

Alley Company Dividend Portfolio 2020 Q4 Letter

January 15, 2021

“Our belief is that investors who keep their eyes on the longer term horizon ahead, and not on the unsettled ground at our feet, will experience the best investment outcomes in the future....” *April 16, 2020 Alley Company Dividend Portfolio Letter*

As we look back on 2020 through the lens of investment management, there exists a glaring paradox. On one hand, there was a global pandemic-induced economic recession with unrelenting bad news surrounding COVID-19, and on the other hand, a sharply recovering stock market that rebounded to all-time highs despite the challenging headlines. This paradox reflects the notion that the “economy is not the market and the market is not the economy!” The challenge for investors throughout 2020 was understanding the “discounting mechanism,” or forward-looking nature, of the stock market while coping with the real-time damage to the economy from COVID-19. This, of course, was not an easy task when one considers that there is no available playbook for investing in the first pandemic in over 100 years.

In retrospect, the stock market correction in February and March of approximately 34 percent in only 19 trading days was understandable given investors’ unfamiliarity with the effects of a pandemic on the economy. The market correctly forecasted an impending economic recession. But very soon after the bottom was made on March 23rd, the market began a steady rise to new highs throughout the remainder of the year, albeit with some significant volatility in the early going. This is where the discounting mechanism of the stock market kicked into gear and began forecasting well beyond the recession itself with an eye toward an eventual recovery.

As the year progressed, the following factors began to be discounted in the marketplace for their forward-looking impact on the economy:

- Favorable prospects for the medical science community to develop antivirals and vaccines to help deal with COVID-19.
- The Federal Reserve’s early and seemingly limitless liquidity response to the pandemic.
- The CARES ACT putting money directly into the hands of individuals and businesses.
- The prospect for corporate America to produce operating leverage in the coming quarters, whereby recovering revenue growth is matched against a lower cost structure resulting in an outsized boost to earnings.
- The adaptability of businesses to use technology to navigate and, in some cases, prosper in an uncertain business climate.

In real time, it was difficult for investors not to focus on the unsteady ground at their feet during 2020 – businesses closing, rising unemployment, COVID-19 cases and deaths rising, the second wave coming in the winter, a divisive election, etc. But the forward looking mechanism of the market paid very little attention to the here and now and pressed on to the future prospects for the economy given the aforementioned remedies.

The year 2020 has taught investors that investing is all about the future. And in that vein, our strongly held view for compounding investment returns over time is to own high quality companies that pay stable and growing dividends and have dominant market power in the markets they serve. As we look to 2021 and beyond, the wind appears to be at the back of a recovering global economy as the stock market has been signaling. There will surely be more corrections along the way as the market’s discounting mechanism continues to be at work, but in any case, staying with quality is always a good idea for the future.

Quarterly Performance Update

During the fourth quarter, the Alley Company Dividend Portfolio trailed the sharp increase of 16.25 percent for the Russell 1000 Value Index. This is not surprising given the relatively defensive nature of the high-quality dividend holdings in our portfolio. For the full year, the Alley Company Dividend Portfolio delivered substantial outperformance relative to the benchmark as our quality dividend payers held up much better earlier in the year and we benefited from strong security selection throughout the year.

From an individual holdings perspective, top contributors to and detractors from performance in the portfolio during the fourth quarter were:

<u>Top Contributors</u>	<u>Top Detractors</u>
Discover Financial (DFS) Phillips 66 (PSX) JPMorgan Chase (JPM)	Kimberly-Clark (KMB) Lockheed Martin (LMT) Home Depot (HD)

Top and bottom performing sectors in the marketplace during the quarter are displayed in the table below.

<u>Top Performing Sectors</u>	<u>Bottom Performing Sectors</u>
Energy (-) Financials (-) Industrials (-)	Real Estate (+) Consumer Staples (+) Utilities (+)

(+) indicates that the portfolio is overweight this sector and (-) indicates that the portfolio is underweight this sector relative to the benchmark.

Duke Energy (DUK) was added to the portfolio during the fourth quarter, while BCE Inc. (BCE) was removed from the portfolio. DUK owns and operates utility assets in the southeastern part of the U.S. and has made a concerted effort to transition assets toward running on renewable energy. While still early, this strategy should enhance the economic profile of DUK over time. BCE was sold primarily to make room for the new holding in DUK.

Portfolio weightings in Pepsico (PEP), Phillips 66 (PSX), and Starbucks (SBUX) were increased during the quarter, while Apple (AAPL) and Microsoft (MSFT) were trimmed back on strength.

Dividend announcements among Alley Company Dividend Portfolio holdings during the fourth quarter were:

<u>Company</u>	<u>Dividend Change</u>
Abbott Labs (ABT)	+25%
AbbVie (ABBV)	+10%
Crown Castle (CCI)	+11%
Merck (MRK)	+7%
RPM International (RPM)	+6%
Snap-On (SNA)	+14%

Alley Company Dividend Portfolio

The investment philosophy of the Alley Company Dividend Portfolio focuses on striking the balance between attractive absolute dividend yield and strong dividend growth underpinned by solid company fundamentals of our portfolio holdings. We employ a bottom-up, research-driven process focused on fundamental analysis of our portfolio holdings.

Alley Company, LLC

Alley Company is a boutique investment management firm that is dedicated to operating a discernible and disciplined investment philosophy and generating superior risk-adjusted investment returns. Alley Company was founded in 1998 and in 2006 established the Alley Company Dividend Portfolio to capitalize on investment opportunities in quality companies with strong dividend-paying cultures.

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