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The Advisor

QUARTERLY NEWSLETTER

2021 Q4 REVIEW:

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GENERAL MARKET COMMENTARY

Companies, many of which are represented in our core portfolio holdings, continued to report excellent earnings growth throughout the fourth quarter despite dealing with supply shortages, transportation issues, increased labor costs, and lack of workers.

Although there are signs that the worst of the supply issues may be behind us, the lack of workers persists and likely won't be going away anytime soon. These issues delay the shipment of orders, diminish productivity, and reduce profit margins. However, corporate managements have done an excellent job of meeting these challenges by focusing on reducing costs, creatively finding alternative materials, and increasing prices. This has led to The Dow Jones Industrial Average, the Standard & Poor's 500 Stock Index, and the NASDAQ Composite Index ending the year with gains of 18.7%, 26.9%, and 21.4%, respectively. The third year in a row of strong double-digit increases!

The economy is strong and will likely remain so well into the start of 2022 along with robust earnings growth. The consumer has a strong balance sheet and is spending money. Businesses, particularly travel, entertainment, and service establishments, are recovering. Big box retailers such as Costco, Target, and Walmart are experiencing remarkable same store sales growth. Home Depot is seeing increasing revenues due to the strong demand for home improvement projects, and Deere & Company is experiencing robust demand for agricultural products resulting in a nearly full order book for their current 2022 fiscal year. Electricity demand is bouncing back, with a focus on transitioning to green energy generation.

One notable piece of information from the earnings conference calls came from General Motors (GM). Normally, they have approximately 800,000 cars in dealer lots throughout the United States. Today they have just 125,000.

Vehicle production will be increasing as the chip shortage eases and that will help companies such as Corning, DuPont, 3M, and many other suppliers to the auto industry. We doubt, however, that they will be going back to prior inventory levels. Instead, tight and balanced inventory levels will be used to maintain profitability. It is our opinion that consumers should be prepared for future vehicle prices to increase 5% or greater per year under normal economic conditions.

In addition, over the next 4 years, GM will be introducing an impressive line-up of electrical vehicles (EVs) that will accelerate the transition to a net zero carbon future. The Hummer is now being delivered and orders for the first Cadillac EV were sold out in 10 minutes with another model being introduced in mid-2022. At the upcoming Consumer Electronics Show (CES) in early January, GM will be unveiling their new Chevrolet Silverado EV. This will be followed by a new Chevy EV sedan with a price point around $30,000 in the fall.

GM may be viewed as your grandfather's stock and perhaps not as interesting as Tesla, Lucid, and Rivian Automotive. But the company is led by an outstanding Chairman and CEO, Mary Barra, who has a grand vision for consumers — one with zero crashes, zero emissions, and zero congestion.

Ford Motor Company, another US automaker that may also be viewed as your grandfather's stock, is making a foray into the EV market. In November 2021, CEO Jim Farley announced that Ford plans to increase EV production capacity to 600,000 units globally by 2023. The new Ford F-150 Lightning pickup has been well received by the public with reservations approaching 200,000. Ford has ambitious plans to be the #2 EV manufacturer within two years.

One significant event that occurred during the quarter that affected stock market averages, and will in the future, was the passage of the Infrastructure Investment and Jobs Act (Infrastructure Bill), which was signed into law in November. This Act will repair and upgrade roads, bridges, ports, airports, rail lines, upgrade public transit, provide broadband access to rural areas, and build a national network of EV charging stations. Projects will commence in late Q1 of 2022 and will contribute to economic growth, likely for many years in the future. Companies that will benefit include those that make large equipment such as Caterpillar and Deere along with a wide range of others that manufacture products that support the activities listed above.

Inflation concerns became the topic de jour as high single digit inflation increases were reported over several months in 2021. Reappointed Federal Reserve Chairman, Jerome Powell, became more vocal about the need to address these wide-spread concerns. An investor can now assume that after many years of maintaining a near-zero interest rate monetary policy by the Federal Reserve, sentiment is changing.

In 2022, the era of easy money will end and short-term interest rates will begin to increase. Market volatility and overall performance in 2022 will be tied to inflation and continued economic growth. We suspect that the economy, stimulated by the $1.9 trillion American Rescue Plan Act of 2021 last March and the recently passed $1.2 trillion Infrastructure Bill, will spur economic growth throughout 2021 and beyond. Inflation, however, will be the unknown variable that will affect stock market performance.

Inflation puts pressure on corporate profit margins as there is a lag affect prior to cost increases being passed along. The consumer, who drives the economy, is also squeezed by inflation. Their real purchasing power is reduced. Ultimately inflation increases moderate, profit margins and consumer purchasing power is rebuilt, economic growth occurs, and equity appreciation resumes. Indications are that inflationary increases will moderate next year. How much? Nobody knows, but the smaller the monthly increase, the better stock markets will perform.

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The utility sector today provides attractive investment opportunities for investors. This heavily regulated industry is not one you check daily to look up the price changes of a specific company. Changes are usually small and boring. But a utility stock generally appreciates by the rate of its earnings per share growth which is typically 4 - 7% per year. They also provide dividends that go up about the same rate. You can see that a 2.5 - 4% annual dividend, along with mid-single digit appreciation, makes for an attractive total return. In addition, the industry will benefit from the recently passed Infrastructure Bill as $65 billion is earmarked for power grid updates and clean energy funding.

Numerous dividend increases were announced during the quarter. These included moderate single digit increases of

4 - 9% from companies such as AbbVie Inc., Abbott Laboratories, Dominion Energy, Inc., and Starbucks Corporation. Double digit increases were reported by Motorola Solutions, Inc., and Zoetis Inc. Given the strong earnings momentum, we expect dividend increases to continue into 2022, which will provide benefits to investors of all age groups.

Many people don't fully comprehend the importance of dividend increases. When hearing of or looking at the percentage increase we like to ask ourselves, "how long it will take for my money to double?" In other words, if I receive $500 in dividend income, how many years will it take for my income to reach $1,000?

Dividends are not guaranteed, nor are earnings always steady and robust, but a 7% annual increase will double your income in 10 years. Then, if you continue adding new money to your investments on a regular basis, the doubling will occur sooner since you are purchasing additional shares. Dividends and dividend increases are a powerful tool in creating future financial security but are often overlooked by the market.

Most of the focus is on momentum stocks and what's moving now or what's hot. However, new and mid-career investors should be thinking well ahead and continuously be building up or adding to a dividend growth portfolio. Investors should look at stocks that may not be in the news daily but ones that have a history of value creation and are less volatile than the market. Some examples are Abbott Laboratories, Duke Energy, Honeywell International Inc., Lockheed Martin Corporation, and Nestle S.A. Someday you will be glad you did.

One important fact that people forget is the tax advantages of holding dividend-yielding stocks or mutual funds outside of a retirement account or a qualified plan. Since the beginning of 2003, dividends have been taxed at a reduced rate of 15% for federal income tax purposes for most American taxpayers.

For high income individuals in 2022, the rate increases to 20% when income exceeds $517,200 for a married couple filing jointly. In any case, a 4% dividend payment will yield 3.4% after tax assuming 15% is lost to federal taxes. The yield would be a little less if state income taxes are considered. Regardless, the yield is attractive given today's level of fixed income rates and is an incentive to build and maintain a non-IRA investment portfolio of dividend-yielding stocks throughout one's working and investment years.

Regardless of what 2022 or 2023 brings, we continue to invest for the long term with an emphasis on quality, value, growth, and the production of cash flow (dividends) into the portfolio. It is this income that gives the investor choices. They may use the income for living expenses or for their use and enjoyment activities. For new or mid-career investors, it allows them to reinvest their dividends into existing or new positions and compound their future cash flows, helping to create a comfort level in down and volatile markets.

FINANCIAL PLANNING – BUILD BACK BETTER ACT (BBBA)

One other notable event that occurred in Q4 was the House passing the BBBA legislation. It was then stalled in the Senate and has been pushed into 2022.

We will have to wait and see what the outcome turns out to be. However, based on the House bill, we can now determine that some of the individual tax law changes have been dropped out of the bill from earlier in 2021. Most of these changes were concerns that earlier in the year caused some people to make portfolio adjustments.

No longer on the table are increases in the individual income tax rate, no increase in capital gains rates, no estate tax changes, and no elimination of the step up in basis for capital assets held until death.

Revenue raisers include a 15% minimum corporate tax, a 1% tax on stock buybacks payable by corporations, a 5% tax on adjusted gross income (AGI) above $10 million and a 3% surtax on AGI above $25 million. The SALT deduction cap was increased to $80,000 in the House passed bill and several retirement plan changes affecting Roth conversions and large or mega IRAs above $10 million will likely be enacted too.

2022 TAX CHANGES

Estate and gift tax breaks will be larger in 2022. You will now be allowed to gift $16,000 per donee or $32,000 if making a joint gift to children, grandchildren, friends, etc. without having to file a gift tax return. Remember, these limits do not apply if you are paying for someone's

> Avoid the crowd and focus on wealth creation over time!

medical bills or education costs. However, be sure to make out the check to the medical facility or educational institution.

The estate tax exemption will be increased to $12,060,000 or $24,120,000 for couples electing portability at the death of the first spouse.

401(k) contributions for people under 50 years of age have been increased to $20,500 with a $6,500 catchup provision for individuals age 50 and over. This brings their maximum contribution to $27,000.

INVESTMENT PLANNING FOR NEW INVESTORS

Avoid the crowd and focus on wealth creation over time!

Over the last couple of years there have been numerous new investors investing in the stock market, which we love to see! Investing in American industry is an appropriate way to provide for one's family and create financial security over time. However, there are no quick ways to get rich.

It is fine to include in your portfolio meme stocks, IPOs, pandemic-related names, and even crypto, but you must diversify. One can't concentrate in all the momentum-related stocks that everyone is buying.

Too often over the last year or so, we have heard of discouragement from new investors who, while well-meaning, have loaded up on what's hot through Robinhood — only then to see the value drop. Nothing against Robinhood or having an exciting name in your portfolio, but investment success takes time, patience, and diversification. Portfolios must include electric utilities, health care, pharmaceuticals, industrials, technology, and other categories. You should continuously add new money to your portfolio to either existing securities or new ones. Also, you should stay fully invested throughout market downturns. Patience will be required but the results will be very satisfying! Keep investing!

As always, we are here for you. Don't hesitate to contact us. For those in the northern states, stay warm!

Wishing you a happy, healthy, and prosperous 2022!

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