Reaves Asset Management

# Market Commentary
## First Quarter 2022

### REVIEW AND OUTLOOK

The defensive characteristics of the Reaves LTV investment strategy helped to minimize portfolio declines during a volatile first quarter of 2022. The Reaves LTV Wrap Composite declined by 2.2% in the quarter, before fees. Over the past five years, the portfolio's annualized return of 9.9%, before fees, is in line with our expectations given anticipated contributions from earnings growth and dividend yield generated by the portfolio's companies. The portfolio's beta over the last five years was 0.74, slightly above the portfolio's beta of 0.71 since inception in 2003.

| *Performance as of 3/31/22* | Q1 2022 | 1 Year | 5-Year Annualized |
|---|---|---|---|
| LTV Wrap Composite, gross of fees[1] | -2.22% | 11.82% | 9.85% |
| LTV Wrap Composite, net of fees[1] | -2.84% | 9.08% | 7.16% |
| MSCI USA Infrastructure Index[2] | 4.40% | 11.89% | 7.57% |
| S&P 500 Index[3] | -4.60% | 15.65% | 15.99% |

The invasion of Ukraine along with spiking commodity prices, rapidly increasing interest rates, and changing Federal Reserve policies led to deteriorating market conditions. From peak to trough, the S&P 500 Index declined 13% before rallying in the last two weeks of the quarter. The 10-Year U.S. Treasury Note yield jumped from 1.52% at the end of 2021 to 2.32%, while Brent crude oil spot prices doubled from a low just after Thanksgiving to the high in early March. Natural gas, corn, wheat, soybeans, and other commodities experienced similar increases, driving inflation above 8% during the quarter.

What may have been surprising to many investors was that utilities were the second-best performing S&P 500 industry sector during the quarter despite the increase in interest rates. Often seen as a bond proxy, the defensive nature of utilities proved to be an important factor as the fear of recession trumped rising rates.

Another factor supporting the positive performance of the utility sector may have been the decline in bond funds. This was highlighted by investment grade bond fund, iShares Core U.S. Aggregate Bond ETF (AGG)[4], posting the worst quarterly performance in its history. Investors may have rotated from fixed income to sectors like utilities because of their higher dividend yield, but more importantly, their ability to grow those dividends and potentially keep pace with inflation.

Energy transition and grid resiliency investments, we believe, should support long-term capital deployment opportunities and add to investor confidence for continued income growth in the sector.

## PORTFOLIO REVIEW

| *Top 5 Contributors in Q1* | *Symbol* | *Contribution (basis points)* |
|---|---|---|
| Exelon/Constellation Energy | EXC/CEG | +88 bps |
| T-Mobile US | TMUS | +43 bps |
| Canadian Pacific Railway | CP | + 34 bps |
| Union Pacific | UNP | + 34 bps |
| CMS Energy | CMS | + 32 bps |

**EXC and CEG**: Exelon Corp spun off Constellation Energy to shareholders on 2/1/2022. The combined companies were the top contributors to performance this quarter. After spinning out the unregulated nuclear power business, investors focused on the strengthening regulated utility business and its relatively attractive valuation. The transaction also de-risked EXC which, in hindsight, created exactly the right attributes to do well in the stock market as risk increased. For CEG, we saw market sentiment beginning to form that placed a higher value on carbon free, baseload nuclear power. At the time of the spin, the market placed very little value on the nuclear assets after years of falling power prices. CEG provided exposure to upside in power and commodity pricing, potential carbon pricing, energy transition advances, and the newly growing demand for 24/7 baseload clean power. The environment in the first quarter quickly highlighted the value of nuclear power assets as underinvestment in fossil fuel supplies, power market scarcity events, growing demand for clean baseload power, and Russian natural gas supply disruption drove power prices significantly higher. Seemingly overnight, sentiment on nuclear power shifted from an expensive form of power that was on its way out to a must-have power source that was crucial to energy transition and geopolitical stability. Consequently, CEG finds itself a uniquely positioned utility compared to peers.

**TMUS**: T-Mobile US benefitted from an ongoing relief rally to start 2022. Exiting 2021, we felt the three main concerns for investors were: 1) market share gains amidst rising competition; 2) costs and disruptions associated with integrating the Sprint deal; and 3) the near-term financial loss of DISH Networks as a wholesale customer. As to the first two concerns, telecom mergers are notorious for their complexity, but TMUS has continued to exceed qualitative and quantitative operating benchmarks during deal integration. The company also seemed to smooth-out a public spat with DISH over the timing of wholesale customer transitions. Lastly, preliminary success in the fixed wireless business has captured the imagination of some investors. We continue to view U.S. wireless to be a challenging business, but we believe TMUS has clearly distinguished itself.

**CP and UNP**: Both Canadian Pacific and Union Pacific benefitted from expectations of volume recovery as COVID restrictions loosened. In addition, high fuel prices are a relative benefit for rails versus their primary trucking competitors. CP further benefited from reduced west coast port congestion. Additionally, it appears that the company's merger with Kansas City Southern is on track to close later this year as the Surface Transport Board so far has not required material divestitures or changes to the deal. UNP has exhibited relatively strong volume growth, complementing its aggressive share repurchase program.

**CMS**: CMS Energy's performance caught up to peers after a disappointing end to 2021. Volatility over the last six months largely reflects changes in sentiment surrounding the company's Integrated Resource Plan filing at the Michigan Public Service Commission. A significant point of contention has been the potential purchase of the Dearborn Industrial Generator facility from the CMS parent company to the utility operating company. The timing of the retirement of coal plants has also been an issue. We expect a final order from the Commission in the coming months that could be constructive for the company.

| *Top 5 Detractors in Q1* | *Symbol* | *Contribution (basis points)* |
|---|---|---|
| GXO Logistics | GXO | -78 bps |
| American Water Works | AWK | -66 bps |
| SBA Communications | SBAC | -65 bps |
| Equinix | EQIX | -58 bps |
| Charter Communications | CHTR | -55 bps |

**GXO**: GXO Logistics fell in sympathy with the trucking and logistics group as fuel prices and recession fears rose. While the company's business of warehouse design and management should not, in theory, be all that correlated with the factors that impact other transportation subsectors, in practice the equity has been highly correlated. Investors have become concerned that inflation in raw materials will translate into higher finished goods prices and drive a decline in sales volumes. Despite the near-term challenges, we believe that secular trends of reshoring and e-commerce growth should soften the cyclicality of the business and provide ongoing growth in demand for the company's services.

**AWK**: American Water shares suffered from two main issues. First, CEO Walter Lynch retired after a medical leave and the board made interim CEO Susan Hardwick permanent. While there were no operational issues during the transition, the leadership uncertainty generated some discomfort among investors. Second, the company is well represented in many ESG and clean future-oriented indices which exposure it benefited from over the past few years. Commodity price inflation and Russia's invasion of Ukraine caused investors to seek safety in cheaper, more traditionally defensive utilities, and American Water suffered relatively as a result.

**SBAC**: Weakness in shares of SBA Communications during the first quarter of 2022 are best explained by macroeconomic factors. Namely, rising interest rates have had outsized negative impacts on both the financial model of REITs and the valuations ascribed to high quality, durable-growth businesses. From a fundamental perspective, the setup for wireless towers continues to be as good as ever. Consumer demand for wireless continues to grow unabated, and wireless carriers are deploying spectrum onto towers at record rates to satisfy the ever-growing usage.

**EQIX**: The macroeconomic dynamics that hindered shares of Equinix mirror those mentioned for SBAC above. Additionally, surging power prices, the failure to hedge these prices in certain markets, and the nature and timing of EQIX contracts led to higher costs and renewed investor questions about long-term margin assumptions. Nonetheless, demand for space in the EQIX data centers continued to grow at impressive rates, with strong bookings helping to buck expectations for decelerating growth. Many industry observers anticipated that a slowdown in demand for cloud services would follow the uptick in activity created by the pandemic, but so far, the industry has seen nothing but continued positive momentum.

**CHTR**: Negative sentiment around cable stocks persisted during the quarter as broadband subscriber additions continued to appear subdued while telecom competitors seemed to make progress in deploying competing networks. We continue to think that unrealistic sell-side subscriber estimates contributed to the change in sentiment for cable, and we believe recent negative revisions have more appropriately set expectations. While multiples have contracted, little has changed related to our long-term cable thesis. We expect operating margin expansion, declining capital intensity, significant return of capital to shareholders, and a free option on what could potentially be a very disruptive wireless business.

Thank you for your continued support of our investment management services. Please let us know if you have any questions about the market developments and stocks discussed in this commentary. We look forward to hearing from you.

*Reaves Asset Management is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. Reaves is a privately held, independently owned "S" corporation organized under the laws of the State of Delaware.*

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*[1]Reaves' Long Term Value Strategy (Reaves LTV) seeks a high risk-adjusted total return. The strategy tends to be invested in relatively larger companies with strong balance sheets, good cash flow and a history of dividend growth. Core positions are accumulated in financially strong, high-quality companies and generally have the following characteristics: strong management, above industry-average growth rates, large/mid-market capitalization and low price-earnings multiples.*

*Beginning December 2019 Reaves Long Term Value Strategy (LTV) is represented by the LTV SMA Wrap Composite. This composite contains those LTV discretion¬ary portfolios with wrap (bundled) fees. Wrap accounts are charged a bundled fee which includes the wrap sponsor fee, as well as Reaves' investment advisory fee. Due to compliance requirements, the net-of-fees calculation is computed based on the highest annual fee assigned by any wrap sponsor who utilizes this portfolio in an investment wrap program (300 basis points from 1/1/03 through 12/31/16 and, effective 1/1/2017, 250 basis points). LTV SMA Wrap Composite performance consists of money-weighted, time-weighted returns and it includes the reinvestment of all dividends and other earnings. 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 LTV ERISA Composite which ended in December of 2019. The LTV SMA Wrap Composite does not represent all of Reaves' assets under management.*

*[2]The MSCI USA Infrastructure Index captures the opportunity set of U.S. companies that are owners or operators of infrastructure assets. Constituents are selected from the equity universe of the MSCI USA Index, the parent index, which covers large and mid-cap securities in the U.S. All index constituents are categorized in one of thirteen sub-industries, which MSCI aggregates and groups into five infrastructure sectors: Telecommunications, Utilities, Energy, Transportation and Social. Reaves' portfolios may at times be more diversified by including companies classified as operating in the Real Estate and Industrials sectors.*

*The MSCI USA Infrastructure Index was launched on Jan 22, 2008. Data prior to the launch date is back-tested data (i.e., calculations of how the index might have performed over that time period had the index existed). There are frequently material differences between back-tested performance and actual results. Past performance -- whether actual or back-tested -- is no indication or guarantee of future performance.*

*During the third quarter of 2021, we began using the MSCI USA Infrastructure Index as the new benchmark for the Reaves LTV Strategy. We believe the MSCI USA Infrastructure Index, with its large weightings in companies that operate in the Utilities and Communications Services sectors, will provide a better way to measure the relative performance of the Reaves LTV Strategy.*

*[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 Index. However, Reaves' portfolios are far less diversified, resulting in higher sector concentrations than found in the broad-based S&P 500 Index.*

*[4]The iShares Core U.S. Aggregate Bond ETF seeks to track the investment results of an index composed of the total U.S. investment-grade bond market.*

*An annualized total return is the geometric average amount of money earned by an investment each year over a given time period. The annualized return formula is calculated as a geometric average to show what an investor would earn over a period of time if the annual return was compounded.*

*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.*

*Peaks and troughs are patterns that are developed by the price action experienced by all securities. Peaks and troughs can be seen on a chart by recognizing the higher peaks, or tops, and higher troughs, or bottoms, creating an uptrend or downtrend.*

*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.*

*Brent Crude Oil may refer to any or all of the components of the Brent Complex, a physically and financially traded oil market based around the North Sea of Northwest Europe; colloquially, Brent Crude usually refers to the price of the ICE Brent Crude Oil futures contract or the contract itself.*

*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.*

*A real estate investment trust (REIT) is a company that owns, operates, or finances income-generating real estate. Modeled after mutual funds, REITs pool the capital of numerous investors. This makes it possible for individual investors to earn dividends from real estate investments—without having to buy, manage, or finance any properties themselves.*

*Reaves' portfolio characteristics, holdings and sector weightings are subject to change at any time and, unless otherwise noted, are based on our Long Term Value Strategy. Holdings, sector weightings and portfolio characteristics of individual client portfolios may differ, sometimes significantly, from those shown. Portfolio holdings are rounded to the nearest whole percent, and returns are rounded to the nearest tenth of a percent. This information does not constitute, and should not be construed as, investment advice or recommendations with respect to the securities and sectors listed. The securities mentioned in this commentary does not represent all the securities held in the Reaves LTV SMA Wrap Strategy. Reaves' LTV SMA Strategy does not represent all of Reaves' assets under management.*

*This document is a supplement to the Fact Sheet for the Reaves LTV Strategy First Quarter 2022.*

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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.***

***Important Tax Information:** Reaves Asset Management and its employees are not in the business of providing tax or legal advice to taxpayers. Any such taxpayer should seek advice based on the taxpayer's own individual circumstances from an independent tax adviser.*

***Fees:** Net performance reflects the deduction of advisory fees which are described in detail in our Form ADV Part 2A.*

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*Additional information about Reaves may be found on our website: www.reavesam.com.*



**Reaves** Asset Management

10 Exchange Place, 18th Floor
Jersey City, NJ 07302
**www.reavesam.com**

**For further information, please contact:**
Thomas M. Grimes, Director of Investor Relations
Email: tgrimes@reavesam.com • Phone: 201.793.2384