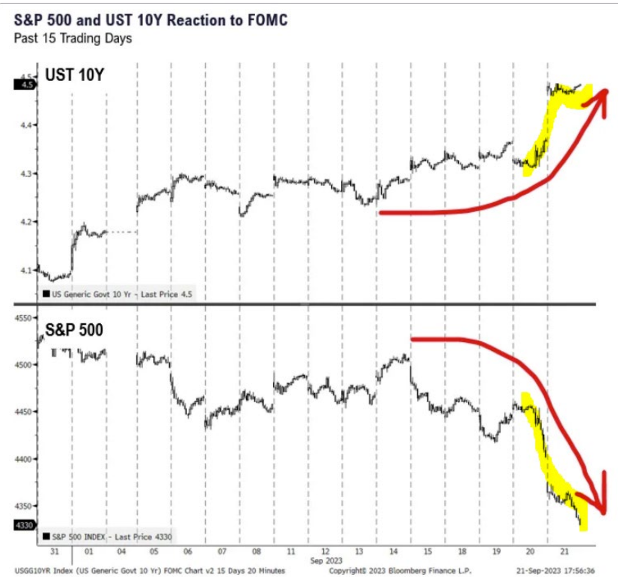
LAFFER | TENGLER
INVESTMENTS

Market Commentary | Third Quarter 2023

The Fed's Word Goulash—spicy and soggy. September 20th Press Conference.

What did I hear from Federal Reserve Chairman, Jay Powell's press conference? A muddled stew of Fed speak that would argue for a soft landing and a Fed voting bloc that leans hawkish in the face of their own economic estimates. In addition, the Chairman seemed to confuse the narrative a few times (contradicting previous statements earlier in the conference) and left me, at least, nonplussed by the number of times he said: "we don't know"—6x, "we don't really know"—1x, and 2 "not sures." (Thanks to LTI's John McGinn!) This from the much-heralded data dependent Fed. And about the data… What seemed to really trouble the market is that the SEP or Summary of Economic Projections released by the Fed showed GDP higher and unemployment lower than the previous SEP—the proverbial soft landing. But the chairman spooked investors when he responded to the first question indicating that a soft landing was no longer a priority then later in the presser suggested the opposite was true.

Bonds sold off, yields rose, and stocks sold off. The markets, after all, do not like uncertainty—a specialty of this Federal Reserve for the last three years.

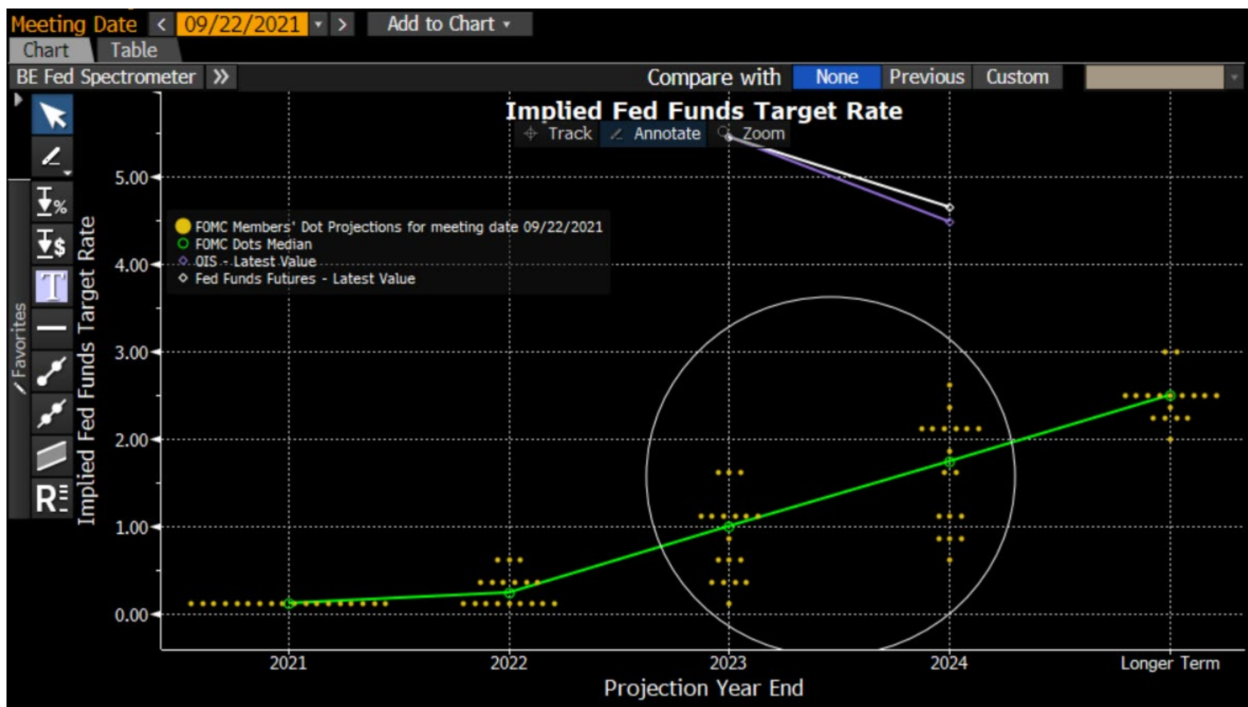


Source: Fundstrat, Bloomberg

September 21, 2023

Since the presser, the financial media has been full of speculation around how much higher for how much longer the Fed will remain hawkish. (Barron's had this to say: "The Fed's Dot-Plot Told One Story. Powell Gave Us Another.")

They cite the latest dot plot which indicates we will only see 50 basis points of cuts next year. As though it were gospel. Yet the dots represent the view of 19 FOMC members, most of whom do not vote on monetary policy. This is not the gospel according to anyone, it is merely a best guess based on what the members know now, or think they know. Therefore, I thought it would be instructive to look at the September 2021 dot plot when the Fed Chairman was still referring to inflation as "transitory." Note how wrong the "guesses" were. The vast majority expected to see rates slightly above or below 1.0% in 2023 (reference point: we are at 5.5%) and slightly above or below 2.0% by 2024 (current estimate is 5.1% by the end of 2024). In other words, as the Fed Chairman so aptly put it (repeatedly) in his press conference they just don't know.



Why then does the market react so dramatically to every word uttered and some that are not uttered? It's the short-term traders using algorithms who drive near-term volatility…and create opportunities for long-term investors. Last fall we added to technology when the algos were running for the hills. We think this sell-off will also provide excellent opportunities and are examining our watch list for high-quality, well-managed companies that will generate excess returns over the next few years.

Finally, I think it is important to note that *real* yields are hovering just above 2.0%. During the productivity (and stock market) boom in the 1990s, ***real*** yields traded in a range of 2.0%-4.5%. A 4.5% nominal yield is not, as Tom Lee, puts it "a P/E killer. In fact, the "sweet spot" for P/E is 3.5% to 5.5% yields which have seen an average P/E of ~20X. In fact, US yields below 3.5% are associated with lower P/E."

Market Commentary | Third Quarter 2023

The third quarter has been volatile. We suggested we would, and likely should, get a correction in the quarter. We get one, on average, every 12 months. Think of a correction as a release valve for rapidly rising stock prices which allows the engine to recalibrate. Remember that time in the market rather than timing the market is the best strategy. LTI adjusts risk around the edges, but our goal is to keep you invested. In my new book, The Women's Guide to Successful Investing, I cite the following study from our friends at Strategas: *Even more deleterious to returns is trying to time the market. Strategas Research Partners analyzed stock returns as measured by the S&P 500 from January 1, 1995, to December 31, 2022. For the investor who remains fully invested in the market over that 27-year period, the average annual return is 8.0%. By missing just the five best days, the annualized return drops to 6.2%. (Think; a cost to your $100,000 portfolio of $291,393. Missing the 30 best days over that 27 years results in an annualized total return of 1.3% or a cost in dollar terms of $657,078. Staying put during bear markets is important to achieving returns in stocks. Peter Lynch, one of greatest growth investors of all time once said: "The real key to making money in stocks is not to get scared out of them."*

Nancy Tengler,
CEO and Chief Investment Officer

Equity Income | Third Quarter 2023

LEADERS

Abbvie Inc. (ABBV) was the highest contributor to performance during the quarter as the company reported Q2 2023 earnings results above consensus expectations on July 27. The company has been at the forefront of healthcare innovation with breakthrough treatments like Ubrelvy, Skyrizi, and Rinvoq, which are addressing challenges in migraines, psoriasis, and rheumatoid arthritis. These new drugs are not only garnering billions in sales but also are on track to potentially surpass the renowned Humira's earnings. Their oncology department, with treatments like Imbruvica and Venclexta, is also achieving substantial revenues. Beyond product development, AbbVie's strategic acquisition of Allergan, including the addition of Botox, further solidifies their diversified portfolio. Their collaborations with industry leaders like Roche and J&J highlight their commitment to partnership and growth. Financially savvy, AbbVie maintains a strong cash stance while actively addressing their debt.

EOG Resources Inc. (EOG) was the second highest contributor to performance during the quarter. As oil prices soared 30%, this upstream name gained steam and turned its focused to more exploration versus M&A. With four additional wells coming online over the past few months, EOG is poised to benefit from general tightness in the oil market. The company also remains bullish on natural gas and expects to benefit from higher prices due to gas replacing coal-fired generation globally, growing Cheniere Energy, Inc (LNG) export capacity, and increasing petrochemical demand. Couple that bullish demand picture with the company's focus on growing the fixed dividend double-digits, and shareholders should be pleased. EOG's dividend (fixed + specials) has grown at an annualized rate of over 50% over the past five years.

Chevron Corp. (CVX) was the third highest contributor during the quarter, as the integrated oil and gas giant benefited from increasing prices and tight petrochemical markets. Chevron also continued with its inorganic strategy, as it completed its acquisition of PDC Energy in August. And while labor disputes continue at two LNG facilities in Australia, operational issues in the Permian were normal and transitory. Chevron remains committed to playing the new game in renewable fuels, as management sees opportunities and advantages of the Inflation Reduction Act (IRA) and other support for a low carbon energy world. Chevron's dividend (fixed) has grown at an annualized rate of 6% over the past five years.

Chubb Limited. (CB) was the fourth highest contributor during the quarter as the company rose over 5% immediately following their Q2 2023 earnings report released on July 25th, which has been the majority of their approximately 6% price return for the quarter. Chubb has consistently used acquisitions for growth and global expansion, completing 17 in the past 15 years. In 2022, Chubb acquired Cigna's personal accident, supplemental health, and life insurance businesses in Asia for $5.4 billion, contributing about 7% to its consolidated revenues in the first half of 2023. The acquisition also included $1.2 billion of goodwill and $3.6 billion of business value. By mid-2023, Chubb increased its ownership in Huatai Group to nearly 69.6%, with plans to raise it to 83.2%. Chubb's net investment income grew by 31.7% in the first half of 2023 to $2.25 billion, largely due to higher reinvestment rates on fixed maturities, and it is projected to rise by 22.2% for the entire year. The higher short term rate environment has helped income on float investment, but the volatile rate environment can potentially put pressure on premium growth. We have recently reduced our exposure and are evaluating our future positioning in the property and casualty space.

Carrier Global Corp. (CARR) was the fifth highest contributor during the quarter. As the company's transformational change begins to take shape, Carrier is strategically aligned for high growth and high margins longer-term (Fire & Safety and Commercial & Refrigeration segments are out / Heat pumps are in). This

imminent pure-play Climate Solutions provider has lined itself up to benefit from domestic and European legislation alike (Inflation Reduction Act [IRA], Infrastructure Investment and Jobs Act [IIJA], CHIPs Act, European Green Deal, and the U.S. is still less than halfway through American Rescue Plan funds, with ESSER-related [Elementary and Secondary School Emergency Relief Fund] funding still not allocated). And once Carrier completes its acquisition of Viessmann (slated for later this year), the company will catapult to number one in Europe for heat pumps. Carrier's dividend has grown at an annualized rate of over 50% over the past three years (note: the company was spun out of RTX Corp in 2020).

LAGGARDS

RTX Corp. (RTX) was the single worst contributor during the quarter. As the company grappled with uncertainty surrounding its GTF engines, RTX lost over $30 billion in market capitalization. And while the longer-term picture for the company remains upbeat (backlog is over $180 billion – well over a year's worth of revenue), medium-term risks remain surrounding the impact of these issues on earnings and free cash flow, which is why Laffer Tengler reduced its exposure to RTX during the quarter. The company also changed its name on July 17 from "Raytheon Technologies Corp." to a simpler "RTX Corp." RTX's dividend has grown at an annualized rate of approximately 7.5% over the past three years (dividends before 2020 are not comparable due to spin-offs).

Oracle Corp. (ORCL) was the second worst contributor during the quarter, as the company grappled with criticism over slowing Cloud growth related to its Cerner acquisition. Despite this, Oracle's Cloud Infrastructure segment (OCI) continued to impress with 64% growth and over $2 billion in additional AI-related bookings during the quarter. Oracle is in the early innings of its Cloud transformation across both Infrastructure and Apps, which should accelerate revenue growth and margin expansion consistent with 2026 targets that were again reiterated at the company's "CloudWorld" in late September. Oracle's dividend has grown at an annualized rate of over 13.5% over the past five years.

Interpublic Group Cos Inc. (IPG) was the third worst contributor to performance as the share price dropped over 13% following its Q2 2023 earnings report. Management addressed their position on AI, emphasizing its nascent stage as a reason for their limited exposure, particularly in the creative realm. However, they've integrated AI into media and data sectors to develop personalized ads. AI's significance in the competitive landscape was acknowledged, especially with the rise of generative AI in advertising. The call didn't extensively delve into their AI strategies, even though partnerships, like with Acxiom, exist. Industry peers are forging alliances with tech leaders, pointing to AI's burgeoning role in advertising. The company reported a dip in their media organic growth, and their stance on traditional advertising raised some concerns with our team. Their response to queries about digital transformation was somewhat ambiguous. Overall, the sentiment suggested that management is grappling with the rapid technological shifts in the industry. After further qualitative analysis, we decided to exit this position to pursue more favorable opportunities.

McDonalds Corp. (MCD) was the fourth worst contributor to performance during the quarter. CFO Ian Borden recently cited higher interest rates and macro headwinds are expected to hurt the consumer. McDonald's has also seen a decrease in the number of visits since the end of July. The National Labor Relations Board is also preparing to issue a highly anticipated, and in some circles, highly controversial new rule expanding the definition of "joint employer," or when a company is considered to hold a joint responsibility for another businesses' employees. The proposed NLRB (National Labor Relations Board) rule would make it easier to hold franchisors liable in labor disputes and bring them to the bargaining table

with unions. Also, McDonald's recently raised the royalty rate for new franchise owners from 4% to 5%. This could impede growth for the company as they receive 60.8% of their revenue from the Franchise Operated segment. Regardless of some of the more recent headwinds, we continue to hold our position in MCD. Their Q2 2023 earnings report showed great sales growth and market share gains across key markets, with a strong contribution from their digital transformation plans.

Texas Instruments Inc. (TXN) was the fifth worst contributor to performance during the quarter. The company beat expectations for their Q2 earnings report, however, the outlook for the third quarter has been less optimistic with lowered guidance, primarily due to persistent weaknesses in all segments apart from the automotive sector. Near-term challenges are expected, stemming from concerns over a slow recovery in China and consumer spending, potential diminishing auto demand, and the risk of AI overbuilding. Despite these factors, our decision to maintain our position is influenced by several strengths of Texas Instruments. As one of the premier suppliers of both analog and digital signal processing integrated circuits, the company boasts a diverse product range, efficient manufacturing approaches, and cost-effective 300mm capacity which are projected to boost long-term earnings. Moreover, with a keen focus on the Internet of Things (IoT) market, Texas Instruments has seen strong growth in its embedded business, particularly from microcontrollers, which are key enabling products.

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