Reaves Asset Management

Review and Outlook

First Quarter 2020

	Q1 2020 Performance
Reaves LTV Wrap Composite[1] Gross of Fees	**- 17.47%**
Reaves LTV Wrap Composite Net of Fees	**- 18.04%**
Reaves Custom Benchmark[2]	**- 28.23%**
S&P 500 Index[3]	**- 19.60%**

Reaves Asset Management strives to invest in companies that we believe will be steady in good times and bad. We take comfort in knowing that essential electric, gas, water, and communications services will continue to be utilized even during this period of extreme economic disruption from the COVID-19 pandemic. While the companies in these sectors face operational disruption like every other, we believe, the financial impact is orders of magnitude smaller. Encouragingly, several companies in the portfolio have reiterated earnings guidance over the past couple weeks. We believe none of the current holdings have dividends that are in jeopardy, and we expect most companies in the portfolio to grow distributions this year.

We believe these types of characteristics leave the portfolio well-positioned during this highly uncertain time. Long-term growth plans for most are unchanged, driven by secular changes like the decarbonization of the power grid and an exponential rise in data consumption. In addition, several companies have issued debt in recent weeks, showing they continue to have access to capital in the worst of times. Also, the Federal Reserve's aggressive actions pushed interest rates lower which highlight the attractiveness of the dividends paid by most of the portfolio investments. Communications and utilities are two of the few areas investors can feel comfortable holding with today's economic unknowns and volatility. We saw some of this play out already as many utility, data center, tower, and broadband companies rallied 20% to 30% in the last days of March.

Unfortunately, we are not out of the woods yet. We do not know how long the lockdown will last and how much economic damage will occur because of it, nor do we know when normal life will resume. There is likely to be permanent impairment of value in several industries. We were encouraged by the response of the Federal Reserve to keep the market functioning, but the fact that the Fed had to provide trillions of liquidity in the first place shows how much leverage is in the system and how susceptible the market remains to economic shocks.

The upside to all that liquidity is that it may find its way into stocks. Short-term interest rates declined to negative territory at the end of March, incentivizing those with money market funds to re-allocate to higher risk assets. We believe some of those investors will look for companies like utilities that have suffered little financial impact, or, in the case of communications companies, have improving fortunes as a result of the quarantine. We are looking at utilities with high-quality regulation, automatic capex trackers, and bad debt recovery, and communications companies that are well-positioned to benefit from increased data demand. Volatility is likely to remain high, especially until we know what the total economic damage looks like, so we retain a higher-than-normal cash balance.

PORTFOLIO DISCUSSION

Communications

The portfolio's investments in communications[4] generated a return of -11.2% in the first quarter of 2020, comfortably outperforming the S&P 500 Telecommunications Services[5] Index (-17.4%). Our communications and real estate investments, representing more than 20% of the total portfolio at quarter's end, were the standout performers. Specifically, each of our data center and tower investments generated positive absolute returns during the market's worst quarter since the financial crisis of 2008. The safe-haven qualities of growing dividends and secular growth drivers proved resilient for those two business models.

The rally in shares of SBA Communications, a tower REIT that returned 50% in 2019, continued into the New Year. SBA is the closest thing in existence to a pure play on U.S. towers. The combination of new wireless spectrum being auctioned by the government with investment plans contemplated as a result of the T-Mobile and Sprint merger was positive for towers. Specific to the deal, wireless spectrum that was previously auctioned to both Sprint and DISH Networks will finally be deployed, creating new revenue for companies like SBA. Towers have rising dividends, accelerating growth, and the safe-haven of high-quality, long-term tenants investing to satisfy the ever-increasing underlying demand for wireless data.

Like SBA, Equinix shares extended a rally into the first quarter after returning 69% in 2019. The underlying driver of the Equinix business model is the outsourcing of IT budgets to the cloud. We've all become increasingly reliant on the connectivity that enables tele-commuting, tele-health, and tele-education, highlighting the important role a data center like Equinix plays. As companies increasingly transact commerce in the cloud, we think that the monthly fee paid by businesses to data centers like Equinix is perhaps their second most critical bill after electricity.

Our investments in cable were somewhat more mixed during the quarter. Both Charter and Altice USA outperformed the benchmark as investors took comfort that the cable cash flow was better insulated from recessionary fears than most other segments of the economy. However, a position in Comcast was a drag on returns as investors worried about the company's exposure to media and theme parks. Obviously, we didn't anticipate the abrupt slowdown in these entertainment segments, but as both investors in Comcast and consumers of content, we hope to be sharing in the upside from these sorts of activities again in the future.

Utilities

The portfolio's investments in utilities generated a return of -15.1%, underperforming the S&P 500 Utilities Index[6] return of -13.5%. The largest utility holding, NextEra Energy, was a standout performer with a flat return in the quarter, but the portfolio was dragged down by companies with economic sensitivity and high debt levels.

NextEra Energy continued to act as a safe-haven, and for good reason. The company is the largest utility by market capitalization in the United States and operates in the one of the most constructive regulatory environments in the country. It also is the biggest developer of wind and solar power in the country. Renewable development should continue unabated as growth is driven by economics. New wind and solar are two of the cheapest forms of new electricity for most utilities, and the rapid declines in battery prices mean that reliability is less of a problem. According to management, the company can grow earnings six to eight percent per year through at least 2022, and in this economic environment, reliable growth is at a premium. Several utilities in the portfolio fit this profile, and we believe investors may focus on them as panic selling ends.

Sempra Energy, on the other hand, was the worst contributor to performance in the sector after the stock dropped nearly 50% from an all-time high in the middle of February before regaining some of those losses in the last two weeks of the quarter. The base utility business is strong with operations in Southern California and Texas, but investors became increasingly concerned about its LNG[7] business, its stake in a Mexican pipeline company, and its ability to close the sale of Latin American utility assets to a Chinese investor. Sempra held a virtual analyst day near the end of the quarter to allay many of these fears and encouragingly reiterated guidance, helping the stock to rally from its low of $87 to $113 in two weeks.

Several other utilities joined Sempra in reiterating guidance. The services are essential, and many companies have regulatory mechanisms that enable them to endure short-term disruptions better than most industries. Consensus earnings expectations are little changed for most stocks, and we expect dividend growth to continue as planned across the sector. Valuations have fallen, creating compelling opportunities for many of the highest quality utilities.

Transportation and Energy

The portfolio's investments in transports and energy generated a return of -33.9% in the quarter while the S&P 500 Energy Index[8] lost 50.4%. The saving grace, if any, were that the sectors had a combined weight in the portfolio in the 20% range at the beginning of the year, and most of the oil and gas production companies were sold prior to the panic. Our best performers were Canadian National Railway and TC Energy as Canadian equities generally were more stable than U.S. equities during the worst of the selling in March.

Unsurprisingly, the emergence of COVID-19 and associated lockdown fundamentally altered the outlook for both rail volumes and demand for oil. While the recession risk is acute, the sector remains attractive long term. Rail margins have been improving because of industry efforts to modernize logistics and implement precision railroading principles into their operations. While the prospective recession will impact some of these positive trends, we do not expect permanent loss of capital or reduction in dividends.

In energy, the impact of lower prospective demand was compounded by the Saudi decision to raise production at the OPEC[9] meeting in March. The Kingdom had hoped for a deal with Russia to curtail production, but after no deal was reached, it increased production to force the Russians back to the negotiating table. This proved to be a one-two punch for the U.S. energy industry already reeling as a result of poor returns and the growing importance of ESG[10].

While a deal to cut production was reached shortly after the end of the first quarter, the long-term outlook for fossil fuel producers and associated industries remains challenged. Climate regulation and electrification of transportation will likely become increasingly difficult hurdles for the industry to overcome.

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For further information contact:
Thomas M. Grimes
Director of Marketing
Reaves Asset Management
10 Exchange Place, Jersey City, New Jersey 07302
Telephone 201.793.2384
Fax 201.332.8593
tgrimes@whreaves.com
reavesassetmanagement.com

[1]*Reaves' Long Term Value Wrap Composite contains those Long Term Value Strategy (LTV) discretionary SMA portfolios with wrap (bundled) fees. This bundled fee includes the wrap sponsor fee, as well as, Reaves' investment advisory fee. We are unable to identify the transaction costs included in the fee; therefore, net-of-fees returns would be net of the highest wrap fee provided to Reaves (300 basis points through 12/31/16 and, effective 1/1/2017, 250 basis points). The inception date of the composite is December 2002; however, the composite was created in January 2013. This composite has been managed in a similar manner to the Reaves Long Term Value Strategy ERISA Composite which ended in December of 2019. The LTV Wrap Composite does not represent all of Reaves' assets under management.*

[2]*Reaves Custom Benchmark is comprised of 33.3% S&P 500 Utilities Index, 33.3% S&P 500 Energy Index, 33.3% S&P 500 Telecommunications Services Index, rebalanced monthly.*

[3]*The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The typical Reaves portfolio includes a significant percentage of assets that are also found in the S&P 500. However, Reaves' portfolios are far less diversified, resulting in higher sector concentrations than found in the broad-based S&P 500 Index.*

[4]*Communications investments include Communications Services and Real Estate Investment Trusts (REITS).*

[5] *The S&P 500 Telecommunications Service Index is a capitalization-weighted index which is a subset of the S&P 500 Communications Services Index and is comprised of those companies included in the S&P 500 Index that provide wireline and wireless telecommunications services.*

[6] *The S&P 500 Utilities Index is a capitalization-weighted index containing 28 electric and gas utility stocks (including multi-utilities and independent power producers) in the S&P 500 Index that are classified as members of the utilities sector.*

[7]*Liquefied natural gas (LNG) is natural gas that has been converted to liquid form for the ease and safe of transport.*

[8] *The S&P 500 Energy Index comprises those companies in the S&P 500 that are classified as members of the energy sector.*

[9] *The Organization of the Petroleum Exporting Countries (OPEC) is a group consisting of 14 of the world's major oil-exporting nations. OPEC was founded in 1960 to coordinate the petroleum policies of its members and to provide member states with technical and economic aid.*

[10] *Environmental, social and governance (ESG) criteria are a set of standards for a company's operations that socially conscious investors use to screen potential investments.*

Reaves' portfolio characteristics, holdings and sector weightings are subject to change at any time and are based on our *Long Term Value Strategy SMA Wrap Composite* portfolio. Holdings, sector weightings and portfolio characteristics of individual client portfolios may differ, sometimes significantly, from those shown. This information does not constitute, and should not be construed as, investment advice or recommendations with respect to the securities and sectors listed.

An investor cannot invest directly in an index.
Past performance is no guarantee of future results.