requirements, and its dividend obligations are quite material. In the face of low raw energy resources pricing, cost cuts and reductions in Chevron's capital expenditure expectations can only do so much as it concerns its potential free cash flow generating abilities (or lack thereof, in certain circumstances). However, the company has a stellar dividend track record. Management remains committed to defending Chevron's payout, even if it is at the expense of the company's balance sheet.

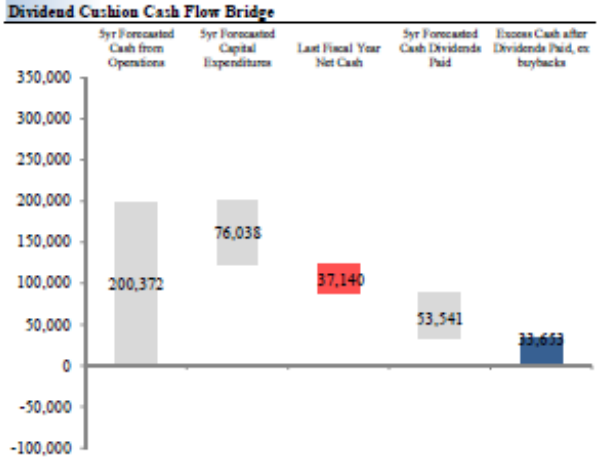
Graphical Relationship, Earnings and Dividends (per share)

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. Chevron'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 greater 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

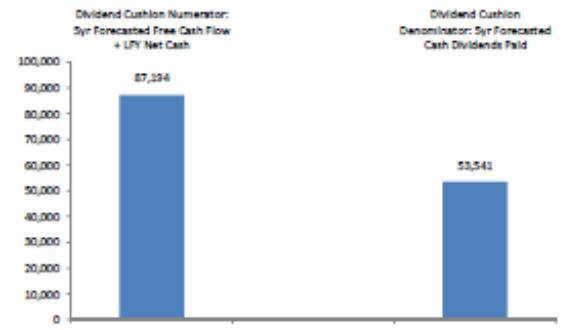


Source: Company Filings, Valuentum Projections

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, Chevron's numerator is larger than its denominator suggesting strong 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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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, BITO, and IWM. Brian Nelson's household owns shares in HON, DIS, HAS, NKE.*

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Amended June 1, 2021.