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INVESTMENT PARTNERS

VANTAGE POINT | Q2

True North or the Barking Dogs

Becoming lost

I HAVE ONLY BEEN TRULY LOST ONE TIME IN MY LIFE. I was hunting grouse in the backwoods of Wisconsin with my dad, who was in his 70's at the time, on a cold overcast fall afternoon. We had taken a trail off a dirt road where our guide dropped us, and my dad was getting cold and tired, so I suggested we take a short-cut back to the road. I was certain I knew where that road was. The terrain was laden with swampy areas, and by trying to avoid wading into cold swamp water, we ended up going in circles for the next two hours. As it got closer to night fall, we tried to come up with a way to set a direction, so we could at least go in a straight line in hopes of crossing a trail or road. There was no sign of where the sun was due to the overcast, and the only sound we heard was some barking dogs in the distance—barely audible.

We felt we had to do something, so we decided to go in the direction of the barking dogs, which meant wading through icy swamp water. After about an hour of following the barking dogs and with barely any daylight left, we came to some dry land—what appeared to be a small island surrounded by swamp water. Out of nowhere, I heard faint voices off to my left. My dad thought I was delusional, but it turned out that a young couple had decided to put on waders and make their way through the swamp to put out corn in case the local deer got hungry. They took us back to their cabin, gave us dry clothes (and some bourbon), and the story had a happy ending. See page 3 for "the rest of the story".

The recent market sell-off

THIS IS HOW THE MARKET SEEMS TO US NOW. INVESTORS FEEL LOST because we are in such an unfamiliar place, and there are so many unknowns facing us over the next couple of months. Because we've never been in this situation, we do not know the way out. This extreme uncertainty, combined with a massive liquidity crunch and the multiplying effects of high frequency algorithmic trading, resulted in one of the fastest market-drops in history. As Lee Ferridge, head of macro strategy for North America at State Street, put it in the midst of the sell-off: *"It's all about raising dollar liquidity: People are selling whatever assets they have indiscriminately because they have a short-term need for dollar cash for redemptions, margin calls, collateral requirements, or whatever else."* In the process, equity valuations became unhinged and dislocated from fundamentals. Even dividend paying stocks, which historically have been more resilient than the broader markets during downturns, sold off more than usual.

What to do about it

INVESTORS ARE LEFT WONDERING WHAT TO DO NEXT, and the urge to do something is powerful. So, what should you do? Well, the "barking dogs" in this case are the press, the "experts" on CNBC, your friends, your children—everyone has an opinion as to what is going to happen and what you should be doing. We believe the best answer is to be patient. The reason for this comes back to the big mistake I made when I took my dad hunting in the wilderness. You were probably already wondering, "why didn't you have a compass?" Good question! A compass is always attuned to "*true north*", and this enables you to know what direction you are going so that you can make your way to your destination.

Stock valuations also have a "true north", and it is called **intrinsic value**. Every company has a long-term intrinsic value that is separate from its short-term market price. As Warren Buffett put it, **"Intrinsic value is an all-important concept that offers the only logical approach to evaluating the relative attractiveness of investments and businesses. Intrinsic value can be defined simply: It is the discounted value of the cash that can be taken out of a business during its remaining life".** It is worth noting that intrinsic value is an estimate because future cash flows are uncertain, so at any time there will be a range of estimates of intrinsic value. Furthermore, there is generally more clarity about the intrinsic value of dividend paying companies because one can more accurately project the cash that investors will receive over time in the form of dividends.

Exogenous short-term events do not have a significant impact on intrinsic value unless they change the long-term trajectory of a company's revenues and cash flows. In the case of Covid-19, there are some industries that are likely to experience a longer-term impact, such as airlines, cruise ships and hospitality. We believe the companies we are invested in are well positioned to resume the trajectory they were on before Covid-19 once the crisis passes. In other words, their intrinsic value will mostly remain intact. While equity valuations may currently seem lost and dislocated from fundamentals, once there are fewer unknowns, we believe investors will guide valuations back towards their "true north" which is their intrinsic value.

In the meantime, we have found it is easier to "be patient" when we are paid to wait, and that is one of the benefits of receiving dividend income during down markets. If you need to take withdrawals, you can use the dividend income to fund them without selling shares of stock at depressed valuations. If you don't need to take withdrawals, you can reinvest the income at valuations that are well below intrinsic value.

We realize the volatility over the past six weeks has been extreme and has likely caused heightened levels of concern and perhaps even some anxiety. We want to continue to encourage you to reach out to any of us at any time if you have any questions or concerns that you would like to discuss. Most importantly, please stay safe and healthy!

The rest of the story

As we warmed up and got to know the young couple that had rescued us, we learned that they were recently engaged and planned to fulfill their lifelong dream of going to the Kentucky Derby for their honeymoon next spring. They were planning to join the thousands of people in the infield. As good fortune would have it, my mother was from Louisville and our family had purchased a box for the upcoming Derby. We were grateful to have a way to thank our saviors, and we offered to give them our seats. We explained that the seats were in the "social section" of the grandstand, and therefore people would be somewhat dressy compared to the infield—they took this to heart and showed up in their finest hunting camo! Their attire made such a splash that the local TV station interviewed them, and they told the story of getting the tickets from these two hunters, Will and Bill Verity, who they found lost in the swamps of Wisconsin, explaining "they told us they forgot to bring a compass so they were trying to follow some barking dogs".

Dividend Growth Summary

QUARTERLY DIVIDENDS PAID PER SHARE

Company	2020Q1	2019Q4	Growth
3M	1.47	1.44	2.1%
Aflac	0.28	0.27	3.7%
Amgen	1.60	1.45	10.3%
Archer Daniels Midland	0.36	0.35	2.9%
Arthur J Gallagher Co	0.45	0.43	4.7%
Chevron	1.29	1.19	8.4%
Coca-Cola	0.41	0.40	2.5%
Colgate-Palmolive	0.44	0.43	2.3%
Consolidated Edison	0.77	0.74	3.4%
Corning	0.22	0.20	10.0%
Digital Realty Trust	1.12	1.08	3.7%
Dominion Energy	0.94	0.92	2.5%
Enbridge	0.61	0.56	9.8%

Company	2020Q1	2019Q4	Growth
Eversource Energy	0.57	0.54	6.1%
First Horizon National	0.15	0.14	7.1%
Genuine Parts	0.79	0.76	3.6%
Gilead Sciences	0.68	0.63	7.9%
Intel	0.33	0.32	4.8%
Lamar Advertising	1.00	0.96	4.2%
ONEOK	0.94	0.92	2.2%
PPL	0.42	0.41	0.6%
Prudential Financial	1.10	1.00	10.0%
QUALCOMM	0.65	0.62	4.8%
United Parcel Service	1.01	0.96	5.2%
WP Carey	1.04	1.04	0.2%

LTM DIVIDENDS PAID PER SHARE

Company	2020Q1	2019Q4	Growth
Enterprise Prods Partners	1.77	1.73	2.3%
Magellan Midstream Prtnrs	4.07	3.87	5.0%

* MLP distributions usually vary each quarter; therefore, a yearly comparison is more appropriate.

Fear and Investing—Understanding your Amygdala

We all know we are not supposed to sell low and that market timing is a fool's errand. Countless studies have shown the harm investors have done to their financial plans by reacting to market volatility by selling with the plans of "getting back in after the dust settles". So why do so many make this mistake?

Fear:

Fear is a chemical reaction in our bodies, and it is produced by the amygdala. The amygdala's response of "fight or flight" has been protecting humans since the beginning of time. Think about the feeling of being on the edge of a cliff. You want to jump back, right?

So how does something in our brains designed to protect us, begin to harm us? The amygdala's emotional response is short-term and in the moment. It is not how your brain thinks about next year, it is how your brain thinks about the next 5 minutes. And the harm to long-term investment plans is that when afraid, the amygdala takes over thinking about immediate survival, and we shut off the prefrontal cortex which makes long term, rational decisions.

The spread of the novel coronavirus, COVID-19, has elicited the fear response in our brains. That feeling is uncomfortable, which is why we want to act to change our circumstances. This response has been helpful in initiating society to create actions such as social distancing and work towards treatments and vaccines. But at times, it has also led to panic and irrational decisions such as the over purchasing of items like toilet paper.

As markets react to the expectations of an earnings recession and stock prices decline, the amygdala responds. "This time is different" is how the amygdala is trying to argue for selling out of the market. But if we take a step back and use our prefrontal cortex, we realize that every time is different. We felt the same way during the first Dot-com bubble and the mortgage banking crisis—each of these situations was unique. Once the amygdala settles down, then the prefrontal cortex would tell us that the crises will pass (as they have in the past), and the economy and markets will return to growing.

Understanding how our brains work is the first step in reducing anxiety and preventing harmful investing behavior, such as selling at the wrong time. Here are some ideas for managing the amygdala's response:

Don'ts:

- **Don't watch the news.** The television stations want to trigger the fear response so you will keep watching. Instead read the paper, once per day, to stay informed.
- **Limit social media.** Much like the news, social media can prompt the amygdala. It can also generate "herding" behavior. If everyone else is panicking, should I panic?
- **You don't need to check your account balances daily.** If you have a long-term plan in place, know that the short-term volatility is just activating the amygdala and your short-term survival instinct.

Dos:

- **Have a financial plan.** Part of a plan is preparation for the unexpected events that cause market volatility to ensure you have enough cash flow, so you don't need to sell stocks at depressed prices and erode the longevity of your assets.
- **If you are concerned, review your financial plan and allocation with your advisor.** Sometimes just talking about it will reinforce that you have a strategy in place to navigate these unexpected events.
- **Spend time in nature**
- **Read fiction**
- **Listen to music**
- **Exercise, get enough sleep and eat healthy**

If you have questions or need assistance, Andrew is always available to assist with any financial questions or to help you in putting together a comprehensive financial plan. Andrew Jones (andrew@verityvip.com or 843-379-6661).

Economic Indicators

Below is a summary of the key economic indicators that we track on an ongoing basis to help inform our investment decisions.

Economic Indicators	Reported	Current	Y/Y Δ	Last Year	10 YR AVG
BUSINESS					
Real Gross Domestic Product (q/q%)	12/31	2.1%	100 bps	1.1%	2.3%
ISM Manufacturing	2/28	50.1	-7.4%	54.1	54.3
ISM Non-Manufacturing	2/28	57.3	-2.1%	58.5	55.8
Industrial Production	2/28	109.6	0.0%	109.6	102.9
Corporate Profits Before Tax	12/31	2,131.0	2.2%	2,085.6	1,978.8
SENTIMENT					
Consumer Confidence	3/31	120.0	-3.4%	124.2	93.2
Consumer Sentiment	3/31	89.1	-9.5%	98.4	86.0
NFIB Small Business Optimism	2/28	104.5	2.8%	101.7	96.9
CEO Confidence	3/31	7.0	4.0%	6.7	6.2
LABOR MARKET					
Unemployment Rate, U-3, SA (%)	2/28	3.5%	-30 bps	3.8%	6.1%
Labor Force Participation Rate, SA (%)	2/28	63.4%	30 bps	63.1%	63.3%
Nonfarm Payrolls (monthly Δ, 000s)	2/28	273.0	1265.0%	20.0	168.4
Real Average Hourly Earnings	2/28	$9.49	1.0%	$9.40	$9.03
INFLATION					
Producer Price Index (PPI) (y/y%)	2/28	1.3%	-54 bps	1.8%	1.4%
Core PPI (y/y%)	2/28	1.3%	-117 bps	2.5%	1.7%
Consumer Price Index (CPI) (y/y%)	2/28	2.3%	83 bps	1.5%	1.8%
Core CPI (y/y%)	2/28	2.4%	28 bps	2.1%	1.9%
Personal Consumption Expenditures (PCE) (y/y%)	2/28	3.0%	69 bps	2.3%	2.4%
Core PCE (y/y%)	2/28	1.8%	21 bps	1.6%	1.6%
Breakeven Inflation Rate (%)	3/31	0.87%	-103 bps	1.90%	1.97%
CAPITAL COSTS					
10Y Treasury	3/31	0.70%	-179 bps	2.49%	2.35%
10Y-2Y Treasury Spread	3/31	0.47%	31 bps	0.16%	1.38%
Federal Funds Rate Target	3/31	0.25%	-225 bps	2.50%	0.76%
30 Year Fixed-Rate Mortgages	3/31	3.45%	-82 bps	4.27%	4.06%
New Car Loan, 48-month	12/31	5.45%	16 bps	5.29%	4.94%

As always, we look forward to your comments and suggestions and thank you for your continued trust and support.