

Market Commentary

Third Quarter 2021

REVIEW AND OUTLOOK

The **Reaves Dividend Income Strategy's** composite performance was strong in July and August before a change in sentiment due to worries about inflation and a slowing economy led to a selloff in September. The portfolio, net of fees, was down 0.8% in the third quarter which reduced performance for the first nine months of 2021 to about 6.8%. The current yield on the portfolio is 4.0%.

The U.S. 10-Year Treasury rate¹ rose from 1.30% to as high as 1.55% during September as Federal Reserve officials indicated they were planning to taper the pace of asset purchases, sparking the selloff. Several companies issued earnings warnings due to supply chain issues and a tight labor market which added to the anxiety. All but one sector in the S&P 500 Index² fell in the month, with income sectors generally performing worse.

The outlook remains strong for the composite's stocks despite the recent quarter's performance. We invest in companies that we believe have a high degree of certainty for compounding earnings and cash flow growth, characteristics that could become more appealing in an unsettled economic environment. We think many of the companies in the portfolio can grow earnings in the mid-to-high single-digit range, which when combined with dividends and/or share buybacks, provides the potential to generate competitive returns. Valuations across the portfolio remain attractive, especially relative to the S&P 500. The beta of the portfolio relative to the S&P 500 Index since inception is 0.71.

PORTFOLIO REVIEW

At quarter's end, the portfolio remained concentrated in dividend-paying stocks of companies which own essential infrastructure assets. Most income-oriented sectors were impacted by volatility in interest rates during the quarter, which declined in July and August before rising sharply in September. On the following pages, we briefly highlight factors we believe influenced the performance of the best and worst performers in the quarter.

| <i>Top 5 Contributors in Q3</i> | <i>Symbol</i> | <i>Contribution (basis points)</i> |
|---------------------------------|---------------|------------------------------------|
| CoreSite Realty | COR | + 30 bps |
| Southern Company | SO | + 29 bps |
| BCE, Inc. | BCE | + 28 bps |
| NextEra Energy | NEE | + 20 bps |
| Public Service Ent. Group | PEG | + 18 bps |

CoreSite Realty's management increased guidance on its second quarter conference call and indicated that new lease momentum has picked up. Given the company's significant existing and easily developable capacity, investors began to anticipate improvements to already strong returns on invested capital and accelerating growth.

Southern Company's stock rose in the third quarter after investors received a positive update from management regarding the Vogtle nuclear plant and effective completion of the hot functional testing (HFT) milestone during the quarter. HFT was one of the more complex and uncertain steps of the process, and the revised plant completion date of June 2022 aligns with the timeline laid out by the Georgia Public Service Commission staff. Additionally, ahead of a January 2022 integrated resource plan filing, investors are beginning to take a favorable view towards capital expenditure upside opportunities that may arise over the next decade from early retirement coal. The company points to a \$5 billion to \$8 billion incremental investment opportunity.

BCE, Inc. continued to perform well during the quarter, buoyed by solid operating results, a favorable macro backdrop, and an easing of pressure on wireless prices as the worst part of the pandemic for wireless operators was lapped.

NextEra Energy's stock rallied after announcing a settlement in its Florida rate case, helping it to bounce back from its underperformance earlier this year. The constructive outcome should continue to allow the company to invest aggressively in renewable power and grid reliability.

Public Service Enterprise Group may be a beneficiary of an anticipated nuclear tax credit in the Infrastructure Bill. Optimism about nuclear technology has rebounded recently as lawmakers have begun to acknowledge the important role 24-hour power production with zero-emissions has in energy transition. High costs and low power prices have pressured operators to shut down plants in recent years, so a tax credit is needed to keep nuclear operational.

| <i>Top 5 Detractors in Q3</i> | <i>Symbol</i> | <i>Contribution (basis points)</i> |
|-------------------------------|---------------|------------------------------------|
| Pinnacle West | PNW | -69 bps |
| Cogent Communications | CCOI | -41 bps |
| Crown Castle | CCI | -35 bps |
| Edison International | EIX | -15 bps |
| Verizon Communications | VZ | -15 bps |

Pinnacle West had the largest negative contribution to performance in the quarter. The company faces an increasingly hostile regulatory environment, highlighted by recommendations to reduce the allowed return on equity. The decline means that the stock now has the

second highest dividend yield in the utility sector, but future growth may be at risk should the worst of regulatory outcomes come to pass.

Cogent Communications continues to benefit from outsized growth in its net-centric business segment, especially in international markets where the company has relatively favorable economics. However, concerns about the Covid Delta variant and ongoing delays in office reopening has led to concern about the near-term prospects for the corporate segment.

Shares of **Crown Castle** were hurt by a late-quarter spike in interest rates, but relative under-performance can best be explained by its business mix. Crown's investments in fiber and small cells over the years are unique amongst macro tower operators and are best suited for later stages of wireless generations whereas the market is in the early days of 5G deployments. While Crown is seeing significant demand for its macro towers, small cell activity has ground to a halt making for a less favorable near-term setup when compared to peers.

Edison International's stock declined by nearly 6% in July after an early start to wildfire season, though containment efforts over the past month seem to have been successful. As a result, the stock was one of the stronger performers in the utilities sector in September.

Lastly, **Verizon Communications** was negatively impacted by worries about the U.S. wireless market becoming more competitive as cable companies have shown accelerating subscriber growth. While Verizon's mobile virtual network operator agreement currently benefits from this growth, cable companies have started to drop prices and may begin to take share from the wireless companies. In addition, AT&T signed a long-dated, wholesale deal with DISH Network that allows them time to build out a competitive network. The agreement effectively creates a fourth wireless company, likely leading to a more challenging competitive environment going forward.

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¹ The 10-Year U.S. Treasury Note (UST) is a debt obligation issued by the United States government with a maturity of 10 years upon initial issuance. A 10-Year U.S. Treasury Note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity. The U.S. government partially funds itself by issuing 10-Year U.S. Treasury Notes.

² The S&P 500 Index ("S&P 500") 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.

Beta measures a stock's volatility relative to the broad market. A stock with a beta higher than 1.0 has historically been more volatile than the market, while a stock with a beta lower than 1.0 has been less volatile.

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This document is a supplement to the Fact Sheet for the [Reaves Dividend Income Strategy Third Quarter 2021](#).

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All investments involve risk, including loss of principal.

All data is presented in U.S. dollars.

Cash is cash and cash equivalents.

An investor cannot invest directly in an index.

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Please contact your financial professional, or click the following links, for a copy of Reaves' [Form ADV Part 2A](#) and [Form CRS](#).

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