

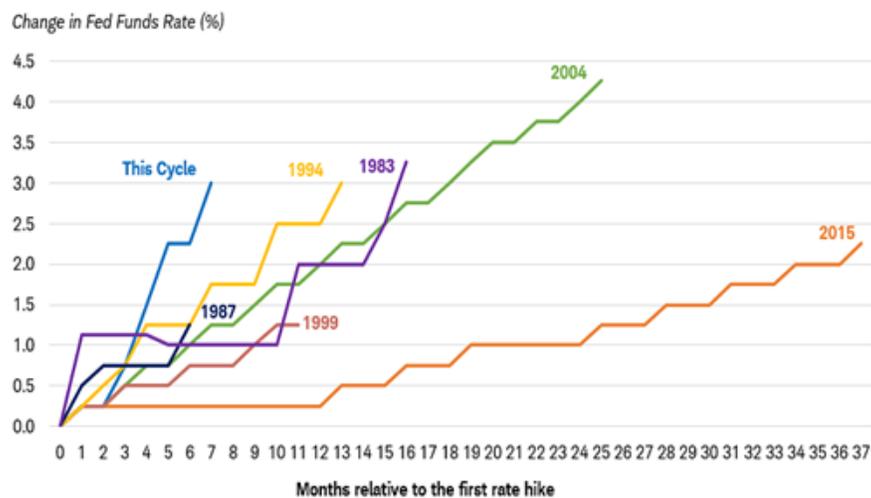
Alley Company Dividend Portfolio 2022 Q3 Letter

October 18, 2022

After being generally well controlled for multiple decades, inflation reared its ugly head as a by-product of the COVID-19 pandemic. A confluence of factors were at play: elevated demand stoked by accommodative fiscal and monetary policy; global supply-chain disruptions; tight labor markets; ongoing lockdowns in China; and Russia's invasion of Ukraine.

With the benefit of hindsight, the Fed was caught flatfooted in 2021 – initially believing that inflationary pressures would be “transitory” in nature. In 2022, the Fed has done an about face, proclaiming “resolve” to fight inflation and thus has been playing catch-up by raising interest rates at the most aggressive pace since the early 1980s.

Exhibit 1: The fastest rate hiking cycle since the early 1980s



Source: Charles Schwab. Bloomberg. Lines represent the cumulative change in the Fed Funds target rate from the start of each rate-hike cycle. For the current cycle, the Fed Funds target rate has risen 3%, to 3.25% from 0.25%.

Rapidly rising interest rates have no doubt had implications for financial assets. For stocks, a higher *discount rate* used in the calculation of present value of future cash flows has compressed valuations. As a result, the price-to-earnings (P/E) multiple on the stock market has moved to 15.1x compared to 21.4x at the beginning of the year.¹ As for bonds, when interest rates rise, prices fall, especially for longer-dated maturities that are most sensitive to rate volatility.

In our last quarterly letter, we contemplated the timing of the next recession. While impossible to pinpoint, we do know that financial markets move *ahead* of the formal evidence. Said differently, markets are discounting mechanisms, always trying to “price in” future fundamentals and at least a fair bit of negativity is already priced into markets.

Our view is that companies with market leadership positions, pricing power, and robust financial health are best positioned to navigate the choppy waters and could emerge even stronger on the other side of an economic cycle.

Furthermore, our longstanding belief in the investment merits of high-quality dividend payers is strengthened in the current environment.

During times of market volatility, cash dividends offer a tangible return on investment and the opportunity to re-invest back into the portfolio at attractive prices. In addition, high-quality companies that can sustain and *grow* dividends can provide a hedge against inflation/rising consumer prices.

To paraphrase a John D. Rockefeller quote: “nothing gives me more pleasure than seeing my dividends come in.”

Quarterly Performance Update

During the third quarter of 2022, the Alley Company Dividend Portfolio modestly outperformed the Russell 1000 Value Index and on a year-to-date basis is slightly ahead of the benchmark.

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

<u>Top Contributors</u>	<u>Top Detractors</u>
Starbucks (SBUX) Ameriprise Financial (AMP) Arthur J. Gallagher (AJG)	Verizon (VZ) Philip Morris International (PM) Crown Castle (CCI)

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>
Consumer Discretionary (+/-) Energy (-) Financials (-)	Communication Services (-) Real Estate (+) Materials (-)

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

No portfolio changes were made during the third quarter.

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

Company	Dividend Change
Accenture (ACN)	+15%
Altria (MO)	+4%
Duke Energy (DUK)	+2%
Honeywell (HON)	+5%
Illinois Tool Works (ITW)	+7%
Lockheed Martin (LMT)	+7%
Microsoft (MSFT)	+10%
Philip Morris International (PM)	+2%
Starbucks (SBUX)	+8%
US Bancorp (USB)	+4%
Verizon (VZ)	+2%

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

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.

¹ S&P 500 Index. Based on forward 12-month EPS forecasts.

The Alley Company Quarterly discusses general developments, financial events in the news and investment principles. It is provided for information purposes only. It does not provide investment advice and is not an offer to sell a security or a solicitation of an offer, or a recommendation, to buy a security. The statements and opinions contained herein are solely those of Alley Company and are based upon sources and data believed to be accurate and reliable. The Russell 1000 Value Index measures the performance of large- and mid-capitalization value sectors of the U.S. equity market. Additional information regarding Alley Company can be found by accessing the SEC's website at adviserinfo.sec.gov.