Valuentum Securities, Inc. 7/1/2023 Volume 6 Edition 7

HIGH YIELD DIVIDEND NEWSLETTER

We Added Two Big Yielders to the High Yield Dividend Newsletter Portfolio

Prior Changes to High Yield Dividend Newsletter
***NEW* Added:** **JEPI, DIV;** **Increased:** **IDV– June 27 (email to members)**

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By Brian Nelson, CFA

On June 27, we notified members via email that we had added the JPMorgan Equity Premium Income ETF (JEPI) and the Global X SuperDividend U.S. ETF (DIV) to the portfolio of the High Yield Dividend Newsletter **(see page 28)**. At that time, we also upped the weighting in the iShares International Select Dividend ETF (IDV) to 7.5% from 5%. This brought the cash "position" in the High Yield Dividend Newsletter portfolio to ~0%.

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). 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%**. These two additions will serve to bolster the portfolio's estimated forward dividend yield in an environment where risk-free rates have increased considerably.

Image: *Shares of the JPMorgan Equity Premium Income ETF (JEPI) look very attractive (above).*

Image: *Shares of the Global X SuperDividend U.S. ETF (DIV) offer exposure to the highest-yielding companies in the United States (above).*

4 Very Good Reasons Why We Don't Like Dividends of Banking Stocks

Untermyer: Is not commercial credit based primarily upon money or property?
Morgan: No, sir. The first thing is character.
Untermyer: Before money or property?
Morgan: Before money or anything else. Money cannot buy it … a man I do not trust could not get money from me on all the bonds in Christendom.

- *Mr. JP Morgan's testimony before the Pujo Committee (questioning from Samuel Untermyer), 1912-1913*

Image: *Bank Run in Michigan, USA, February 1933. Source: Public Domain.*

By Brian Nelson, CFA

It's sometimes easy to lose sight of the fragility of a banking firm's business model. Let's examine the reasons why we don't like banking firms' dividends. Reason #1: A Bank Run Is Always Possible. Reason #2: Others Have Tried to Invest in Bank Dividends and Have Failed. Reason #3: Cash Flow Is Not Meaningful at Banks. Reason #4: There Are Plenty of Other Options.

Reason #1: A Bank Run Is Always Possible

Though the history of banking dates back to as early as 2000 BC in Babylonia, the makings of the present-day banking system in the U.S. really didn't take hold until the beginning of the 20th century. Some financial historians may argue for a later date, but we think the Panic of 1907 is of particular importance, where the core of the fragility of the banking system was highlighted yet again in this episode, which followed two other well-known panics in 1893 and 1873.

Also dubbed the Knickerbocker Crisis, the Panic of 1907 primarily came about from lost confidence driven by the failed attempt by Otto Heinze and company to corner the market in shares of United Copper. Once the attempt failed, shares of United Copper collapsed, bringing down with it Heinze's brokerage house (Gross & Kleeberg) and causing the insolvency of the supporting bank (State Savings Bank of Butte Montana). However, it wasn't until the association of Heinze and the Montana bank to the Mercantile National Bank in New York City that a panic actually spread.

Depositors, stripped of their confidence in the banking system as a result of the string of events to this point, began withdrawing deposits en masse. The panic extended to one of the largest banks in the U.S., the Knickerbocker Trust Company, where within a few hours it was forced to suspend banking operations as a result of hefty withdrawals. Then two other large trusts, the Trust Company of America and Lincoln Trust Company, started facing runs, followed by a number of other banks. Confidence in the banking system had been shaken to the core, and creditors that were willing to lend money just a few weeks before were now hunkering down with any capital they had left. It wasn't until Mr. J.P. Morgan and John D. Rockefeller came to the aid of America's credit that the panic finally subsided.

Just a couple of decades later, America saw yet another crisis of confidence during the Crash of 1929. Margin requirements were so thin back in the 1920s that brokers were left holding the bag when stocks collapsed and investors could not settle debts. During the first months of 1930, more than 700 U.S. banks failed, and the financial institutions left standing built up reserves (and stayed far away from expanding their loan books), creating one of the greatest depressions our world has yet seen.

Most investors credit the Great Depression as the primary cause for the creation of the Securities and Exchange Commission in 1933 and the passing of the Glass-Steagall Act, which separated commercial banking operations from investment banking endeavors. The Gramm-Leach-Bliley Act subsequently repealed part of Glass-Steagall

in 1999, allowing the combination of a variety of banking, insurance, and securities-related operations.

Enter the Financial Crisis of 2008 and the Great Recession

During the past three decades alone, there have been three significant banking crises: the savings and loan crisis of the late 1980s/early 1990s; the fall of Long-Term Capital Management and the Russian/Asian financial crisis of the late 1990s; and the Great Recession of the 2007-2009 that not only toppled Lehman Brothers, Bear Stearns, Washington Mutual, and Wachovia but also caused the seizure of Indy Mac, Fannie Mae and Freddie Mac.

We firmly believe that an investment in a bank must come with the acknowledgement of the distinct possibility that another financial crisis may occur at an unknown time in the future. Why? Banks do not keep a 100% reserve against deposits. Our good friend George Bailey knew this very well when he tried to discourage Bedford Falls residents from making a "run" on the famous and beloved Building and Loan.

In the words of Mr. J.P. Morgan, character is the only thing that matters in banking--or said differently, perceived confidence that the banking system will continue to work is really the duct tape that holds the financial markets together. Once this perceived confidence breaks down as it has many a time before, a "run on the bank dynamic" occurs. Such a unique risk will always be present for banking firm investors relative to investors in general operating corporations.

All else equal (especially valuation), we prefer general operating corporations with hefty Valuentum Dividend Cushion ratios to any banking firms that have equal (or even higher) dividend yields. We think non-bank dividend growth options are plentiful, and we just don't want or need to be bothered with the added risk of banking firms in our dividend growth portfolio.

Note: We have modest banking exposure in the portfolio of our Best Ideas Newsletter via a diversified ETF, the Financial Select Sector SPDR (XLF), primarily for diversification and valuation reasons.

Reason #2: Others Have Tried to Invest in Bank Dividends and Have Failed Miserably

In turning to page 178 of Morningstar's (MORN) publication, *The Ultimate Dividend Playbook*, the research firm showcases a managed portfolio that it calls the Dividend

Builder Portfolio, which means the portfolio seeks to hold constituents with increasing dividends. Here's the portfolio as shown in the book.

Company/Ticker	Jun-07 Price	Shares Held	Jun-07 Market Value
3M Company (MMM)	86.79	55	4,773.45
Associated Banc-Corp (ASBC)	32.7	215	7,030.50
Bank of America (BAC)	48.89	200	9,778.00
BB&T (BBT)	40.68	200	8,136.00
Bemis (BMS)	33.18	150	4,977.00
Coca-Cola (KO)	52.31	100	5,231.00
Compass Minerals (CMP)	34.66	270	9,358.20
Crosstex (XTXI)	28.73	330	9,480.90
Diageo (DEO)	83.31	85	7,081.35
First Horizon (FHN)	39	100	3,900.00
Johnson&Johnson (JNJ)	61.62	150	9,243.00
Microsoft (MSFT)	29.47	165	4,862.55
Sysco (SYY)	32.99	130	4,288.70
United Parcel Service (UPS)	73	100	7,300.00
US Bancorp (USB)	32.95	275	9,061.25
Wells Fargo (WFC)	35.17	200	7,034.00
			111,535.90
Source: The Ultimate Dividend Playbook			

The above is a real-money portfolio (the positions are not hypothetical). In June 2007, this portfolio was yielding 3.3%. Let's say you were a big fan of dividend-paying banking firms and held on to them because they had nice yields. In fact, Morningstar went on to say in the book--same page--that "if the market were to close for the next five years...I don't think I'd make many changes, if at all."

Well, things didn't work out great, especially for banking entities. Associated Banc-Corp (ASBC) cut its dividend January 2010, BB&T (BBT) cut its dividend in May 2009, US Bancorp (USB) cut its dividend March 2009, Wells Fargo (WFC) cut its dividend in March 2009, First Horizon (FHN) cut its dividend in January 2008, and Bank of America (BAC) cut its dividend October 2008. Interestingly, even energy firm Crosstex (XTXI) cut its distribution October 2008.

Others focused on the long term and on Warren Buffett's economic moat did not foresee the inevitable long-term risks inherent to investing in dividend-paying banking stocks, and we will not expose our members to the same financial catastrophe, of which we know the risks well. We're not going to do it.

Reason #3: Cash Flow Is Not Meaningful at Banks

Valuentum members know that cash flow analysis is the most critical component of our assessment of a firm's ability to keep paying investors dividends long into the future.

In corporate finance, there are generally three types of free cash flow: traditional free cash flow (cash flow from operations less capital expenditures); free cash flow to the firm (as used in enterprise valuation); and free cash flow to equity (which is applied to banking and insurance firms).

Though we think traditional free cash flow and free cash flow to the firm are acceptable methods for calculating the intrinsic value of general operating corporations, our valuation methods apply a residual income model to assess the value of banking and insurance firms, as we have significantly reduced confidence in the use of free cash flow to equity as a way to value banking entities.

But why? **Free cash flow at banks is nearly impossible to assess because banks use cash to generate cash.** Other firms, on the other hand, use non-cash assets to generate cash--a subtle but important difference.

A look at JP Morgan's (the company) cash flow statement compared to that of a general operating corporation such as Union Pacific (UNP), for example, is perhaps all that may be necessary to illustrate this point. Examples of their respective cash flow statements are shown on the pages that follow.

Where traditional free cash flow (cash flow from operations less capital expenditures) can be calculated rather easily at Union Pacific (second image below), it's nearly impossible to come away with a meaningful free cash flow figure at JP Morgan, in our view.

Quite simply, cash flow from operations and capital expenditures are relatively easy to forecast at Union Pacific and most general operating companies, but they are nearly impossible and borderline meaningless for banking companies.

JP Morgan's Cash Flow Statement

Consolidated statements of cash flows

Year ended December 31, (in millions)	2012	2011	2010
Operating activities			
Net income	$ 21,284	$ 18,976	$ 17,370
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:			
Provision for credit losses	3,385	7,574	16,639
Depreciation and amortization	4,190	4,257	4,029
Amortization of intangibles	957	848	936
Deferred tax expense/(benefit)	1,130	1,693	(968)
Investment securities gains	(2,110)	(1,593)	(2,965)
Stock-based compensation	2,545	2,675	3,251
Originations and purchases of loans held-for-sale	(34,026)	(52,561)	(37,085)
Proceeds from sales, securitizations and paydowns of loans held-for-sale	33,202	54,092	40,155
Net change in:			
Trading assets	(5,379)	36,443	(72,082)
Securities borrowed	23,455	(18,936)	(3,926)
Accrued interest and accounts receivable	1,732	8,655	443
Other assets	(4,683)	(15,456)	(12,452)
Trading liabilities	(3,921)	7,905	19,344
Accounts payable and other liabilities	(13,069)	35,203	17,325
Other operating adjustments	(3,613)	6,157	6,234
Net cash provided by/(used in) operating activities	25,079	95,932	(3,752)
Investing activities			
Net change in:			
Deposits with banks	(36,595)	(63,592)	41,625
Federal funds sold and securities purchased under resale agreements	(60,821)	(12,490)	(26,957)
Held-to-maturity securities:			
Proceeds	4	6	7
Available-for-sale securities:			
Proceeds from maturities	112,633	86,850	92,740
Proceeds from sales	81,957	68,631	118,600
Purchases	(189,630)	(202,309)	(179,487)
Proceeds from sales and securitizations of loans held-for-investment	6,430	10,478	9,476
Other changes in loans, net	(30,491)	(58,365)	3,022
Net cash received from/(used in) business acquisitions or dispositions	88	102	(4,910)
All other investing activities, net	(3,400)	(63)	(114)
Net cash (used in)/provided by investing activities	(119,825)	(170,752)	54,002
Financing activities			
Net change in:			
Deposits	67,250	203,420	(9,637)
Federal funds purchased and securities loaned or sold under repurchase agreements	26,546	(63,116)	15,202
Commercial paper and other borrowed funds	9,315	7,230	(6,869)
Beneficial interests issued by consolidated variable interest entities	345	1,165	2,426
Proceeds from long-term borrowings and trust preferred capital debt securities	86,271	54,844	55,181
Payments of long-term borrowings and trust preferred capital debt securities	(96,473)	(82,078)	(99,043)
Excess tax benefits related to stock-based compensation	255	867	26
Redemption of preferred stock	–	–	(352)
Proceeds from issuance of preferred stock	1,234	–	–
Treasury stock and warrants repurchased	(1,653)	(8,863)	(2,999)
Dividends paid	(5,194)	(3,895)	(1,486)
All other financing activities, net	(189)	(1,868)	(1,666)
Net cash provided by/(used in) financing activities	87,707	107,706	(49,217)
Effect of exchange rate changes on cash and due from banks	1,160	(851)	328
Net (decrease)/increase in cash and due from banks	(5,879)	32,035	1,361
Cash and due from banks at the beginning of the period	59,602	27,567	26,206
Cash and due from banks at the end of the period	$ 53,723	$ 59,602	$ 27,567
Cash interest paid	$ 11,161	$ 13,725	$ 12,404
Cash income taxes paid, net	2,050	8,153	9,747

The Notes to Consolidated Financial Statements are an integral part of these statements.

Image Source: *J.P. Morgan*

Union Pacific's Cash Flow Statement

CONSOLIDATED STATEMENTS OF CASH FLOWS
Union Pacific Corporation and Subsidiary Companies

Millions, for the Years Ended December 31,	*2012*	*2011*	*2010*
Operating Activities			
Net income	$ 3,943	$ 3,292	$ 2,780
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation	1,760	1,617	1,487
Deferred income taxes and unrecognized tax benefits	887	986	672
Other operating activities, net	(160)	(298)	(483)
Changes in current assets and liabilities:			
Accounts receivable, net	70	(217)	(518)
Materials and supplies	(46)	(80)	(59)
Other current assets	(108)	178	(17)
Accounts payable and other current liabilities	(185)	395	243
Cash provided by operating activities	6,161	5,873	4,105
Investing Activities			
Capital investments	(3,738)	(3,176)	(2,482)
Acquisition of equipment pending financing	(274)	(85)	-
Proceeds from sale of assets financed	274	85	-
Proceeds from asset sales	80	108	67
Other investing activities, net	25	(51)	(73)
Cash used in investing activities	(3,633)	(3,119)	(2,488)
Financing Activities			
Common share repurchases (Note 18)	(1,474)	(1,418)	(1,249)
Dividends paid	(1,146)	(837)	(602)
Debt repaid	(758)	(690)	(1,412)
Debt issued	695	486	894
Debt exchange	-	(272)	(98)
Other financing activities, net	1	108	86
Cash used in financing activities	(2,682)	(2,623)	(2,381)
Net change in cash and cash equivalents	(154)	131	(764)
Cash and cash equivalents at beginning of year	1,217	1,086	1,850
Cash and cash equivalents at end of year	$ 1,063	$ 1,217	$ 1,086
Supplemental Cash Flow Information			
Non-cash investing and financing activities:			
Cash dividends declared but not yet paid	$ 318	$ 284	$ 183
Capital lease financings	290	154	-
Capital investments accrued but not yet paid	136	147	125
Cash paid during the year for:			
Interest, net of amounts capitalized	$ (561)	$ (572)	$ (614)
Income taxes, net of refunds	(1,552)	(625)	(936)

The accompanying notes are an integral part of these Consolidated Financial Statements.

Image Source: *Union Pacific*

We're not saying that we don't understand how to analyze banking stocks. Quite the contrary, it is because we understand the banking business model well that we don't like them.

We fully understand traditional analysis in how to assess the attractiveness of a banking entity and how to value them in good times. In times of panic or distress, however, all bets are off. We don't think it's all that easy for anyone to ascertain the dividend strength of any banking entity through the course of the economic cycle, particularly given the ever-present risks of bank runs during times of panic or distress, their opaque loan books (securities portfolios) and arbitrary cash flow generation.

Others have tried to incorporate meaningful banking exposure into dividend-paying portfolios, and they just haven't been successful. We refuse to expose our members to dividend growth positions that we're not completely confident in--and it is our view that nobody can be completely confident in the future dividend growth profile of a banking entity.

Reason #4: There's Plenty of Other Non-Banking Firm Ideas

Frankly, we just don't see the need for us to take the leap into the banking sector just for dividends. That's why we don't have much or any banking exposure across the newsletter portfolios, and we only highlight banking ideas sparingly across the newsletters.

It's not that we forgot about a sector in our portfolio construction--it is that we don't want our members to face the prospects of any dividend cuts...ever. We want to have conviction in the long-term dividend strength of the companies in the newsletter portfolios and with respect to our idea generation.

Valuentum does not believe the long-term dividend health of any financial institution can be accurately predicted. Investing in banking entities often has unique risks that investors are not being adequately compensated for.

A version of this article previously appeared on our website.

Key Reports in the Mining & Chemicals Industry

Valuentum Retail Equity Research — Visit us at www.valuentum.com — Ratings as of 20-Jun-2023 — Data as of 20-Jun-2023

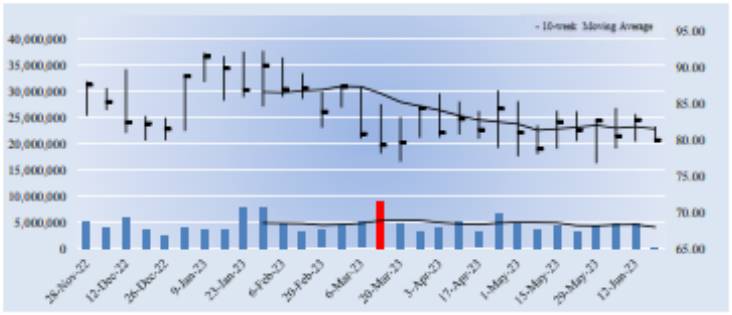
Eastman Chemical EMN FAIRLY VALUED

Buying Index™ 4 — Value Rating

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Attractive	$79.00	$63.00 - $95.00	LARGE-CAP CORE	Materials	Mining & Chemicals

Inflationary pressures represent sizable near term headwinds for Eastman Chemical, but the company's fundamentals remain strong.

Stock Chart (weekly)



The week with the highest trading volume out of the last 30 weeks was a week of heavy selling, or distribution (red bar).

Investment Considerations

DCF Valuation	FAIRLY VALUED
Relative Valuation	ATTRACTIVE
ValueCreation™	EXCELLENT
ValueRisk™	LOW
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	HIGH
Growth	MODEST
Technical Evaluation	BEARISH
Relative Strength	NEUTRAL
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BULLISH
Near-term Technical Resistance, 10-wk MA	81.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Company Vitals

Market Cap (USD)	$10,954
Avg Weekly Vol (30 wks)	4,537
30-week Range (USD)	76.73 - 92.21
Valuentum Sector	Materials
5-week Return	-3.0%
13-week Return	-1.2%
30-week Return	-7.0%
Dividend Yield %	4.0%
Dividends per Share	3.16
Forward Dividend Payout Ratio	49.7%
Est. Normal Diluted EPS	8.49
P/E on Est. Normal Diluted EPS	9.4
Est. Normal EBITDA	2,058
Forward EV/EBITDA	9.3
EV/Est. Normal EBITDA	8.0
Forward Revenue Growth (5-yr)	0.2%
Forward EPS Growth (5-yr)	10.4%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	12.0%
Return on Assets	4.4%
ROIC, with goodwill	10.9%
ROIC, without goodwill	16.3%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	6,016
Net Debt	5,557
Total Debt/EBITDA	3.0
Net Debt/EBITDA	2.8
EBITDA/Interest	10.0
Current Ratio	1.6
Quick Ratio	0.2

NMF = Not Meaningful

Investment Highlights

• Eastman Chemical is a global specialty chemical company that produces a broad range of advanced materials, additives and functional products, specialty chemicals, and fibers. The company's strategic shift away from 'commodity' chemicals has brightened its future. It was founded in 1920 and is headquartered in Tennessee.

• Medium-term growth drivers include its portfolio of specialty businesses creating their own growth markets, growth in high-margin innovative products, and productivity to offset inflation. Eastman Chemical's capital expenditure expectations are on the rise.

• Eastman Chemical responded to the COVID-19 pandemic by curtailing discretionary spending and seeking out long-term improvements in its cost structure. While some of the company's near-term cost savings are temporary in nature, management aims to unlock millions in net cost savings, with room for additional savings.

• Two thirds of the company's sales come from product lines with leading market positions, from additives (cellulosic polymers, insoluble sulfurs) to advanced materials (copolyester, PVB resin) to fibers (acetate tow, acetate yarn). Eastman Chemical has a diverse customer base.

• Eastman Chemical stands to benefit from long-term global trends such as energy efficiency, a rising middle class in emerging economies, and increased health and wellness. Bolt-on acquisitions will likely support its long-term revenue growth trajectory.

Relative Valuation

	Forward P/E	PEG	Price / FV
Air Products & Chemicals	28.7	2.9	107.0%
BHP Billiton	15.6	5.0	109.3%
DuPont	33.8	NMF	105.4%
Sherwin-Williams	32.2	1.9	101.0%
Peer Median	30.4	2.9	106.2%
Eastman Chemical	**12.6**	**1.2**	**101.1%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-20	Dec-21	Dec-22
Revenue	8,473	10,476	10,580
Revenue, YoY%	-8.6%	23.6%	1.0%
Operating Income	1,095	1,451	1,238
Operating Margin %	12.9%	13.9%	11.7%
Net Income	478	857	854
Net Income Margin %	5.6%	8.2%	8.1%
Diluted EPS	3.50	6.25	6.35
Diluted EPS, YoY %	-36.1%	78.5%	1.6%
Free Cash Flow (CFO-capex)	1,072	1,064	364
Free Cash Flow Margin %	12.7%	10.2%	3.4%

In Millions of USD (except for per share items)

Structure of the Chemicals Industry — POOR

The broad chemicals industry includes firms that make thousands of different chemical substances, ranging from basic raw materials to advanced specialty chemicals. Making chemicals is a cyclical and energy-intensive business, with volatile oil/gas prices influencing feedstock, operation, and transportation costs. Specialty providers can carve out niches, but commodity chemicals producers are largely undifferentiated, making it impossible to gain a sustainable competitive edge. The industry is very capital intensive, and large swings in prices and volume should be expected. We don't like the industry structure.

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Page 1

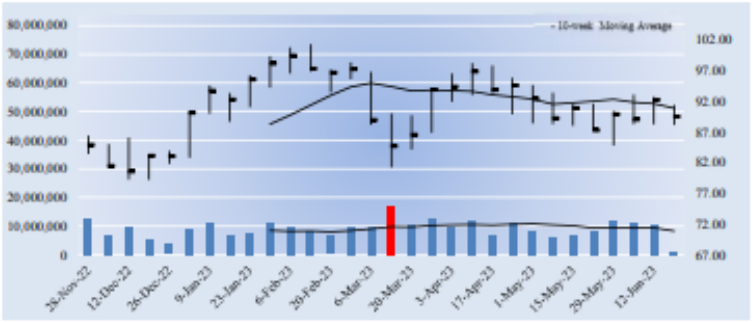
LyondellBasell LYB FAIRLY VALUED

Buying Index™ 3 **Value Rating**

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Attractive	$93.00	$74.00 - $112.00	LARGE-CAP VALUE	Materials	Mining & Chemicals

In April 2022, LyondellBasell announced plans to exit the refining space by the end of December 2023 by ceasing operations at its fire-damaged refinery in Houston.

Stock Chart (weekly)



The week with the highest trading volume out of the last 30 weeks was a week of heavy selling, or distribution (red bar).

Investment Considerations

DCF Valuation	FAIRLY VALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	LOW
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	MEDIUM
Growth	DECLINING
Technical Evaluation	BEARISH
Relative Strength	NEUTRAL
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	DETERIORATING
Near-term Technical Resistance, 10-wk MA	91.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueRisk™ \ ValueCreation™	Very Poor	Poor	Good	Excellent
Low				■
Medium				
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Company Vitals

Market Cap (USD)	$29,893
Avg Weekly Vol (30 wks)	9,130
30-week Range (USD)	79.2 - 101.3
Valuentum Sector	Materials
5-week Return	-1.5%
13-week Return	2.2%
30-week Return	4.8%
Dividend Yield %	5.4%
Dividends per Share	4.82
Forward Dividend Payout Ratio	40.8%
Est. Normal Diluted EPS	9.57
P/E on Est. Normal Diluted EPS	9.4
Est. Normal EBITDA	5,713
Forward EV/EBITDA	5.7
EV/Est. Normal EBITDA	7.0
Forward Revenue Growth (5-yr)	-3.0%
Forward EPS Growth (5-yr)	-12.0%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	36.8%
Return on Assets	10.5%
ROIC, with goodwill	19.9%
ROIC, without goodwill	21.9%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	11,614
Net Debt	10,128
Total Debt/EBITDA	1.3
Net Debt/EBITDA	1.1
EBITDA/Interest	17.0
Current Ratio	1.7
Quick Ratio	0.2

NMF = Not Meaningful

Investment Highlights

• LyondellBasell is a chemical company that participates across the petrochemical value chain. Its business primarily consists of converting hydrocarbon feedstock into plastic resins and other chemicals. Sales of polyethylene (PE) and polypropylene (PP) collectively account for over half of its business. The firm was incorporated under Dutch law in 2009.

• LyondellBasell acquired plastics maker A. Schulman for ~$2.25 billion in August 2018. The deal expanded its reach into high-growth markets such as engineered composites, powders (specialty particle materials), and masterbatches (coloring and additive materials).

• One of our major concerns with LyondellBasell has little to do with the company at all. We are just not big fans of the ultra-cyclical and volatile chemicals/refining business. Its operations and ultimately financial performance are tied to the supply-demand balance of chemical/refining margins, which can exhibit wild swings.

• It's difficult for LyondellBasell to carve out any sustainable competitive advantage due to its commodity-based end markets, but an NGL advantage and advantaged feedstock can help. Inflationary headwinds, such as rising raw materials expenses, need to be monitored going forward.

• LyondellBasell should continue to benefit from growth in the number of upper and middle class households around the world, particularly in emerging markets such as China and India, and in various nations in Southeast Asia such as Vietnam.

Relative Valuation

	Forward P/E	PEG	Price / FV
Air Products & Chemicals	28.7	2.9	107.0%
BHP Billiton	15.6	5.0	109.3%
DuPont	33.8	NMF	105.4%
Sherwin-Williams	32.2	1.9	101.0%
Peer Median	30.4	2.9	106.2%
LyondellBasell	**7.6**	**NMF**	**96.2%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-20	Dec-21	Dec-22
Revenue	27,753	46,173	50,451
Revenue, YoY%	-20.1%	66.4%	9.3%
Operating Income	2,141	7,397	5,407
Operating Margin %	7.7%	16.0%	10.7%
Net Income	1,422	5,616	3,911
Net Income Margin %	5.1%	12.2%	7.8%
Diluted EPS	4.26	16.81	11.83
Diluted EPS, YoY %	-55.7%	294.9%	-29.7%
Free Cash Flow (CFO-capex)	1,457	5,736	4,229
Free Cash Flow Margin %	5.2%	12.4%	8.4%

In Millions of USD (except for per share items)

Structure of the Chemicals Industry — POOR

The broad chemicals industry includes firms that make thousands of different chemical substances, ranging from basic raw materials to advanced specialty chemicals. Making chemicals is a cyclical and energy-intensive business, with volatile oil/gas prices influencing feedstock, operation, and transportation costs. Specialty providers can carve out niches, but commodity chemicals producers are largely undifferentiated, making it impossible to gain a sustainable competitive edge. The industry is very capital intensive, and large swings in prices and volume should be expected. We don't like the industry structure.

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VALUENTUM

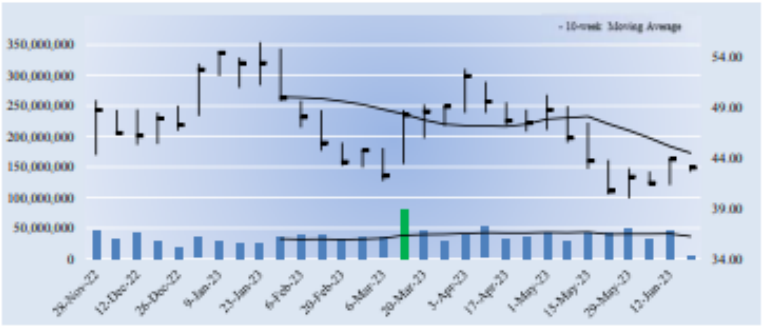
Newmont Mining NEM FAIRLY VALUED

Buying Index™ 3 **Value Rating**

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Neutral	$48.00	$31.00 - $65.00	LARGE-CAP VALUE	Materials	Mining & Chemicals

Newmont's free cash flow generation and dividend payment are heavily tied to the price of gold, while costs have increased at the mining giant in this inflationary environment.

Stock Chart (weekly)



The week with the highest trading volume out of the last 30 weeks was a week of heavy selling, or distribution (red bar).

Company Vitals

Market Cap (USD)	$34,611
Avg Weekly Vol (30 wks)	37,102
30-week Range (USD)	39.95 - 55.41
Valuentum Sector	Materials
5-week Return	-1.5%
13-week Return	-9.1%
30-week Return	-6.1%
Dividend Yield %	3.7%
Dividends per Share	1.60
Forward Dividend Payout Ratio	-277.9%
Est. Normal Diluted EPS	2.40
P/E on Est. Normal Diluted EPS	17.9
Est. Normal EBITDA	4,899
Forward EV/EBITDA	20.6
EV/Est. Normal EBITDA	7.3
Forward Revenue Growth (5-yr)	2.2%
Forward EPS Growth (5-yr)	15.2%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	10.1%
Return on Assets	5.4%
ROIC, with goodwill	4.7%
ROIC, without goodwill	5.3%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	6,196
Net Debt	1,122
Total Debt/EBITDA	1.4
Net Debt/EBITDA	0.3
EBITDA/Interest	15.7
Current Ratio	2.9
Quick Ratio	2.0

NMF = Not Meaningful

Investment Highlights

• Newmont merged with Goldcorp in 2019 through an all-stock deal worth ~$10 billion. The enlarged gold miner has captured meaningful synergies. The lion's share of its gold reserves and potential resources are located in the Americas and Australia. Newmont has exploration ventures on six continents searching for new gold resources to develop.

• Newmont has captured hundreds of millions in run rate pre-tax synergies from the merger thanks to G&A takeouts and supply chain efficiencies. Its credit rating was recently upgraded by S&P Global Ratings to a BBB+ from BBB with a stable outlook.

• Newmont sees itself sitting on the largest gold reserves in the gold sector. The gold miner's future rests on its ability to develop its existing resource base while utilizing exploration activities to uncover additional resources to develop. In 2019, Newmont Goldcorp entered into a JV with Barrick Gold to reduce costs at their Nevada mining operations.

• Newmont expects its capital expenditures (sustaining plus development) will fall from ~$1.65 billion in 2021 to ~$1.1-$1.3 billion in 2025. Its gold output is forecasted to grow marginally during this period, while its other metals output (copper, zinc, lead, and silver) is expected to grow moderately.

• Investing in a gold miner is largely a speculative bet on the direction of gold prices. The yellow metal exhibits many 'greater fool' tendencies in that it relies mostly on speculative demand for its price to move higher. That dynamic is unlikely to change.

Investment Considerations

DCF Valuation	FAIRLY VALUED
Relative Valuation	NEUTRAL
ValueCreation™	POOR
ValueRisk™	HIGH
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	LOW
Growth	MODEST
Technical Evaluation	BEARISH
Relative Strength	WEAK
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BULLISH
Near-term Technical Resistance, 10-wk MA	44.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				
High		■		
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Relative Valuation

	Forward P/E	PEG	Price / FV
Air Products & Chemicals	28.7	2.9	107.0%
BHP Billiton	15.6	5.0	109.3%
DuPont	33.8	NMF	105.4%
Sherwin-Williams	32.2	1.9	101.0%
Peer Median	30.4	NMF	106.2%
Newmont Mining	**-74.7**	**NMF**	**89.6%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-20	Dec-21	Dec-22
Revenue	11,497	12,222	11,915
Revenue, YoY%	18.0%	6.3%	-2.5%
Operating Income	3,239	1,988	-533
Operating Margin %	28.2%	16.3%	-4.5%
Net Income	2,666	176	-463
Net Income Margin %	23.2%	1.4%	-3.9%
Diluted EPS	3.31	1.46	-0.58
Diluted EPS, YoY %	NMF	NMF	NMF
Free Cash Flow (CFO-capex)	3,580	2,626	1,090
Free Cash Flow Margin %	31.1%	21.5%	9.1%

In Millions of USD (except for per share items)

Structure of the Gold Mining Industry — POOR

Gold miners are tied to the world price of gold, which depends on a number of demand drivers: industrial and jewelry; gold as an investment; central bank activity; inflation expectations; and speculative trading. If realized prices on the yellow metal fall and remain at low levels, mining profitability would be significantly impaired. Industry constituents must constantly seek to replace reserves depleted by production via new exploration, which remains a speculative activity. Unexpected project cost overruns remain another key risk. In general, we're not huge fans of the volatile fundamentals of the gold mining sector.

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VALUENTUM

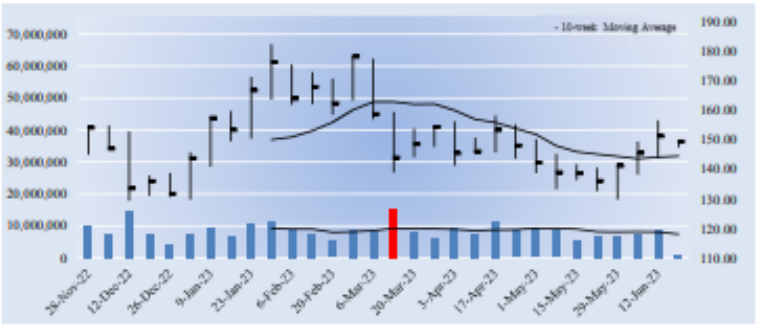
Nucor NUE FAIRLY VALUED

Buying Index™ 6 **Value Rating**

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Attractive	$160.00	$104.00 - $216.00	LARGE-CAP VALUE	Materials	Mining & Chemicals

Nucor's asset-base modernization and optimization efforts have significantly improved its longer term outlook.

Stock Chart (weekly)



The week with the highest trading volume out of the last 30 weeks was a week of heavy selling, or distribution (red bar).

Investment Considerations

DCF Valuation	FAIRLY VALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	HIGH
ValueTrend™	POSITIVE
Cash Flow Generation	STRONG
Financial Leverage	LOW
Growth	DECLINING
Technical Evaluation	VERY BULLISH
Relative Strength	NEUTRAL
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BEARISH
Near-term Technical Support, 10-week MA	145.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueCreation™

ValueRisk™	Very Poor	Poor	Good	Excellent
Low				
Medium				
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Company Vitals

Market Cap (USD)	$43,882
Avg Weekly Vol (30 wks)	8,352
30-week Range (USD)	129.47 - 182.68
Valuentum Sector	Materials
5-week Return	7.5%
13-week Return	-0.9%
30-week Return	1.2%
Dividend Yield %	1.4%
Dividends per Share	2.04
Forward Dividend Payout Ratio	7.1%
Est. Normal Diluted EPS	17.33
P/E on Est. Normal Diluted EPS	8.6
Est. Normal EBITDA	7,646
Forward EV/EBITDA	3.9
EV/Est. Normal EBITDA	6.1
Forward Revenue Growth (5-yr)	-1.0%
Forward EPS Growth (5-yr)	-9.3%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Investment Highlights

• Nucor makes steel and steel products, including carbon and alloy steel, hollow section tubing, electric conduit, and steel joists, among many other applications. It may be North America's largest recycler, using scrap steel as its primary raw material. It has operating facilities in the US, Canada, and Mexico. Nucor was founded in 1940.

• Nucor pursues five drivers to profitable growth: 1) low cost production; 2) market leadership; 3) moving up the value chain; 4) expand channels to market; and 5) commercial excellence. It is the leading US provider for most of the products it supplies.

• The US government continues to combat the detriments of foreign, low-cost steel producers via anti-dumping duties and other measures, but the risk of pricing pressure may never go away. Excess global steelmaking capacity has always been a challenge for the industry, and most of the industry's excesses come from state-owned Chinese entities.

• Nucor's financial strength enables it to register the highest credit rating among its peer group (A-/Baa1). The company's flexible capacity and variable cost structure makes Nucor best-in-class in market responsiveness and helps it generate positive cash even during downturns.

• The company does not shy away from investing in down markets. Projects coming on line in coming periods will help the firm gain greater control of raw material costs and expand offerings of specialized, higher-margin products.

Relative Valuation

	Forward P/E	PEG	Price / FV
Air Products & Chemicals	28.7	2.9	107.0%
BHP Billiton	15.6	5.0	109.3%
DuPont	33.8	NMF	105.4%
Sherwin-Williams	32.2	NMF	101.0%
Peer Median	30.4	NMF	106.2%
Nucor	**5.2**	**NMF**	**93.5%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Returns Summary

	3-year Historical Average
Return on Equity	22.6%
Return on Assets	12.2%
ROIC, with goodwill	25.0%
ROIC, without goodwill	29.9%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	5,685
Net Debt	3,067
Total Debt/EBITDA	0.6
Net Debt/EBITDA	0.3
EBITDA/Interest	64.0
Current Ratio	2.5
Quick Ratio	0.5

NMF = Not Meaningful

Financial Summary

	---- Actual ----		Projected
Fiscal Year End:	Dec-20	Dec-21	Dec-22
Revenue	20,140	36,484	41,512
Revenue, YoY%	-10.8%	81.2%	13.8%
Operating Income	1,613	9,318	11,202
Operating Margin %	8.0%	25.5%	27.0%
Net Income	-94	6,827	8,319
Net Income Margin %	-0.5%	18.7%	20.0%
Diluted EPS	-0.31	23.27	28.79
Diluted EPS, YoY %	NMF	NMF	23.7%
Free Cash Flow (CFO-capex)	1,154	4,609	8,124
Free Cash Flow Margin %	5.7%	12.6%	19.6%

In Millions of USD (except for per share items)

Structure of the Steel Industry — VERY POOR

Firms in the steel industry face strong international competition, especially from China, which can often produce steel at rock-bottom prices thanks to lower-cost operations and structural advantages. Steel producers operate at the whim of the prices of volatile raw materials used in production, namely iron ore, coal, natural gas and scrap. Products are sold on the spot market, while other shipments can often be sold under agreements that do not allow for recovery of changes in input costs. Labor unions and the threat of structural overcapacity add more uncertainty. We think the industry structure is very poor.

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VALUENTUM

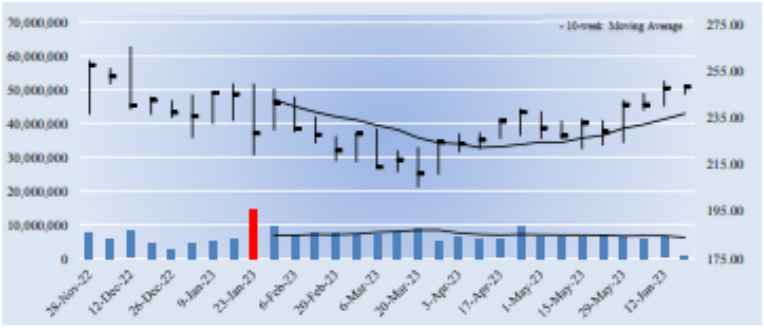
Sherwin-Williams SHW FAIRLY VALUED

Buying Index™ 6 **Value Rating**

Economic Castle	Estimated Fair Value	Fair Value Range	Investment Style	Sector	Industry
Very Attractive	$246.00	$185.00 - $308.00	LARGE-CAP CORE	Materials	Mining & Chemicals

In June 2022, Sherwin-Williams announced it was acquiring Gross & Perthun GmbH, a German industrial coating company.

Stock Chart (weekly)



The week with the highest trading volume out of the last 30 weeks was a week of heavy selling, or distribution (red bar).

Company Vitals

Market Cap (USD)	$66,340
Avg Weekly Vol (30 wks)	6,801
30-week Range (USD)	205.43 - 265.64
Valuentum Sector	Materials
5-week Return	6.5%
13-week Return	16.2%
30-week Return	0.4%
Dividend Yield %	1.0%
Dividends per Share	2.42
Forward Dividend Payout Ratio	31.4%
Est. Normal Diluted EPS	11.55
P/E on Est. Normal Diluted EPS	21.5
Est. Normal EBITDA	4,515
Forward EV/EBITDA	22.0
EV/Est. Normal EBITDA	16.7
Forward Revenue Growth (5-yr)	4.6%
Forward EPS Growth (5-yr)	19.0%

NMF = Not Meaningful; Est. = Estimated; FY = Fiscal Year

Returns Summary

	3-year Historical Average
Return on Equity	54.9%
Return on Assets	9.7%
ROIC, with goodwill	19.3%
ROIC, without goodwill	39.9%

ROIC = Return on Invested Capital; NMF = Not Meaningful

Leverage, Coverage, and Liquidity

In Millions of USD

Total Debt	9,355
Net Debt	9,189
Total Debt/EBITDA	3.0
Net Debt/EBITDA	2.9
EBITDA/Interest	9.4
Current Ratio	0.9
Quick Ratio	0.0

NMF = Not Meaningful

Investment Highlights

• Sherwin-Williams makes and sells paint, coatings and related products to professional, industrial, commercial and retail customers primarily in North and South America with additional operations in the Caribbean region, Europe and Asia. It completed a 3:1 stock split in 2021. The company was founded in 1866 and is headquartered in Cleveland, Ohio.

• Sherwin-Williams bought Valspar for ~$11.3 billion in an all-cash transaction in 2017. It has achieved hundreds of millions in annual run-rate cost synergies since then and meaningful cash flow improvements have been evident, too.

• Valspar's business brings with it new growth opportunities including in the areas of coil and packaging, as well as an enhanced geographic footprint in growth markets such as Asia-Pacific. Management has its work cut out for it in deleveraging the balance sheet, however. The company has a sizable net debt load on the books.

• Sherwin-Williams is home to well-known paint, coating, and sealer brands with ample pricing power. It has the #1 architectural paint brand (SWP), the #1 stain (Minwax), the #1 aerosol paint (Krylon), the #1 auto specialty paint (Dupli-Color), the #1 painting tool brand (Purdy), and the #1 wood sealer (Thompson's).

• Sherwin-Williams is a Dividend Aristocrat and has raised its dividend over the past 40+ consecutive years. The company's ability to generate free cash flows in almost any operating environment is impressive, and its growth outlook is quite bright.

Investment Considerations

DCF Valuation	FAIRLY VALUED
Relative Valuation	NEUTRAL
ValueCreation™	EXCELLENT
ValueRisk™	MEDIUM
ValueTrend™	NEGATIVE
Cash Flow Generation	STRONG
Financial Leverage	MEDIUM
Growth	MODEST
Technical Evaluation	BULLISH
Relative Strength	STRONG
Money Flow Index (MFI)	NEUTRAL
Upside/Downside Volume (U/D)	BULLISH
Near-term Technical Support, 10-week MA	237.00

DCF = Discounted Cash Flow; MFI, U/D = Please see glossary. MA = Moving Average

Business Quality

ValueRisk™ \ ValueCreation™	Very Poor	Poor	Good	Excellent
Low				
Medium				■
High				
Very High				

Firms that generate economic profits with little operating variability score near the top right of the matrix.

Relative Valuation

	Forward P/E	PEG	Price / FV
Air Products & Chemicals	28.7	2.9	107.0%
BHP Billiton	15.6	5.0	109.3%
DuPont	33.8	NMF	105.4%
Rio Tinto	8.7	NMF	99.9%
Peer Median	22.1	4.0	106.2%
Sherwin-Williams	**32.2**	**1.9**	**101.0%**

Price / FV = Current Stock Price divided by Estimated Fair Value

Financial Summary

	----- Actual -----		Projected
Fiscal Year End:	Dec-20	Dec-21	Dec-22
Revenue	18,362	19,945	22,149
Revenue, YoY%	2.6%	8.6%	11.1%
Operating Income	2,862	2,558	2,829
Operating Margin %	15.6%	12.8%	12.8%
Net Income	2,030	1,864	2,020
Net Income Margin %	11.1%	9.3%	9.1%
Diluted EPS	7.36	6.98	7.72
Diluted EPS, YoY %	3.9%	-5.2%	10.6%
Free Cash Flow (CFO-capex)	3,105	1,873	1,275
Free Cash Flow Margin %	16.9%	9.4%	5.8%

In Millions of USD (except for per share items)

Structure of the Specialty Retailers Industry — NEUTRAL

The specialty retail segment is fragmented, highly competitive, and economically-sensitive. The group covers a broad array of businesses and is dominated by retailers with large brick-and-mortar store footprints. Though some constituents may be insulated from e-commerce competition, others risk obsolescence as product distribution moves to digital means, and online retailers offer lower prices for identical goods and services. We're fairly neutral on the structure of the industry, though some constituents will inevitably face secular and permanent declines.

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VALUENTUM

ICYMI: Expect Huge Equity Returns This Decade, Much More Volatility However

By Brian Nelson, CFA

The game has changed folks.

The flooding of the markets with liquidity during the Great Financial Crisis [GFC] and the bailout of the banks in 2007-2009 marked the beginning of a new "regime" that we now live in. It wasn't until the collapse of the markets during COVID-19, however, that the belief these markets would continue to move ever higher was reinforced.

Where is the risk? What does "Lehman" even mean anymore? "Lehman" was not risk – "Lehman" was a generational buying opportunity. What was the worst global pandemic in a hundred years? COVID-19 wasn't "risk" to the markets. Like "Lehman," COVID-19 was a generational buying opportunity.

These markets are no longer built for price discovery. They have become "socialized" retirement accounts. Every two weeks or every month, workers pump money into the markets via their retirement accounts, and government agencies backed by appointed or elected officials need to make sure that these accounts continue to grow.

Has it really become that simple for equity investors? A regional banking crisis? Nope. The FDIC is there, and then of course, an "implicit" guarantee that all deposits over FDIC insurance would be safe came so fast our heads are still spinning. Is there any reason to ever sell stocks anymore?

Seriously – where are the risks to this market? 2022 was a surprising year in how the markets reacted to inflationary pressures, but markets merely retraced to late 2020 levels last year (on some pretty high levels of inflation). Is the risk to the downside in these markets really just a couple years' worth of returns? That's not "risk." How could that be risk?

"Risk" to me is another Great Depression but still -- every historic calamity from the Crash of 1929 to that October day in 1987 to the depths of the GFC has been met with eventual buying and the markets setting new highs again and again. With dollar cost averaging, investors made money during the worst of times. What then are the risks to equities anymore?

Maybe the one true risk for diversified equity investors--with an emphasis on diversified--is perhaps one of their own device--panic selling. Selling in March 2020 at the bottom. Selling in October 2022 right before a huge bull market. That seems about it. Falling into the trap of thinking that these markets (i.e. retirement accounts) won't be propped up by everything the U.S. government can do (eventually when needed) and then panic selling. Maybe that's the only risk these days?

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

That's neither here nor there, however. 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. **The new add JEPI helps fill this void in the High Yield Dividend Newsletter portfolio.** 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.**

A version of this article appeared on our website June 21, 2023.

Real Estate Investors Continue to Feel the Pain

Image: *Excluding dividends, as measured by the Vanguard Real Estate ETF (VNQ) and Real Estate Select Sector SPDR (XLRE),* ***real estate investors have lost about a quarter of their capital since the beginning of 2022.*** *We expect that real estate may continue to be among the weaker areas of the market in the coming quarters (and maybe years).*

By Brian Nelson, CFA

It's easy to fall in love with equity REITs because of their dividend yields, but intrinsic values that are a function of future expected enterprise free cash flows act as a magnet over time to equity prices, irrespective of the payout. It's a dynamic of the market that we emphasize within the Valuentum Buying Index framework with the discounted cash flow (DCF) valuation model, or enterprise valuation, as its first primary consideration among the three-pronged approach.

Equity REITs have been pummeled since the Fed started its rate-hiking cycle, and we think many subsegments of equity REITs from offices to malls will continue to feel the pain. Not only is the work-from-home trend a sticky one, but we're hearing that occupancy rates in some of the largest metro areas are suffering. Just a couple years ago, the occupancy rate on Chicago's Magnificent Mile was 81%; now it's down to 73% by some estimates. Other major cities may be experiencing similar pains.

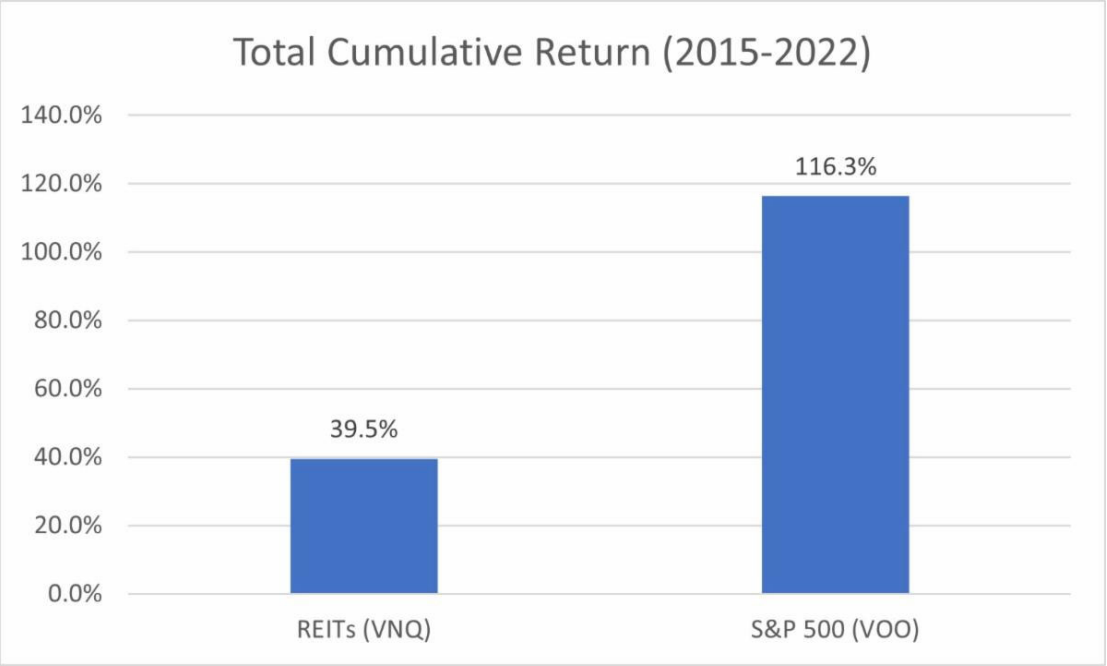

Image: *REITs have not performed as well as one might have thought. Source: Vanguard*

Let's cover in greater detail a few fundamental long-term considerations working against REITs. For starters, the labor force is less-than-enthused about returning to the office, and remote jobs are becoming more and more common, meaning the need for office space may, over the long run, not be as much as previously thought. We're already seeing office REITs slash their payouts. Secondly, consumers are growing more and more comfortable ordering online, making many smaller retailers or mall-based retailers and their rents obsolete in time. How we shop in the coming decades will continue to change, as convenience becomes a huge consideration.

These two trends, in particular, are worrisome for REIT investors, but we're not too enthused about healthcare REITs either. Though the broader healthcare area should benefit, in theory, from long-term secular demographic tailwinds supporting skilled nursing facilities and assisted living facilities, among other locations, competition remains fierce. Many healthcare REITs suffered through the pandemic, but even during normal times, there are myriad risks. We're reminded of the HCP, now Healthpeak Properties (PEAK), and HCR ManorCare debacle in 2016, and frankly, we don't like the uncertainties facing the group's tenants regarding long-term reimbursement by third-party payors.

Here is more about what we're talking about, per Omega Healthcare's 2021 Annual Report:

> A significant portion of our operators' revenue is derived from government-funded reimbursement programs, consisting primarily of Medicare and Medicaid. **As federal and state governments continue to focus on healthcare reform initiatives, efforts to reduce costs by government payors will likely continue. Significant limits on the scope of services reimbursed and/or reductions of reimbursement rates could therefore have a material adverse effect on our operators' results of operations and financial condition.** Additionally, new and evolving payor and provider programs that are tied to quality and efficiency could adversely impact our tenants' and operators' liquidity, financial condition or results of operations, and there can be no assurance that payments under any of these government healthcare programs are currently, or will be in the future, sufficient to fully reimburse the property operators for their operating and capital expenses.

Not all REITs are created equal, of course, and those with triple net leases may be better operators than others, but COVID-19 showed that investing in REITs is not for the faint of heart. Our favorite areas within the REIT space remain the self-storage and tower operators--**and we highlight a few of our favorites in the High Yield Dividend Newsletter portfolio.** We like the traditional free cash flow profile of the self-storage space in how effectively the group can cover cash dividends paid, while tower operators have tremendous operating leverage in their business models that translates into strong economic returns. Again, not all REITs are the same, but in general, REITs haven't been good to investors for a long time, and we don't expect that to change anytime soon given some of the concerns outlined in this article.

REITs, as measured by the Vanguard ETF (VNQ), have generated a total return of 39.5% since the beginning of 2015 through the end of 2022, an eight-year period that has translated into a measly compound annual return of just 4.25%. This compares to a total return of the Vanguard S&P 500 ETF (VOO) of 116.3%, which translates into a compound annual return of 10.1% over the same time period. Not only have REITs underperformed terribly during the past 8 years, but there have been more than 100 dividend cuts by REITs over this time period, too. REITs just aren't what some make them out to be.

Apple Crosses $3 Trillion Market Capitalization!

By Brian Nelson, CFA

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

Apple (AAPL) unveiled its Vision Pro at the company's Worldwide Developers Conference on June 5. We were impressed with the new major product launch, its first since the release of the Apple Watch nearly a decade ago but estimating the total market opportunity for a $3,499 device is a difficult one. The Vision Pro will be available in early 2024 and will compete in many areas with the Meta (META) Quest, and we expect Apple's annual numbers come next year to be impressive.

Image: *Apple released its first major product since the Apple Watch in the Vision Pro on June 5. The device opens the door to the era of spatial computing and is priced at $3,499.*

The market for high-end consumer devices is a large one, and from what we can tell, the number of possible applications of the Vision Pro are many. We're not making any changes to our valuation of Apple until we get a better feel for just how big of a needle-mover the Vision Pro will be, but **we expect to raise our fair value estimate of Apple.** The company has another winner on its hands, in our view.

5 Questions Investors Should Ask When Interviewing Fund Managers

These are not your typical questions. These are the questions investors should ask to help find the most analytical fund managers. The questions don't cover strategy or market outlook, but instead hit upon the analytical foundation of the fund manager, which could be more important than anything else.

By Brian Nelson, CFA

Can you explain the difference between ROA, ROE, and ROIC?

What you are looking for in the answer is a response that goes into the pitfalls of using return on assets (ROA) and return on equity (ROE) as a measure of a company's ability to generate value for shareholders.

Ideally, you'd want to hear a response that says ROA is muddied by the inclusion of non-operating cash in the denominator and that ROE is impacted by leverage (assets divided by equity). The very best of fund managers will refer to the DuPont (DD) equation in explaining that the third term when breaking apart ROE is leverage. The best answer may explain how some firms can hide deteriorating profitability (net income divided by sales) and asset turns (sales divided by assets) by taking on more and more debt to bolster ROE.

What you want is an answer that says ROIC is the best measure of a firm's ability to generate economic value for shareholders. **The very best answer will include a response that says return on new invested capital (RONIC) is the most informative measure of a company's ability to continue to generate economic value for shareholders.** RONIC is calculated by taking NOPLAT (net operating profit less adjusted taxes) divided by net new investment (capital expenditures less depreciation adjusted for working capital).

Be wary of fund managers that just rely on ROE and ROA. These measures provide some information about the return potential of a company, but they have their pitfalls. Every fund manager should know about them.

Would you rather own an overvalued stock with a wide economic moat or an undervalued stock with no economic moat?

The answer that you want to hear is something that goes into the concept that a company's competitive advantages (economic moat) are already incorporated into the valuation. A firm's economic moat translates into an ability to generate elevated RONIC, and this elevated RONIC is reflected in the company's future expected free cash flows, or the relationship between NOPLAT and net new investment. **Said differently, the moat consideration is generally secondary to the valuation consideration.**

Ideally, you'd like to hear the fund manager say that a great company is not always a good stock, meaning that some of the widest economic moats can be some of the worst market performers. Savvy fund managers may even explain how recent research has indicated that wide moat stocks underperform others with weaker competitive advantages. **The savvy fund manager will understand that even a poor company can be a bargain. You want to hear the fund manager explain the difference between a good company and a good stock. As investors, we're interested in good stocks.**

If a company's net income is increasing but cash flow from operations is falling, what is going on?

This is a question that tackles a fund manager's knowledge of financial analysis, and to a larger degree, the ability to identify firms with strong earnings quality. The question directly addresses the cash flow statement, and specifically the cash flow from operations section. What you want to hear is an explanation that working capital changes (inventories, receivables, payables) are impacting the cash dynamics of the business negatively.

Ideally, the fund manager could talk about a retailer's inventory build before the holiday season – Kohl's (KSS) could be a good example – or Boeing's (BA) development of a new airplane and how that may weigh on cash flows. A discussion about the risks of default would be excellent, particularly in the context of payables and/or the cash conversion cycle. **The savvy fund manager will understand the importance of earnings quality and have an in-depth understanding of the cash flow statement.**

How does the P/E ratio, EV/EBITDA multiple, and discounted cash flow model differ?

You may get an answer that includes the definition of each of these metrics. For example, the P/E ratio is the price per share of the stock divided by a company's earnings per share. The EV/EBITDA multiple is enterprise value divided by earnings before interest taxes, depreciation, and amortization. The discounted cash flow model sums the present value of future free cash flows in arriving at an estimate of a company's value. The fund manager may explain that a P/E ratio, EV/EBITDA multiple and the discounted cash flow model are used to set a value on the stock. This is true.

But what you really want to hear in the answer is that the P/E ratio and EV/EBITDA multiple are imperfect and hasty shortcuts to the discounted cash flow model, and that the discounted cash flow model helps break apart the individual drivers to arrive at a better estimate of intrinsic worth. You want to hear the fund manager say that the P/E ratio and EV/EBITDA multiple are great ways of explaining valuations in short-hand, but only through the application of a discounted cash flow model can intrinsic value be thoroughly estimated.

How does the dividend impact a company's valuation?

What you want to hear in the answer is that earnings (as a part of cash flow from operations) and free cash flow (cash flow from operations less capital expenditures) drive the valuation equation and that the dividend is a result or a symptom of strong free cash flow generation (not a driver). **You want to make sure that the fund manager doesn't lose sight of the company's valuation under any circumstance.**

This will help ensure that they are prudently deploying the fund's capital in the best risk-adjusted opportunities available on the market. For example, you may not be comfortable with the manager chasing risky 10%+ yielders such as AGNC Investment Corp. (AGNC) or overpaying for a company's dividend track record, as arguably is the case of Coca-Cola (KO), which has raised its dividend in each of the past 60+ years but is mighty pricey.

A version of this article previously appeared on our website.

Be Careful Dabbling in 7%-Yielding AT&T

Image: *Shares of AT&T have been pummeled, and we don't see a clear path to recovery. Be careful!*

By Brian Nelson, CFA

AT&T's forward estimated dividend yield of ~7% is attractive at face value, but the economics of its business continue to leave a lot to be desired, in our view. Not only is the company saddled with a tremendous amount of net debt to the tune of a whopping $134.7 billion at the end of its first-quarter 2023, resulting in an annualized net debt to adjusted EBITDA ratio of 3.22x, but the company operates a capital-intensive model that eats into its operating cash flow.

The company has put up 11 straight quarters of 400,000+ postpaid phone net adds and 13 consecutive quarters of 200,000 AT&T Fiber net adds, and domestic wireless service revenue and consumer broadband revenue moved in the right direction in the first quarter this year, but **it seems AT&T just can't figure out how to stabilize free cash flow and grow it.** We doubt the market may ever grow comfortable in the sustainability of its payout again, particularly considering the recent dividend cut.

AT&T's Dividend Cushion stands at -1.2 (negative 1.2), indicating very poor dividend quality, and **we have no interest in AT&T's shares in any newsletter portfolio**, which are trading at levels first reached decades ago.

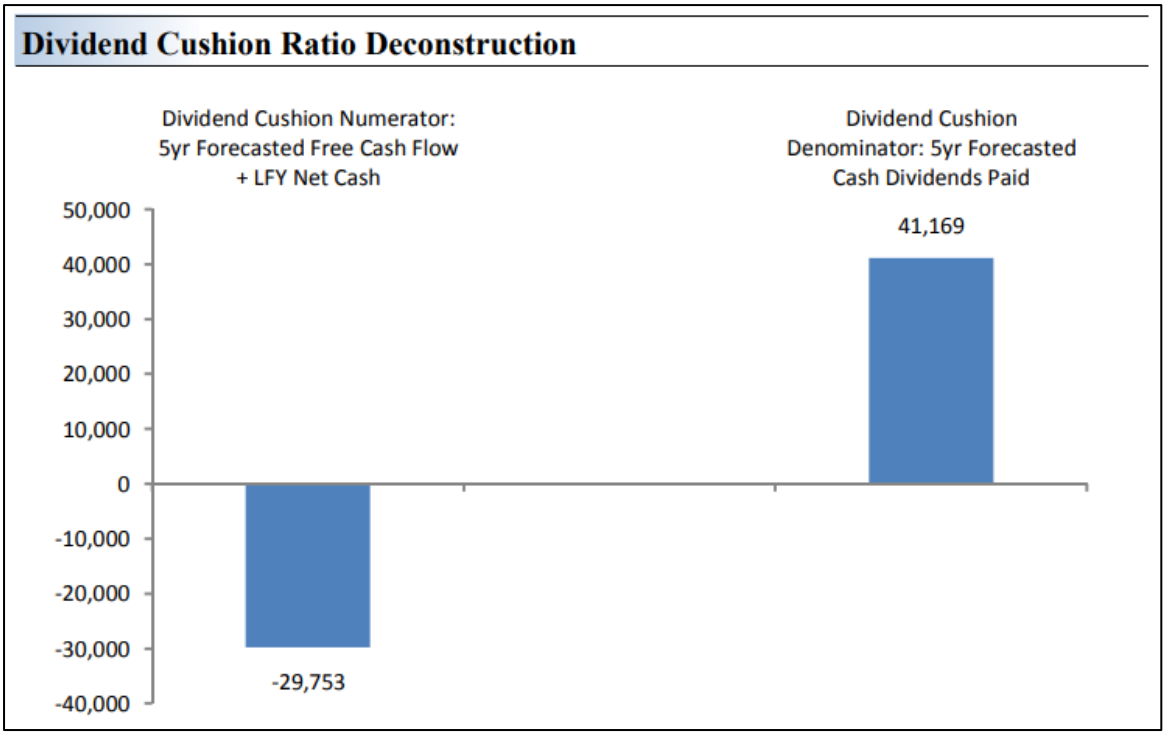

Image: *The Dividend Cushion Ratio Deconstruction, shown in the image above, reveals the numerator and denominator of the Dividend Cushion ratio. At the core, the larger the numerator, or the healthier a company's balance sheet and future free cash flow generation, relative to the denominator, or a company's cash dividend obligations, the more durable the dividend. In the context of the Dividend Cushion ratio, AT&T's numerator is smaller than its denominator suggesting weak dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.*

A version of this article appeared on our website April 20, 2023.

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. 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 dynamic 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. 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			
JPMorgan Equity Premium Income ETF ***NEW***	JEPI	**10.0%**	10.91%
Global X SuperDividend U.S. ETF ***NEW***	DIV	**10.0%**	7.43%
iShares International Select Dividend ETF ***INCREASED***	IDV	**7.5%**	7.29%
PowerShares Senior Loan Portfolio	BKLN	5.0%	7.13%
SPDR Portfolio S&P 500 High Dividend ETF	SPYD	5.0%	4.80%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	5.72%
iShares U.S. Preferred Stock ETF	PFF	5.0%	6.77%
Global X SuperIncome Preferred ETF	SPFF	5.0%	7.21%
Vanguard Real Estate ETF	VNQ	5.0%	4.52%
Energy Select Sector SPDR	XLE	5.0%	3.95%
Utilities Select Sector SPDR	XLU	5.0%	3.21%
EQUITY			
Crown Castle	CCI	5.0%	5.49%
CubeSmart	CUBE	5.0%	4.39%
Philip Morris	PM	5.0%	5.20%
Public Storage	PSA	5.0%	4.11%
Enterprise Products Partners	EPD	5.0%	7.44%
Phillips 66	PSX	5.0%	4.40%
American Tower	AMT	2.5%	3.24%
Cash* **-- REDUCED --**	-	**0.0%**	5.13%
		100.0%	**6.18%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 7/1/2023. Est. Forw Div. Yield info retrieved from SeekingAlpha, YF.

** Reflects federal funds target rate range*

About the High Yield Dividend Newsletter

This information is provided for new members.

The High Yield Dividend Newsletter is not a get-rich-quick newsletter. The content in the High Yield Dividend Newsletter is all about income and yield considerations, and we monitor and often make changes to the simulated High Yield Dividend Newsletter portfolio that can be found on the page immediately preceding this note. We think the simulated newsletter portfolio is one of the biggest value-adds of this publication.

As with any investor, we operate within the constraints of the marketplace. Generally speaking, if markets are difficult, readers shouldn't expect a massive deviation from broader market trends in the newsletter portfolio, though 2022 was very impressive and perhaps a big positive outlier. That said, such large relative "outperformance" in 2022 by the simulated High Yield Dividend Newsletter portfolio relative to the broader markets should be viewed as somewhat atypical. Still, the strength does speak to the merits of our high yield dividend idea generation process, as rising interest rates pummeled many interest-rate sensitive sectors.

It's worth emphasizing, however, that any investment in any financial instrument comes with substantial risk of capital loss. You also must know that investing is a long-term proposition, and it is within the realm of possibilities that individual ideas in the simulated High Yield Dividend Newsletter portfolio might experience a 10%-15% pricing decline or more, even as they pay out a collective yield of 5%+. We saw these types of declines during 2022 with a few of our high yield dividend ideas, but having a few ideas not work out in a widely diversified portfolio is just par for the course in investing.

It should be expected.

For example, Digital Realty Trust (DLR), which we removed from the simulated High Yield Dividend Newsletter portfolio November 2, 2022, had a very rough 2022 as business fundamentals weakened, its short thesis strengthened, and interest rates rose. We're glad to have moved beyond DLR, particularly in the context of how well the ideas in the simulated High Yield Dividend Newsletter portfolio are doing collectively,

and we're not looking back. We don't want readers to be distracted by one or two ideas when the overall newsletter portfolio is doing comparatively great.

Where in the case of Digital Realty Trust, where we felt more comfortable taking "risk" off the table, particularly in light of deteriorating fundamentals, we're sticking with newsletter portfolio idea underperformer CubeSmart (CUBE) for the time being. The REIT has faced some pressure during 2022, but we continue to be long-term fans of the self-storage space, though we note that the self-storage space may be getting a bit crowded, at least from anecdotal hearsay we've been witnessing across social media channels (i.e. Twitter). In any case, we're sticking with CUBE for now, but we view it as a source of cash, if needed.

Let's talk more about what high yield is, and what it isn't, but first some background on the investing categories, more generally. Capital appreciation, or betting on pricing action, and yield-seeking are two separate things, analytically independent of each other, but sometimes misunderstood by the marketplace. This newsletter is focused specifically on high yield, which is another way of saying high risk. A focus on high yield doesn't always mean that ideas will be the best long-term considerations for price appreciation.

What a company pays out today as a dividend/distribution relative to its price today has little, if anything, to do with its long-term intrinsic value calculation, which is based on balance sheet health and future forecasts of free cash flows. Remember: The dividend is capital appreciation that otherwise would have been achieved had the dividend not been paid. The recent rise in short-term interest rates has only complicated the high yield investing landscape, too.

As interest rates rise, for example, the demand for high-yielding equities (and their prices) may fall, as investors opt for "riskless" Treasury assets with secured yields rather than "risky" equities that are exposed to gyrating market forces. The market seems to have started to phase this in a bit with the recent broad-based declines of real estate investment trust (VNQ) equities and mortgage REIT (REM) equities in 2022.

In high yield, you must be aware of the big risk that is rising interest rates. This is unavoidable, but we're worried that many investors searching for yield today may be

taking on way too much risk for their respective personal profiles. It couldn't have been 15-20 years ago, for example, that investors could get a 6%-7%+ yield on a 1-year certificate of deposit (CD) from the local bank. I know because I had one. But CDs are coming back into vogue these days. Marcus and Synchrony, for example, are offering ~4%+ yields on near-term CDs, while I-bonds also are offering even higher rates.

Please always work with your personal financial adviser or seek professional help to determine if any idea or strategy may be right for you. Said bluntly, the ideas in the High Yield Dividend Newsletter may not be your cup of tea, especially in an aggressively rising interest rate environment. We've done a fantastic job showcasing the resilience of *our* diligent process as executed in the simulated High Yield Dividend Newsletter portfolio in 2022, but the high yield dividend arena, in general, is ripe with huge risks and past results are no indication of future performance.

Stock prices can go down, and equities with high yields often have an investor base solely focused on the yield, which complicates matters. That means many ideas highlighted in this newsletter are exposed to what is often called a "clientele effect." In the event that a high-yield equity comes under suspicion of a dividend cut, its price may experience a considerable decline in advance of the dividend cut as income-seeking investors bail, resulting in not only capital impairment but also reduced income if or when the dividend cut happens.

We've seen this happen across the high yield dividend space too many times to count, and we've always cautioned about the risk of high yielders, avoiding them whenever possible in our various other publications because they are downright risky. In this newsletter, however, we are steering as prudently as possible through the high-yield dividend universe, as if we're playing in a mine field trying to avoid having any material high-yield blowups across the simulated newsletter portfolio.

Frankly, when it comes to high dividend yields, it's like "no-man's" land, and most of our efforts will be spent hunkering down in the trenches, trying to avoid stepping on what could be called high-yield landmines. We think success in the simulated High Yield Dividend Newsletter portfolio, as revealed in 2022, will come from avoiding "unforced errors," and avoiding mistakes, rather than simply chasing the highest

yields, as many others try to do. If we venture too far into "no-man's" land – chasing too high of a yield -- we could get burned and burned bad.

With interest-rate risk and dividend-yield ("clientele effect") risk clearly stated, we're also worried about the general make-up of the equity markets these days. With the proliferation of index investors and quantitative investors, many of whom are using backward-looking information, not many market participants are paying attention to the price-to-fair value consideration. This has considerable implications on the traditional underpinnings of equity valuation and the thousands of books written on "value investing" in decades past.

If, for example, very few are paying attention to the price-to-fair value equation, will stocks ever be bid toward their fair values? We think so, of course, but with estimates suggesting only 10% of trading on the markets today is coming from traditional, fundamental investors, we're taking note of the risks, and we think you should, too. After all, the GameStop frenzy showed just how volatile things can get. Savers need not have their hard-earned capital in such an environment should our worst fears come to pass.

Let's talk a bit about the simulated High Yield Dividend Newsletter. In the portfolio, we highlight considerations that are, by definition, riskier than the average equity. There's a reason why such considerations have high yields in the first place, and it is not because they are of the low-risk variety. The sustainability of their yields and the uncertainty of their business structures hold considerable risk, but we're hoping to take an approach to mitigate some of the risk within the portfolio context.

Will our approach guarantee that we won't have a dividend cut from an idea in the simulated newsletter portfolio? No. Unlike the simulated Dividend Growth Newsletter portfolio and the ideas within it that have strong "cushions," most entities in the high-yield arena are already maxing out their payouts and don't have much cushion to guard against exogenous events or cash-flow shortfalls at all. This is what makes them quite risky.

Dividend cuts are not only possible but may even be probable in the simulated High Yield Dividend Newsletter over a long-enough time period, and if they happen, it

should not come as a surprise. We're after high yield, and by very definition, a high yield implies high risk. Diversification will be key across the board, and this served the simulated newsletter portfolio particularly well in 2022.

With all of this said, let's talk through our approach to high yield dividend payers. Because this is a High Yield Dividend Newsletter, we're obviously targeting high yields, and to get things started, it's worth noting that the simulated newsletter portfolio strives to sport a collective yield in excess of 5%-6%, but it could dip down to 4-5% and sometimes rise to 6%+ depending on market conditions.

We think this is pretty good target yield--nearly twice that of the simulated Dividend Growth Newsletter portfolio and more than 3 times that of the average company in the S&P 500. It's also higher than many traditional dividend-oriented ETFs, so we think we're adding considerable value with this diversified list of ideas. We don't want to chase fantasy yields of 9%-10%+, and we're not interested in ideas that have yields below the average of the S&P 500 (~1.6% at the time of this writing).

During the past few years, the estimated forward dividend yield on the simulated High Yield Dividend Newsletter portfolio has moved up and down, and dipped more recently, but the lower yield was largely due to strong market performance and a more conservative and diversified stance with new portfolio selections, an overall strategy that paid off tremendously in 2022 with considerable relative "outperformance." The estimated forward dividend yield of the simulated High Yield Dividend Newsletter portfolio can be found on the newsletter portfolio page.

That said, and as mentioned previously, many of the high yield ideas will be high risk, and part of the high risk will come in the form of capital-market dependency. In the event of another credit crunch like that which occurred during the Great Financial Crisis, we would expect the simulated High Yield Dividend Newsletter portfolio to substantially trail that of the market return and even a broad basket of entities called the Dividend Aristocrats, which generally may be more recession resistant.

Let's explain capital-market dependency? Capital market dependency, by our definition, is derived by comparing a firm's traditional free cash flow generation with its cash dividends paid. If its cash flow from operations less all capital investment is

less than normalized cash dividends paid, it means that the entity must access the capital markets through debt or equity issuance to make up for the shortfall. It is dependent on the capital markets.

Many ideas in the simulated High Yield Dividend Newsletter portfolio need a healthy functioning of the capital markets. Because of this capital-market-dependency risk and because many have little cushion against external shocks, an evaluation of credit quality is paramount. It sounds somewhat counter-intuitive, but we think one of the most important considerations for an equity-heavy simulated High Yield Dividend Newsletter portfolio of ideas is the respective credit quality of constituents, or their corporate credit ratings.

We need to know, for example, how open the debt markets will be to funding operations through thick-and-thin and preserving their payouts if things really head south. As such, we tilt toward investment-grade credits in the simulated newsletter portfolio, and we can't see it another way: When it comes to high yield, access to new capital is going to matter. We may have an idea or two with a non-investment grade credit rating, but one can't become too enamored by the size of the yield. Without access to capital, the payout could go away in a hurry.

Each simulated newsletter portfolio at Valuentum targets a different strategy, whether long-term capital appreciation, dividend growth, income/high yield, and the like. Generally, for the simulated Best Ideas Newsletter portfolio, it targets long-term capital appreciation potential (not in one year or a couple years, but in the long run), whereas the simulated High Yield Dividend Newsletter portfolio in this publication targets capital preservation and high yield/dividend income.
We hope you enjoy this publication, and if you have any questions, please don't hesitate to reach out.

Thank you for your membership!

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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Amended June 1, 2021.