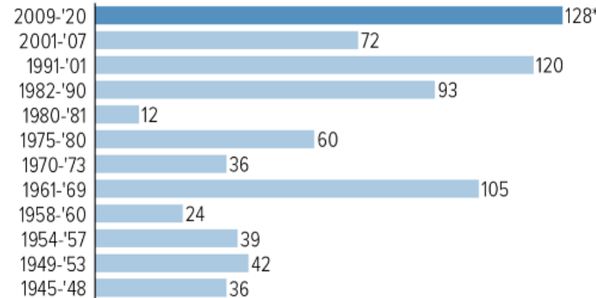
Alley Company Dividend Portfolio
2021 Q1 Letter

April 15, 2021

Heading into 2020, the U.S. economy was on an historic run. The economic expansion that started in 2009 was entering its 127th month, making it the longest business cycle on record. Unemployment, inflation, and interest rates were all at favorably low levels and supportive of durable economic growth.

The COVID-19 pandemic came out of left field and abruptly derailed the economy, throwing it and other countries around the world into recession. Thankfully, the U.S. banking system was in sound financial condition – the exact opposite of the Global Financial Crisis of 2008/2009 – and thus was able to support the functioning of the economy and financial markets. This, combined with bold action by the Federal Reserve and U.S. government, stabilized the economy in just a matter of months.



Now, as we look forward to getting back on track with the next economic expansion, there are a number of positive factors at play:

- The consumer is in the best financial shape in recent history.
- Innovation is plentiful and significant secular advances are occurring.
- Monetary and fiscal stimulus has been substantial and a multi-year infrastructure bill could be in the offing.
- Interest rates remain very low by historical standards with inflation most likely contained.

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The Consumer
Consumer spending represents nearly 70% of GDP in the U.S., making it a key ingredient for a recovery. By most accounts, the consumer looks to be in strong shape:

- Household debt as a percentage of disposable income is at its lowest level in over 40 years.
- The personal savings rate is approximately 14% (twice the rate of savings in recent years) providing dry powder for future consumption.
- While unemployment is relatively high at over 6% currently, it should drop as the economy reopens.

The largest risk to vibrant consumer activity in the near term is if new COVID variants emerge that require a step backwards to ensure containment.

Innovation
Significant technological innovation is reshaping and advancing our economy. Renewable energy, e.g. solar and wind, is augmenting the primary energy sources that power public utilities. Electric vehicles are reducing carbon emissions and reliance upon fossil fuels. 5G is increasing data speeds substantially and allowing for more applications/devices to be connected to the internet. And, as illustrated by the incredible work of scientists developing COVID-19 vaccines in less than a year, significant advancements are happening within the healthcare industry.

Monetary and Fiscal Policy
The Fed's response to the COVID-19 recession has been swift and accommodative. Furthermore, their recent policy shift to allow inflation to run higher than the 2% target before hiking interest rates has sent a strong message to markets that the Fed, with a keen eye on slack in the labor market, does not want to impede this economic recovery.

In terms of fiscal response, a total of $5 trillion has been extended to individuals, families, and businesses to help bridge the gap in lost economic activity in 2020. In addition, a long awaited infrastructure bill appears to be gaining steam and this too would strengthen the economic recovery and likely extend it.

Interest Rates and Inflation
Our "lower for longer" thesis on interest rates remains in place. The yield on the ten-year U.S. Treasury bond bottomed this past summer at 0.50% and currently stands at approximately 1.70%. At these levels, interest rates are *very supportive* of overall economic activity and there is still ample room for rates to increase before impacting a recovery.

Central to any discussion of interest rates is inflation expectations on both a short- and long-term basis. In the short term, inflation may tick higher than normal driven by the reopening of the economy, brisk consumer activity, and a restocking of the global supply chain. On a longer-term basis, the disinflationary forces of globalization and technology are alive and well. Both forces are likely to continue to moderate long-term inflation trends benefiting consumers with stable pricing for goods and services.

A moderate rise in interest rates from here is a reasonable base case. A clear risk would be an unexpected and substantial rise in rates in the near term, however this seems unlikely for a few reasons:

- The bond market is global in nature and with rates in other countries typically below 1% and in some countries (Germany and France) *negative*, a gravitational force exists limiting a decoupling from other markets.
- Many parts of the world are still battling deflationary pressures, which weighs on interest rates.
- Significant changes in interest rates typically take time to unfold over many years, if not decades.

Quarterly Performance Update

During the first quarter of 2021, the Alley Company Dividend Portfolio lagged the strong increase of 11.26 percent for the Russell 1000 Value Index. Performance within the index was skewed towards lower quality companies many of which do not pay a dividend to their shareholders. Given our focus on high-quality dividend payers, we would expect to trail the benchmark in this type of environment.

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

Top Contributors	Top Detractors
Snap-On (SNA)	Apple (AAPL)
Altria (MO)	Merck (MRK)
Chevron (CVX)	PepsiCo (PEP)

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

Top Performing Sectors	Bottom Performing Sectors
Energy (+)	Consumer Staples (+)
Financials (+/-)	Technology (+)
Industrials (+/-)	Utilities (-)

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

Illinois Tool Works (ITW) and U.S. Bancorp (USB) were added to the portfolio during the first quarter, while Kimberly-Clark (KMB) and Xcel Energy (XEL) were removed from the portfolio.

ITW's strategy of culling their portfolio of business units to focus on higher growth and higher margin opportunities has translated into strong operating results. Further, many of their business units look poised to rebound as the U.S. economy recovers. USB has an excellent track record of lending money to their customers. In addition, their credit card processing business, Elavon, is set to perform better as consumers emerge from the COVID-19 recession and spend money at

traditional brick and mortar locations. KMB and XEL were sold primarily to make room for the new holdings.

Portfolio weightings in Phillips 66 (PSX) and Snap-On (SNA) were increased during the quarter, while Accenture (ACN), Apple (AAPL), Microsoft (MSFT), and NextEra Energy (NEE) were trimmed back.

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

Company	Dividend Change
Arthur J. Gallagher, & Co. (AJG)	+7%
BlackRock (BLK)	+14%
Cisco Systems (CSCO)	+3%
Home Depot (HD)	+10%
NextEra Energy (NEE)	+10%
Prologis Inc. (PLD)	+9%

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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