OUR DIVIDEND GROWTH NEWSLETTER

Valuentum Securities

Stock Analysis: From Value through Momentum Investing

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"We're not at all worried about a recession as that was largely priced in during 2022, and we're looking ahead to strong nominal GDP and huge opportunities within artificial intelligence [AI]."
– Brian Nelson, CFA

Dividend Growth Ideas: AAPL, CSCO, *DIV*, DKS, XLE, HD, HON, IDV, *JEPI*, LMT, MSFT, ORCL, MCD, RSG, SDY, UNH, XLV

ALERT: Big Yield Additions to Dividend Growth Newsletter Portfolio

A version of this article was emailed to members June 27.

By Brian Nelson, CFA

With the federal funds rate standing at 5%-5.25%, the hurdle rate for yield in the Dividend Growth Newsletter portfolio is much higher these days. We're not at all worried about a recession as that was largely priced in during 2022, and we're looking ahead to strong nominal GDP and huge opportunities within artificial intelligence [AI].

Though we may add a dividend grower that is yielding below the 5% yield threshold to the Dividend Growth Newsletter portfolio with expectations for breakneck dividend-per-share expansion in the future, these days we're looking for a couple incremental ideas that have yields already much higher than the 5% mark to add to the Dividend Growth Newsletter portfolio.

At new 8%-12% "weightings," respectively, we've added the JPMorgan Equity Premium Income ETF (JEPI) and the Global X SuperDividend U.S. ETF (DIV). The JEPI has a 12-month rolling dividend yield of **11.04%**, and we like its derivative income strategy, which employs writing out-of-the-money S&P 500 call options to bolster income. The JEPI includes many of our favorite tech-related, AI-driven names, too, including Microsoft (MSFT) and Alphabet (GOOGL).

Please see *ALERT: Big Yield Additions to Dividend Growth Newsletter Portfolio…*on next page

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***NOTE:** The goal of the Dividend Growth Newsletter is to highlight ideas with strong dividend growth potential and update readers about new developments in the market. A simulated portfolio of dividend growth ideas is presented on page 5 of each edition.

The simulated Dividend Growth Newsletter portfolio can be found on page 5 of each monthly Dividend Growth Newsletter.

ALERT: Big Yield Additions to Dividend Growth Newsletter Portfolio...**from previous page**

The DIV doesn't pursue a derivative income strategy, but instead includes "50 of the highest dividend paying equities in the United States," and "has made monthly distributions 10 years running." The DIV's 12-month trailing dividend yield stands at **7.89%**. Both of these ETFs will make solid additions to the Dividend Growth Newsletter portfolio, which will receive a very nice boost in forward estimated portfolio yield, especially thanks to the JEPI's inclusion.

In addition to these two new "adds" to the Dividend Growth Newsletter portfolio, we've also increased the "weighting" in McDonald's (MCD), Home Depot (HD), Honeywell (HON), UnitedHealth Group (UNH), and Dick's Sporting Goods (DKS) in the Dividend Growth Newsletter portfolio to the range of 3%-4% from 1%-2% previously. Altogether, these changes should take the Dividend Growth Newsletter portfolio to "fully invested," with the midpoint of all the constituent weighting ranges summing up to ~95%-100%.

Image: *The JEPI has rallied nicely since March of this year.*

The additions to the Dividend Growth Newsletter portfolio will bolster the newsletter portfolio's estimated forward dividend yield, something that we view as necessary for these respective strategies in a world where the federal funds rate stands north of 5%. These changes have been reflected in the newsletter portfolio found on page 5 of this July edition. We're not concerned by the risks of a recession at all, and we remain bullish on equities.

Apple Crosses $3 Trillion Market Capitalization!

Image: *Apple has crossed the coveted $3 trillion market cap market mark.*

Microsoft Holds North of $340 Per Share

***Image**: Microsoft has surged so far in 2023 and continues to trade north of $340 per share.*

The Dividend Growth Newsletter Portfolio

By Valuentum Analysts

The Dividend Growth Newsletter portfolio is not a real money portfolio. Results are hypothetical and do not represent actual trading. Actual results may differ from the simulated performance presented.

DIVIDEND GROWTH IDEAS -- as of July 1, 2023

Company Name	Yrly Div's Paid ($) / Shr	Dividend Yield %	Fair Value Estimate	Dividend Cushion Ratio	VBI Rating	Price/FV	Last Close	% of Portfolio
S&P Dividend ETF SPDR (SDY)	3.19	2.60%	-	-	-	-	122.58	8.0%-12.0%
JPMorgan Equity Premium Income ETF (JEPI) ***NEW***	6.04	10.91%	-	-	-	-	55.33	**8.0%-12.0%**
Global X SuperDividend U.S. ETF (DIV) ***NEW***	1.24	7.43%	-	-	-	-	16.70	**8.0%-12.0%**
Cisco (CSCO)	1.56	3.02%	$51.00	2.72	6	1.01	51.74	5.0%-7.0%
Energy Select Sector SPDR ETF (XLE)	3.21	3.95%	-	-	-	-	81.17	5.0%-7.0%
Health Care Sector SPDR ETF (XLV)	2.10	1.58%	-	-	-	-	132.73	5.0%-7.0%
iShares Int'l Select Dividend (IDV)	1.92	7.29%	-	-	-	-	26.33	5.0%-7.0%
Lockheed Martin (LMT)	12.00	2.61%	$412.00	1.42	6	1.12	460.38	5.0%-7.0%
Microsoft (MSFT)	2.72	0.80%	$262.00	3.72	3	1.30	340.54	5.0%-7.0%
Oracle (ORCL)	1.60	1.34%	$86.00	1.10	5	1.38	119.09	5.0%-7.0%
Apple (AAPL)	0.96	0.49%	$139.00	7.35	5	1.40	193.97	3.0%-4.0%
Dick's Sporting Goods (DKS) ***INCREASED***	4.00	3.03%	$163.00	2.07	6	0.81	132.19	**3.0%-4.0%**
Home Depot (HD) ***INCREASED***	8.36	2.69%	$313.00	1.45	6	0.99	310.64	**3.0%-4.0%**
Honeywell Intl (HON) ***INCREASED***	4.12	1.99%	$210.00	2.14	6	0.99	207.50	**3.0%-4.0%**
McDonald's Corp (MCD) ***INCREASED***	6.08	2.04%	$250.00	0.54	3	1.19	298.41	**3.0%-4.0%**
Republic Services (RSG)	1.98	1.29%	$132.00	2.23	3	1.16	153.17	3.0%-4.0%
UnitedHealth Group (UNH) ***INCREASED***	7.52	1.56%	$513.00	3.20	3	0.94	480.64	**3.0%-4.0%**
Cash								**~0%-5%**

UR = Under Review

Last close and dividend per share information for equities retrieved from Seeking Alpha, Yahoo Finance. Dividend yield information for ETFs retrieved from Seeking Alpha, Yahoo Finance.

This portfolio is not a real money portfolio. Data as of July 1, 2023

Goal:

The goal of the Dividend Growth Newsletter portfolio is to highlight ideas with strong dividend growth potential and update readers about new developments in the market. The Dividend Growth Newsletter portfolio seeks to find underpriced dividend growth gems that generate strong levels of free cash flow and have solid balance sheets, translating into excellent Valuentum Dividend Cushion ratios. *Given market conditions and the importance of diversification, not all stocks in the newsletter portfolio can be undervalued, however*. Stocks in the Dividend Growth Newsletter portfolio may have lengthy dividend growth track records spanning decades, but we focus most of our efforts on assessing the future safety and dividend growth potential of ideas.

Every subscriber has different goals and different risk tolerances, so where before in the newsletter portfolios, we would outline the specific percentage weighting, we think providing weighting ranges makes much more sense. For example, depending on someone's risk tolerances, a larger cash position in an overheated market may be prudent. On the other hand, the longer one's time horizon, perhaps a smaller cash position may make more sense. The Dividend Cushion ratios are so important, so please stay up to date with them. By our estimates, the efficacy of the Dividend Cushion ratio in warning about dividend cuts is roughly 90%. We're available for any questions.

Standard Disclaimer: The simulated Dividend Growth Newsletter portfolio is for information purposes only and should not be considered a solicitation to buy or sell any security. Valuentum is not responsible for any errors or omissions or for results obtained from the use of the simulated Dividend Growth Newsletter portfolio and accepts no liability for how readers may choose to utilize the content.

The midpoints of our respective weighting ranges approximately sum to 100% to reflect the range of possible combinations that may result in various allocations.

Top Dividend-Related News: WBA, KFY, IBM, UNH, OXY

Walgreens Boots Alliance (WBA) is yielding ~6.6% on a forward estimated basis. Though this sounds like a hefty dividend yield worth scooping up, the Walgreen's story is much more complicated these days than it ever was due to the firm's wheeling and dealing the past number of years. The company's third-quarter fiscal 2023 results, released June 27, showed decent revenue expansion, but earnings per share fell $0.20 in the quarter versus the same period a year-ago. The company continues to offload shares of AmerisourceBergen Corp. (ABC) that it owns, and **it lowered its fiscal year 2023 adjusted earnings per share guidance to the range of $4.00-$4.05 from $4.45-$4.65 previously.** Though Walgreens has a storied consecutive annual dividend growth streak of nearly a half-century and should remain on one's radar, we're not going to be adding the stock to any newsletter portfolio anytime soon. Our fair value estimate stands at $33 per share, which is modestly above where shares are trading.

Image: *Walgreens' shares have seen better days.*

Please see *Top Dividend-Related News...*on next page

Top Dividend-Related News...from previous page

Korn/Ferry (KFY) is a fantastically-run consulting firm that we think is mighty cheap from a valuation standpoint. On June 27, the company reported solid fourth-quarter fiscal 2023 results that showed decent fee revenue expansion on a year-over-year basis, but operating income did face pressure as the company experienced a mix shift to lower-margin business. We didn't necessarily like the weak operating income performance in the period, but it seems the company agrees with our valuation assessment of its own shares, with the company buying back 225,000 shares in the quarter. Korn/Ferry also raised its quarterly cash dividend 20% to $0.18, which translates to a forward estimated dividend yield of ~1.49%, which isn't too shabby, but not high enough to really get excited about potentially adding the firm to the Dividend Growth Newsletter portfolio. Korn/Ferry has worked hard to diversify its revenue streams in recent years, and the company has been investing in generative artificial intelligence to better meet client needs. Our fair value estimate per share of $75 stands far about where shares are trading at these days.

Image: *We think Korn/Ferry's shares are cheap, but they don't make the cut for the newsletter portfolios.*

Please see *Top Dividend-Related News*...on next page

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International Business Machines (IBM) remains in the category of 'old tech,' in our view, and the company has been working hard to right the ship these past many years. The company had been an early player in artificial intelligence, but now it takes a back seat to entities such as Microsoft (MSFT) and Alphabet (GOOG) (GOOGL), both of which stand head and shoulders above IBM in this area. The company's forward estimated dividend yield of ~5% is interesting, but there are so many other better tech-related entities to consider than the firm, in our view. IBM has a massive net debt position as long-term debt has swollen to $53.8 billion, and the firm is still looking to transform its operations shelling out $4.6 billion in cash to buy Apptio, which compliments IBM's IT automation business and its Watson AI platform. We're not enamored by IBM's business these days, and we'd much prefer allocating incremental capital to Microsoft or Apple (AAPL) than to "Big Blue," which continues to struggle, from our perspective. Our fair value estimate of IBM stands at $136 per share, which is about in-line with where shares are currently trading.

Image: *IBM's shares have been battling back, but the long term will be tough, in our view.*

Please see *Top Dividend-Related News*...on next page

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UnitedHealth Group (UNH) recently announced that it will buy Amedisys (AMED), which specializes in in-home care services including home healthcare, hospice care, and palliative care. The COVID-19 pandemic changed the preference of many consumers to receive care with convenience and in the safety of their own homes, and the deal with Amedisys will continue to expand UnitedHealth Group's presence in in-home care following its deal with LHC Group, which it closed in February 2023. UnitedHealth Group recently raised its quarterly dividend ~14%, to $1.88 per share, and we continue to like shares as a large cap growth idea in the newsletter portfolios. Shares of UnitedHealth Group had recently come under pressure as healthcare costs are expected to be higher than previously expected as discretionary surgeries pick up following a slowdown during the COVID-19 pandemic. We think UnitedHealth Group will eventually be able to re-price effectively to recover the increased costs, and the name is now trading at the lower end of our fair value estimate range. Our point fair value estimate for UNH stands north of $500, and the company boasts a ~1.6% forward estimated dividend yield.

Image: *UnitedHealth Group's shares have been choppy thus far in 2023.*

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*Top Dividend-Related News...*from previous page

Occidental Petroleum (OXY) has been one of the most followed energy-related stocks the past several months as Warren Buffett's Berkshire Hathaway continues to increase its stake in the firm, with the insurance and industrial conglomerate now owning 25% of the independent oil and gas player. We've always liked Occidental Petroleum, but we've preferred Exxon Mobil (XOM) and Chevron Corp. (CVX) in the newsletter portfolios in the past. We continue to include the Energy Select Sector SPDR (XLE) in the Dividend Growth Newsletter portfolio, as the XLE has a forward estimated dividend yield of ~4%, which is more than double that of Occidental's. 2022 was a great year for energy stocks, and our exposure to XOM and CVX was a key reason why the Dividend Growth Newsletter portfolio did so relatively well last year. We've moved beyond a considerable "overweight" in energy equities, however, having removed XOM and CVX from the newsletter portfolios in March of this year. OXY is worth watching, but we continue to like ideas in the newsletter portfolios.

Image: *After strong performance in 2022, shares of Occidental haven't done much in 2023.*

IMPORTANT: There Are No Free 'Income' Lunches

By Brian Nelson, CFA

This article appeared in a previous edition of the Dividend Growth Newsletter. It is provided here for the benefit of new members.

We often talk about certain areas of the market such as large cap growth and small cap value. One of the big takeaways of the book *Value Trap* is that it explains that there are not really growth or value stocks, but rather there are only undervalued, fairly valued, and overvalued stocks determined on the basis of a price-versus-fair value consideration. This will always be true. Each company is different, and no company can be distilled into a simple price-to-earnings (P/E) or price-to-book (P/B) metric to determine the attractiveness of its valuation.

For example, a company with a low P/E can be overvalued because the market is missing its huge net debt position (net debt is a reduction to enterprise value to arrive at equity value), while a company with a high P/E can be undervalued because the market is underestimating its long-term free-cash-flow growth prospects. Only when a company's share price is compared to an estimate of its discounted cash-flow based intrinsic value can investors discern whether a company is undervalued, fairly valued or overvalued.

That said, at times, there are certain groupings of stocks that just fit the mold of greatness. These stocks have tremendous net cash positions on the balance sheet, strong future expectations of free cash flow, and secular growth prospects. Their cash-based sources of intrinsic value are phenomenal, and they have enough excitement surrounding them where future expectations of their free cash flow can surprise to the upside. For years, this area has been large cap growth.

Quantitative analysts have studied historical data, and more generally, have concluded that small cap value has done the best. However, most of these studies include data that pre-dates the Internet when companies such as Eastman Kodak and Sears & Roebuck dominated the business landscape. Unfortunately, as businesses have evolved to be capital-light subscription-based entities, the measures used to support these historical studies, including price-to-book, have become less relevant in today's analysis.

For one, it doesn't make much sense to use data that pre-dates the founding of advertising giant Alphabet (GOOG) in 1998 or electric-vehicle maker Tesla (TSLA) in 2003. Investors that believed these historical studies about small cap value, which include data from the 1930s, have suffered tremendously the past decade or so. Since late 2009, for example, the inception of the Schwab U.S. Large-Cap Growth ETF (SCHG), the SCHG has outperformed the iShares Russell 2000 Value ETF (IWN) by nearly 350 percentage points. That's the difference between having ~$242,590 and ~$589,690 with a $100,000 investment. The spread is not small potatoes, in our view--and this type of value-versus-growth analysis is the foundation of quant analysis. It's what factor investing has been built upon.

When will 'they' learn that past is simply not prologue, and future expectations determine today's stock prices? The future expectations of "yesterday" will always be different that the future expectations of "tomorrow." We can't just look at history to determine the future. Heading into 2022, many financial advisors had tunnel vision on the 60%/40% stock/bond portfolio. Influencers staked their reputation on the success of this simple strategy. But not only did rising interest

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rates pummel stocks during the year, they also pummeled bonds to the point where the 60%/40% portfolio tumbled by a double-digit percentage in 2022.

Many retirees seemingly continue to be enamored by the siren song that is a 9%-10%+ dividend yield, too. Though investors can achieve this type of income stream for some time (it's easy to find stocks with these types of yields), doing so often comes at the expense of maximizing wealth and the longevity of their retirement savings. For example, since late 2010, ETFs that track a basket of high-yielding energy MLPs (AMLP) and a basket of high-yielding mortgage REITs (REM), respectively, have fallen by ~48% and ~58%, respectively. Many are now caught in what can best be described as a 'yield death spiral,' requiring a higher and higher annual dividend yield as their capital base continues to be eroded by unsustainable dividend payments.

***Image**: Energy master limited partnerships and mortgage REITs have destroyed the accounts of retirees, necessitating them to chase higher and higher yields as their capital positions have eroded.*

In some ways, the dividend, itself, is quite deceptive.

Please see *There Are No Free Income Lunches*...on next page

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While a retiree's income may grow if these 9%-10%+ yielders raise their payouts, the higher income stream just comes more and more at the expense of their capital positions, which are sometimes and likely continuously eroding. The math is simple: When a dividend or distribution is paid, the entity's share price is adjusted down by the amount of the dividend payment, reducing the capital position of the investor. Investors already own the dividend as part of the stock price (their capital position) before it is paid. The dividend is not incremental, but rather a part of capital appreciation that would have occurred had the dividend not been paid.

There are no free 'income' lunches.

This is why some investors don't use dividends in their approach to retirement at all. They can sell off some of their equity in the same manner that a dividend-income investor's capital position is weighed down over time by the payment of a dividend. Their focus instead is on continuously growing their capital base such that they can maximize their total return, and therefore, the total distributions to them during their golden years.

To each their own, of course. It's not for us to say what is right for you. With small cap value underperforming large cap growth for some time now, the 60%/40% stock/bond portfolio dropping considerably in 2022 (as predicted in the second edition of *Value Trap*), and the Dividend Growth Newsletter portfolio and Best Ideas Newsletter portfolio not only beating the S&P 500 last year, but also the 60%/40% stock/bond portfolio, we're excited as we can possibly be at Valuentum.

2023 has been a great year thus far, and we continue to highlight the best areas for consideration following a great relative year in 2022. Highly-rated ideas on the Valuentum Buying Index are few and far between these days, but **we're now "fully invested" in the newsletter portfolios.** The regional banking crisis is having a muted impact on market sentiment at this point, and the Fed looks to be winning the battle against inflation. We're excited about what the back of 2023 may look like, and we hope you are, too.

Latest Report Updates Concentrated in Mining & Chemicals and Healthcare Industries

By Valuentum Analysts

Company Name	Symbol	Industry	VBI	Fair Value Estimate	Report Date
Netflix	NFLX	Discretionary Spending	6	$371.00	6/23/2023
Tesla	TSLA	Discretionary Spending	6	$248.00	6/23/2023
Adobe Systems	ADBE	Technology Giants	6	$459.00	6/23/2023
Advanced Micro Devices	AMD	Technology Giants	6	$106.00	6/23/2023
Broadcom	AVGO	Technology Giants	4	$631.00	6/23/2023
Taiwan Semiconductor	TSM	Technology Giants	6	$90.00	6/23/2023
Air Products & Chemicals	APD	Mining & Chemicals	6	$270.00	6/20/2023
Albemarle	ALB	Mining & Chemicals	7	$257.00	6/20/2023
Alcoa	AA	Mining & Chemicals	3	$34.00	6/20/2023
BHP Billiton	BHP	Mining & Chemicals	6	$57.00	6/20/2023
Carlisle Companies	CSL	Mining & Chemicals	7	$228.00	6/20/2023
DuPont	DD	Mining & Chemicals	3	$65.00	6/20/2023
Eastman Chemical	EMN	Mining & Chemicals	4	$79.00	6/20/2023
Ecolab	ECL	Mining & Chemicals	6	$164.00	6/20/2023
Freeport McMoRan	FCX	Mining & Chemicals	7	$39.00	6/20/2023
Graco	GGG	Mining & Chemicals	5	$71.00	6/20/2023
LyondellBasell	LYB	Mining & Chemicals	3	$93.00	6/20/2023
Martin Marietta	MLM	Mining & Chemicals	5	$417.00	6/20/2023
Newmont Mining	NEM	Mining & Chemicals	3	$48.00	6/20/2023
Nucor	NUE	Mining & Chemicals	6	$160.00	6/20/2023
PPG Industries	PPG	Mining & Chemicals	6	$146.00	6/20/2023
Rio Tinto	RIO	Mining & Chemicals	6	$66.00	6/20/2023
Sherwin-Williams	SHW	Mining & Chemicals	6	$246.00	6/20/2023
Vale	VALE	Mining & Chemicals	3	$16.00	6/20/2023
Vulcan Materials	VMC	Mining & Chemicals	5	$185.00	6/20/2023
Wheaton Precious Metals	WPM	Mining & Chemicals	3	$43.00	6/20/2023
Magellan Midstream	MMP	Oil & Gas Complex	6	$62.00	5/25/2023
Nvidia	NVDA	Technology Giants	4	$285.00	5/25/2023
Paramount Global	PARA	Telecom Services - diversified	3	$15.00	5/25/2023
Abbott	ABT	Health Care Bellwethers	6	$102.00	5/16/2023
Amgen	AMGN	Health Care Bellwethers	3	$253.00	5/16/2023
Bristol-Myers Squibb	BMY	Health Care Bellwethers	3	$80.00	5/16/2023
CVS Health	CVS	Health Care Bellwethers	5	$84.00	5/16/2023
Eli Lilly	LLY	Health Care Bellwethers	4	$320.00	5/16/2023
Gilead Sciences	GILD	Health Care Bellwethers	3	$92.00	5/16/2023
Intuitive Surgical	ISRG	Health Care Bellwethers	5	$266.00	5/16/2023
Johnson & Johnson	JNJ	Health Care Bellwethers	6	$161.00	5/16/2023
Medtronic	MDT	Health Care Bellwethers	6	$84.00	5/16/2023
Merck	MRK	Health Care Bellwethers	6	$106.00	5/16/2023
Pfizer	PFE	Health Care Bellwethers	3	$43.00	5/16/2023
UnitedHealth Group	UNH	Health Care Bellwethers	3	$513.00	5/16/2023
Vertex Pharma	VRTX	Health Care Bellwethers	6	$353.00	5/16/2023
Walgreens Boots Alliance	WBA	Health Care Bellwethers	4	$33.00	5/16/2023
Zoetis	ZTS	Health Care Bellwethers	6	$155.00	5/16/2023
AbbVie	ABBV	Health Care Bellwethers	3	$173.00	5/15/2023

In our 16-page equity research reports, we offer a fair value estimate for each company based on a rigorous and transparent discounted cash flow process, assess the attractiveness of a stock based on a firm-specific margin of safety, and provide a relative valuation comparison in the context of the company's industry and peers.

U.S. Nominal GDP Is Booming!

***Image**: Nominal Gross Domestic Product for United States. **Source**: St. Louis Fed*

By Brian Nelson, CFA

The U.S. economy is surging on a nominal basis.

Stocks are not priced at "real" levels; they are priced at nominal levels, and when it comes to equities, nominal gross domestic product has been booming. Everybody is worried about the economy, but again – call me unconcerned.

Look at nominal GDP.

The trade for the next decade, just like the last decade, remains big cap tech and large cap growth, in my view. Higher levels of volatility will shake out the weak holders as it did during June-October 2022 last year, but we're staring down a $2+ trillion market in artificial intelligence in the next 5-7 years (source: Fortune Business Insights), as nominal GDP continues to surge.

We expect huge equity returns this decade, but much more volatility--the kind of volatility that will make holding stocks painful at times (and shake out some investors at the worst possible time), but it is what it is, as it has always been. We're as bullish today as we've ever been.

Oracle's Larry Ellison Pumps AI Opportunity

Image: *Newsletter portfolio holding Oracle has surged in recent months.*

"Oracle's Gen2 Cloud has quickly become the number 1 choice for running Generative AI workloads. Why? Because Oracle has the highest performance, lowest cost GPU cluster technology in the world. NVIDIA (NVDA) themselves are using our clusters, including one with more than 4,000 GPUs, for their AI infrastructure. Our GPU clusters are built using the highest-bandwidth and lowest-latency RDMA network—and scale up to 32,000 GPUs. As a result, cutting edge companies doing LLM development such as Mosaic ML, Adept AI, Cohere plus 30 other AI development companies have recently signed contracts to purchase more than $2 billion of capacity in Oracle's Gen2 Cloud." – Chairman and CTO Larry Ellison

By Brian Nelson, CFA

On June 12, Dividend Growth Newsletter portfolio holding Oracle Corp. (ORCL) reported fantastic fourth-quarter results for its fiscal year 2023 for the period ending May 31, 2023. Both the company's top- and bottom-lines came in better-than-expected in the quarter, and we expect continued strength at Oracle for the foreseeable future. Shares are trading at just shy of ~$120 each, and we expect to raise our fair value estimate upon the next valuation report update.

During Oracle's fiscal fourth quarter, the headlines were mighty impressive. Total revenue advanced 18% on a constant-currency basis led by strength in its Cloud business (+55% on a constant-currency basis) across all verticals: Infrastructure (+77%), Application (+47%), Fusion Cloud ERP (+28%), Netsuite Cloud ERP (+24%). Cerner contributed roughly $1.5 billion to its revenue tally in the fiscal fourth quarter. Non-GAAP operating income advanced 10%, to $6.2 billion in the fiscal fourth quarter, and the firm's operating cash flow surged during the fiscal year, leaping to $17.2 billion (up 80% in USD). Things are looking great at Oracle.

Please see *Oracle's Larry Ellison…*on next page

Oracle's Larry Ellison…**from previous page**

Here is what CEO Safra Catz had to say:

> "Oracle's revenue reached an all-time high of $50 billion in FY23…Annual revenue growth was led by our cloud applications and infrastructure businesses which grew at a combined rate of 50% in constant currency. Our infrastructure growth rate has been accelerating—with 63% growth for the full year, and 77% growth in the fourth quarter. Our cloud applications growth rate also accelerated in FY23. So, both of our two strategic cloud businesses are getting bigger—and growing faster. That bodes well for another strong year in FY24.

Management's outlook for the next few years is mighty impressive, too. As shown in the image that follows, for fiscal 2026, Oracle is targeting organic revenue of $65 billion, an operating margin that includes Cerner of 45%, and annual earnings per share growth greater than 10%. With the company generating better-than-expected top-line performance during its fourth quarter of fiscal 2023, we think management has a good handle on the business, and if the executive suite can deliver on the 45% operating margin percentage, that would imply upside to our fair value estimate (we're modeling an average EBIT margin of ~40.8% over the next five years).

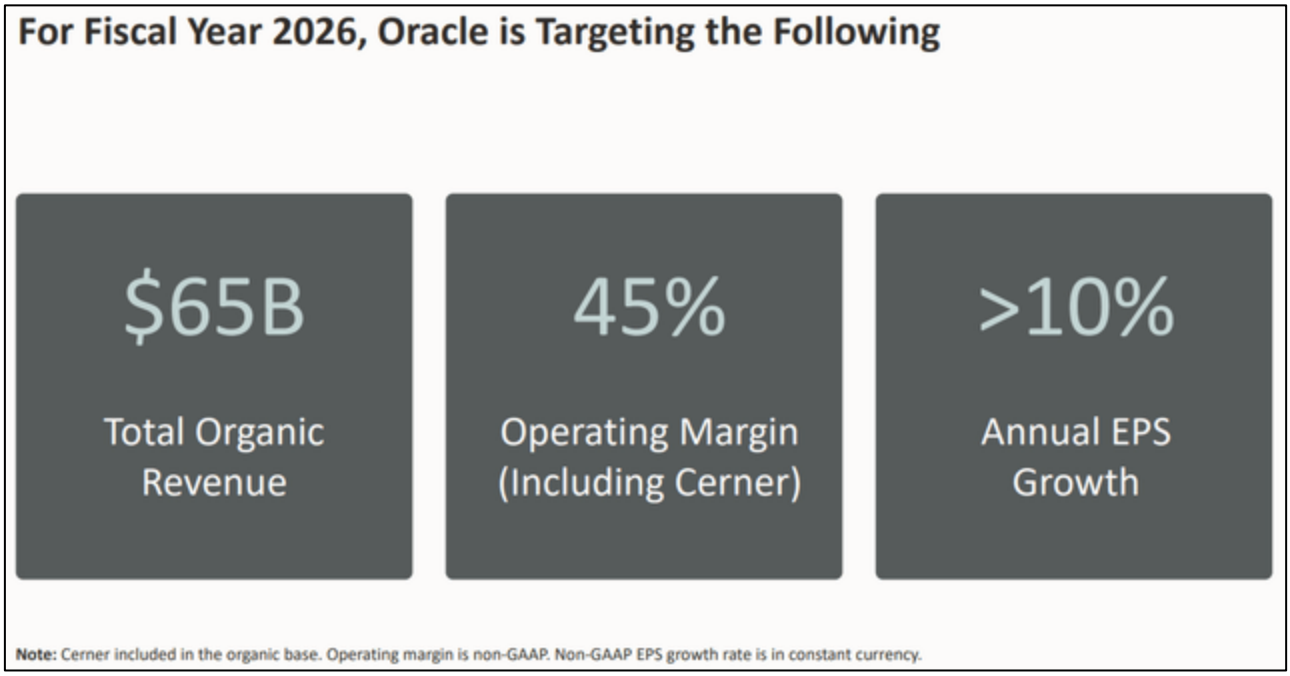

Image Source: *Oracle*

Oracle has been a strong dividend grower in recent years, and while we have no reason to believe that expansion won't continue on the back of such fundamental and financial strength, we continue to cast a cautious eye on the firm's massive debt position. At the end of its fiscal 2023, the company's cash and marketable securities balance has dwindled to ~$10.2 billion while total debt was ~$90.5 billion. Oracle's free cash flow generation surged during fiscal 2023, however, and if the company delivers on its 2026 financial targets, good times are still ahead for the company. We continue to like Oracle in both the Dividend Growth Newsletter portfolio, but its massive debt load is not a risk to be taken lightly.

About the Valuentum Dividend Cushion™ Ratio

By Valuentum Analysts

History has revealed that the best performing stocks during the previous decades have been those that shelled out ever-increasing cash to shareholders in the form of dividends. In a recent study by Ned Davis Research, S&P 500 stocks that initiated dividends or grew them over time registered roughly a 9.6% annualized return since 1972 (through 2010), while stocks that did not pay out dividends or cut them performed poorly over the same time period.

Such analysis is difficult to ignore, and we believe investors may be well-rewarded in future periods by finding the best dividend-growth stocks out there. As such, we've developed a rigorous dividend investment methodology that uncovers firms that not only have the strongest dividends but also ones that are poised to grow them long into the future.

How did we do this? Well, first of all, we scoured our stock universe for firms that have cut their dividends in the past to uncover the major drivers behind the dividend cut. This is what we found out: The major reasons why firms cut their dividend had to do with preserving cash in the midst of a secular or cyclical downturn in demand for their products/services or when faced with excessive leverage (how much debt they held on their respective balance sheets) during tightening credit markets.

The Importance of Forward-Looking Dividend Analysis

Informed with this knowledge, we developed the forward-looking Valuentum Dividend Cushion™, which is a ratio that gauges the safety of a dividend over time.

Most dividend analysis that we've seen out there is backward-looking – meaning it rests on what the firm has done in the past. Although analyzing historical trends is important, we think assessing what may happen in the future is even more important. The S&P 500 Dividend Aristocrat list, or a grouping of firms that have raised their dividends for the past 25 years, is a great example of why backward-looking analysis can be painful. One only has to look over the past few years to see the removal of well-known names from the Dividend Aristocrat List (including General Electric and Pfizer) to understand that backward-looking analysis is only part of the story. After all, you're investing for the future, so the future is what you should care about more.

We want to find stocks that will increase their dividends for 25 years into the future, not use a rear-view mirror to build a portfolio of names that may already be past their prime dividend growth years. The Valuentum Dividend Cushion™ ratio measures just how safe the dividend is in the future. It considers the firm's net cash on its balance sheet (cash and cash equivalents less debt) and adds that to its forecasted future free cash flows (cash from operations less capital expenditures) and divides that sum by the firm's future expected dividend payments. At its core, it tells investors whether the firm has enough cash to pay out its dividends in the future, while considering its debt load. If a firm has a Valuentum Dividend Cushion™ above 1, it can cover its dividend on the basis of our estimates, but if it falls below 1, trouble may be on the horizon.

In the study, the Valuentum Dividend Cushion™ process caught every dividend cut made by a non-financial, operating firm that we have in our database, except for one (Marriott). But interestingly, the Valuentum Dividend Cushion™ indicated that Marriott should have never cut its dividend, and sure enough, two years after the firm did so, it raised it to levels that were higher than before the cut.

Here are the results of the study (a Valuentum Dividend Cushion™ below 1 indicates the dividend may be in trouble). The Valuentum Dividend Cushion™ ratio shown in the table below is the measure in the year before the firm cut its dividend, so it represents a predictive indicator. The measure continues to do well by members in walk-forward analysis (beyond the limitations of a back-tested academic study).

Please see *About the Valuentum Dividend Cushion…*on next page

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The following link, for example, provides more information of the Dividend Cushion ratio tested in a robust out-of-sample walk-forward study across our coverage universe from its inception in 2012 through 2017:

Our Dividend Growth Methodology Is Rocking! ***http://www.valuentum.com/articles/20130528***

The Valuentum Dividend Cushion Caught These Dividend Cuts in Advance

A Valuentum Dividend Cushion Score Below 1 Indicates a Firm's Dividend is At Risk in the Years Ahead

Dividend Cutter	Cut Date	Dividend Cushion (Before Cut)	Reason for Dividend Cut
Avery Dennison (AVY)	31-Jul-09	0.66	Reduced dividend to support debt-reduction efforts.
ConAgra Foods (CAG)	16-Mar-06	-0.59 (1)	Restructuring, divestitures.
Constellation (CEG)	18-Feb-09	-4.36	Refocus on core business of generating and selling power.
DR Horton (DHI)	6-May-08	-0.03	Housing turmoil.
Gannett Co. (GCI)	25-Feb-09	-0.06	Excessive debt; preserve cash amid downturn of newspaper industry.
La-Z-Boy (LZB)	17-Feb-09	0.89	Suspended dividend to preserve cash amid downturn in home furnishings.
Marriott Intl (MAR)	1-May-09	2.18 (2)	Suspended dividend in the wake of weak business travel, but dividend achieved record highs again, May 6, 2011.
Masco Corp (MAS)	11-Feb-09	-0.74	Cut dividend to ensure ability to fund operations and service debt coming due.
New York Times (NYT)	20-Nov-08	0.04	Effort to preserve cash. Downturn in newspaper industry. Loss of investment-grade credit rating.
Pfizer (PFE)	26-Jan-09	0.54	Bought Wyeth to diversify revenue base. Raised $22 billion+ in debt.
Sara Lee Corp (SLE)	8-Aug-06	0.70	Streamlining operations, business unit divestitures to raise cash.
Sunoco Inc. (SUN)	6-Oct-09	-0.85 (3)	Poor margins, overseas competition.
SuperValu (SVU)	20-Oct-09	-5.78	Rising unemployment, competition from Wal-Mart, etc.
Valero Energy (VLO)	27-Jan-10	0.15	Lower demand for gas and diesel.
Vulcan Materials (VMC)	14-Oct-11	-1.42	Free up much-needed cash amid downturn in aggregate demand.

(1) Forecast period for ConAgra, 2007 through 2011.

(2) Marriott is an instance where management prematurely cut its dividend, in our opinion. The Cushion reflected little risk at the time of cut, and sure enough Marriott restored its payout to record high

(3) Forecast adjusted to reflect Sunoco's poor free cash flow trends beyond last reported year.

Backtesting Methodology: Net balance sheet (year prior to dividend cut). Free cash flow for years beginning in year of dividend cut through reported years. If reported years do not total five, last reported year is extrapolated for remainder of forecast period. Dividends paid reflects what the dividends would be ex dividend cut.

Please see *About the Valuentum Dividend Cushion…*on next page

*About the Valuentum Dividend Cushion…*from previous page

At the very least, using the Valuentum Dividend Cushion can help one avoid firms that are at risk of cutting their dividends in the future, and we are the only firm out there that does this type of in-depth analysis. We provide the Valuentum Dividend Cushion ratio in the dividend reports and monthly Dividend Growth Newsletter, and we also scale the safety of a firm's dividend based on this measure in simple terms: Excellent, Good, Poor, Very Poor.

Here's a glimpse of the Valuentum Dividend Cushion ratio **(as of November 2017)** for a sample set of firms in our coverage universe. Please note that the current score on these and hundreds more are available with a membership to our website:

Company Name	Symbol	Sector	Div Cushion
Coca-Cola	KO	Consumer Staples	1.4
PepsiCo	PEP	Consumer Staples	1.2
Air Products & Chemicals	APD	Materials	1.3
Ecolab	ECL	Materials	1.2
PPG Industries	PPG	Materials	2.5
Cintas Corp	CTAS	Industrials	2.7
3M	MMM	Industrials	1.6
W.W. Grainger	GWW	Industrials	1.4
Emerson Electric	EMR	Industrials	2.1
Hormel Foods	HRL	Consumer Staples	2.2
McCormick	MKC	Consumer Staples	1.7
Archer-Daniels-Midland	ADM	Consumer Staples	2.1
Sysco	SYY	Consumer Staples	1.4
Target	TGT	Consumer Staples	1.4
Walgreens Boots Alliance	WBA	Consumer Staples	2.0
Wal-Mart	WMT	Consumer Staples	1.6
Leggett & Platt	LEG	Consumer Discretionary	1.3
Clorox	CLX	Consumer Staples	1.2
Colgate-Palmolive	CL	Consumer Staples	1.8
Johnson & Johnson	JNJ	Consumer Staples	2.2
Kimberly-Clark	KMB	Consumer Staples	1.2
Procter & Gamble	PG	Consumer Staples	1.8
VF Corp	VFC	Consumer Discretionary	1.6
Dover	DOV	Industrials	1.2
Illinois Tool Works	ITW	Industrials	1.6

Understanding Dividend Growth

It takes time to accumulate wealth through dividends, so dividend growth investing requires a long-term perspective. We assess the long-term future growth potential of a firm's dividend, and we don't take management's word for it. Instead, we dive into the financial statements and make our own forecasts of the future to see if what management is saying is actually achievable. We use the Valuentum Dividend Cushion™ as a way to judge the capacity for management to raise its dividend – how much cushion it has – and we couple that assessment with the firm's dividend track record, or management's willingness to raise the dividend.

Please see *About the Valuentum Dividend Cushion…*on next page

About the Valuentum Dividend Cushion...**from previous page**

In many cases, we may have a different view of a firm's dividend growth potential than what may be widely held in the investment community. That's fine by us, as our dividend-growth investment horizon is often longer than others'. We want to make sure that the firm has the capacity and willingness to increase the dividend years into the future and will not be weighed down by an excessive net debt load or cyclical or secular problems in fundamental demand for their products/services. We scale our dividend-growth assessment in an easily interpreted fashion: Excellent, Good, Poor, Very Poor.

What Are the Dividend Ideas We Seek to Deliver to You in Our Newsletter?

First of all, we're looking for stocks with dividend yields that are greater than the average of the S&P 500, or about 2% (but preferably north of 3%). This excludes many names, but we think such a cutoff eliminates firms whose dividend streams aren't yet large enough to generate sufficient income. Second, we're looking for firms that register an 'EXCELLENT' or 'GOOD' rating on our scale for both safety and future potential growth. And third, we're looking for firms that have a relatively lower risk of capital loss, as measured by our estimate of the company's fair value.

The Dividend Cushion Ratio Helps Income Investors

$$\frac{\sum_{t=1}^{5}[A(t) - B(t)] + C(0) - D(0)}{\sum_{t=1}^{5} E(t)}$$

A = cash flow from operations (from the operating section of the cash flow statement),
B = capital expenditures or additions to property plant and equipment (from the investing section of the cash flow statement),
C = cash and cash equivalents (from the balance sheet),
D = long-term debt (from the balance sheet), and
E = cash dividends paid (from the financing section of the cash flow statement).

"All else equal, a firm with billions of net cash on the balance sheet is better positioned to keep paying a dividend than a firm with billions of net debt on the balance sheet. More cash on the books relative to debt reveals significantly more financial flexibility. The dividend payout ratio ignores this important concept, while the Dividend Cushion ratio embraces it." – Valuentum's Brian Nelson, CFA

The Valuentum Dividend Cushion™ ratio has an excellent track record of predicting dividend cuts. For more information, please select the following link (login required):

http://www.valuentum.com/articles/20130528

Valuentum Dividend Growth Newsletter: Volume 12, Issue 7

Valuentum's Dividend Growth Newsletter is published monthly. To receive this newsletter on a monthly basis, please subscribe to Valuentum by visiting our website at http://www.valuentum.com. Or contact us at info@valuentum.com.

Fair Value Range. The fair value range represents an upper bound and lower bound, between which we would consider the firm to be fairly valued. The range considers our estimate of the firm's fair value and the margin of safety suggested by the volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow (the determinants behind our ValueRisk™ rating).

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).

Dividend Track Record. We assess each firm's dividend track record based on whether the fundamentals of the firm have ever forced it to cut its dividend. If the firm has ever cut its dividend (within the last 10 years), we view its track record as RISKY. If the firm has maintained and/or raised its dividend each year (over the past 10 years), we view its track record as HEALTHY.

Dividend Safety. We measure the safety of a firm's dividend by adding its net cash to our forecast of its future cash flows and divide that sum by our forecast of its future dividend payments. This process results in a ratio called the Dividend Cushion™. Scale: Above 2.75 = EXCELLENT; Between 1.25 and 2.75 = GOOD; Between 0.5 and 1.25 = POOR; Below 0.5 = VERY POOR.

Valuentum Dividend Cushion™. This is a proprietary Valuentum measure that drives our assessment of the firm's Dividend Safety rating. The forward-looking measure assesses dividend coverage via the cash characteristics of the business.

Dividend Growth Potential. We blend our analysis of a firm's Dividend Safety with its historical Track Record, while also considering historical dividend growth trends. We believe such a combination captures a firm's capacity (cash flow) and willingness (track record) to raise its dividend in the future. Scale: EXCELLENT, GOOD, POOR, VERY POOR.

Risk of Capital Loss. We think capital preservation is key for the dividend investor. As such, we evalute the risk of capital loss by assessing the intrinsic value of each firm based on our discounted cash-flow process. If a firm is significantly OVERVALUED, we think the risk of capital loss is HIGH. If a firm is FAIRLY VALUED, we think the risk of capital loss is MEDIUM, and if a firm is UNDERVALUED, we think the risk of capital loss is LOW.

Dividend Strength. Our assessment of the firm's dividend strength is expressed in a matrix. If the safety of a firm's dividend is EXCELLENT and its growth prospects are also EXCELLENT, it scores high on our matrix (top right). If the firm's dividend safety and the potential future growth are VERY POOR, it scores lower on our scale (bottom left).

Brian Nelson owns shares in SPY, SCHG, QQQ, DIA, VOT, BITO, RSP, and IWM. Valuentum owns SPY, SCHG, QQQ, VOO, and DIA. Brian Nelson's household owns shares in HON, DIS, HAS, NKE, DIA, and RSP. Some of the other securities written about in this article may be included in Valuentum's simulated newsletter portfolios. Contact Valuentum for more information about its editorial policies.

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The portfolio in the Valuentum Dividend Growth Newsletter is hypothetical and does not represent real money. Past simulated performance, whether backtested or walk-forward or other, is not a guarantee of future results. Actual results may differ from simulated portfolio information being presented in this newsletter. For general information about Valuentum's products and services, please contact us at valuentum@valuentum.com or visit our website at www.valuentum.com.

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