

# Banking Turmoil Adds to Risks

MARCH 31, 2023

**WHEN INFLATION SWELLS, HAWKISH** economists typically advise the Fed to raise interest rates until something breaks. Mission accomplished! The banking turmoil started with Silicon Valley Bank (SIVB, not held). SIVB became vulnerable—not by making bad loans, but by buying long-dated bonds prior to the recent rise in interest rates. SIVB’s deposit base was dominated by tech companies with balances well above the FDIC guarantee. It was the perfect setup for a bank run.

On Wednesday, March 8, SIVB issued a press release announcing they had raised capital by selling equity and convertibles, but crucially, they had sold \$1.8 billion in bonds at a loss. The entire package was meant to soothe the market, but their tech savvy depositors proved to be quick on the trigger. Armed with mobile phones, depositors pulled their money with lightning speed, forcing SIVB to sell even more bonds at a loss. The panic of the depositors pushed SIVB into bankruptcy despite the solid credit quality of their assets. By Friday, March 10, regulators had taken control of SIVB branches. Ultimately, most of the SIVB assets were sold to First Citizens (not held).

Most banks have a much more diversified deposit base than SIVB, but most also own some longer-dated bonds that could only be sold at a loss at current levels. Working with regulators, banks have increased their liquidity by borrowing heavily from the Fed using both the discount window and the newly created Bank Term Funding Program. Historically, there has been a stigma to using these types of facilities, causing banks to only go this route in times of stress. Meanwhile, sources close to the Federal Home Loan Banks have indicated that lending from these “next-to-last resort” facilities has grown at almost twice the pace of loans from the Fed. Overall, the banking system now seems ready to handle runs on deposits in our view, although the chance remains that another weak player may run into trouble.

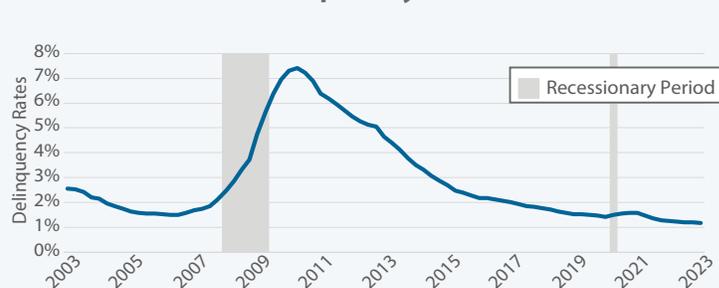
While US banks were bolstering liquidity to fend off any runs on deposits, credit metrics remained remarkably strong. The classic way to lose money in banking is to make loans that are not paid back. The most forward-looking credit metric, loan payments more than 30 days delinquent, still looks good across loan types.

## Banks have Heavily Borrowed from the Fed to Increase Liquidity



As of March 29, 2023. Data reflect credit supplied by the Federal Reserve, including the Federal Reserve’s Primary Credit and Bank Term Funding programs. Source: Federal Reserve Bank of St. Louis.

## Credit Metrics Remain Strong Delinquency Rates



As of December 31, 2022. Source: Federal Reserve System. Delinquency rate is based on charge-off and delinquency rates on loans and leases at commercial banks (seasonally adjusted).

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On the same Friday that regulators took over SIVB branches, Signature Bank (also not held) experienced a run on deposits and was shut down that weekend. Signature had high exposure to the cryptocurrency industry, giving it a concentrated deposit base like at SIVB. Regulators arranged a sale of Signature a week after it closed.

The turmoil among financials did not stop with US regional banks. On March 14, Credit Suisse (not held) announced that it was delaying its annual report after finding material weaknesses in past reports. As with Silicon Valley Bank, the story played out very quickly. Over the following weekend, Swiss regulators engineered the takeover of Credit Suisse by UBS (not held). Why should US investors care? Credit Suisse had a levered balance sheet with global assets worth over half a trillion dollars. Fortunately, Swiss regulators did not allow a Lehman-like outcome, but without a doubt, the financial system is stressed.

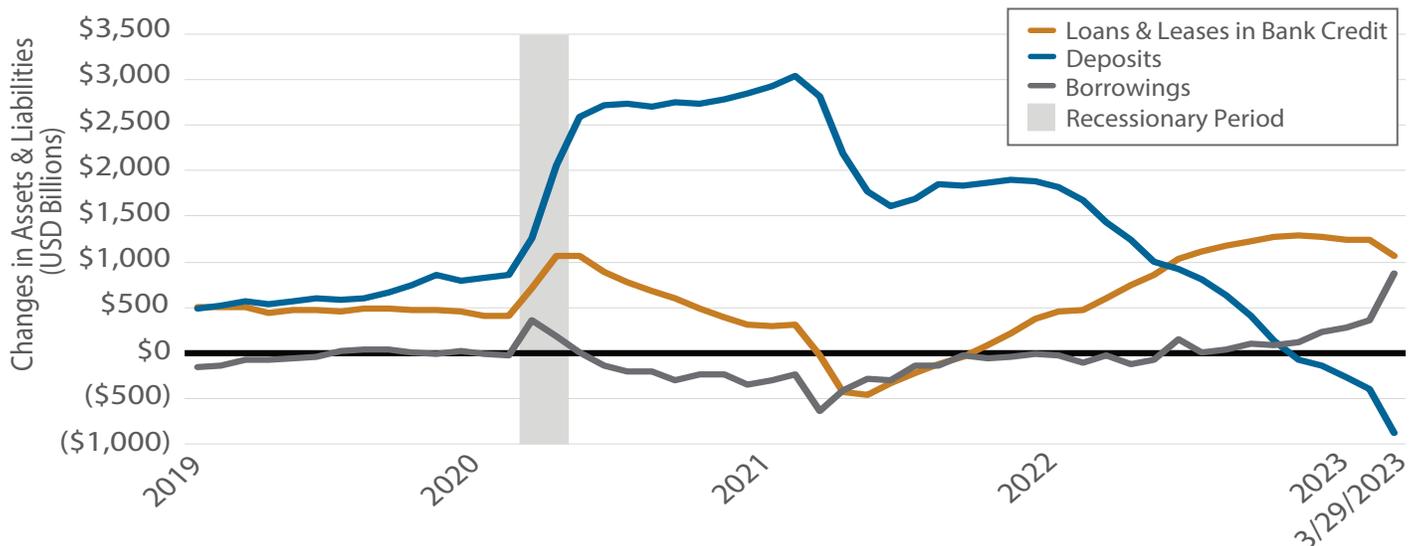
**It's the Interest Rates**

Even prior to the failures of Silicon Valley Bank, Signature Bank, and Credit Suisse, higher interest

rates were having an impact on banks. Beginning in mid-2022, deposits began to shift in two directions: toward time deposits within the banking system and toward money market funds. Clearly depositors made these shifts to earn higher interest rates. Overall, bank deposits have only dropped from \$18 trillion to \$17.5 trillion so far, but the muted decrease was likely caused by higher interest rates on deposits. Banks have had to depend more on borrowing for funding, putting negative pressure on margins.

Loan growth began to slow in 4Q 2022, most likely a response to higher interest rates. This was a change from earlier in 2022 when bank loan growth finally broke out of its pandemic funk, with total US bank loans growing above 12% in the second and third quarters. Slower loan growth means the Fed's hawkish monetary policy is having its desired effect, putting the brakes on the economy. Note, this was happening before the recent bank failures. The critical question—both for the banks and the overall economy—is how will lending change now that the sector is under stress?

**Bank Funding Shifts from Deposits to Borrowing**  
 US Banks: Loans Flat, Deposits Down, Borrowing Up



As of March 29, 2023. Source: Federal Reserve Bank of St. Louis. Data reflect monthly year-over-year changes in the assets and liabilities of US commercial banks. Note: Weekly data for March 29, 2023 is calculated against weekly data for March 30, 2022.

Following the bank run scare, we expect the banks to pull back on lending in order to preserve capital. The Fed’s survey of senior loan officers indicates that standards were tightening for commercial and industrial loans, as well as a range of consumer loans, even before the demise of Silicon Valley Bank, Signature Bank, and Credit Suisse. We believe upcoming survey results will reflect further contraction. Historically, the senior loan officer survey has been an excellent predictor of recessions. The contraction in credit standards combined with the Fed’s continued interest rate hikes make a recession more likely than not, in our view.

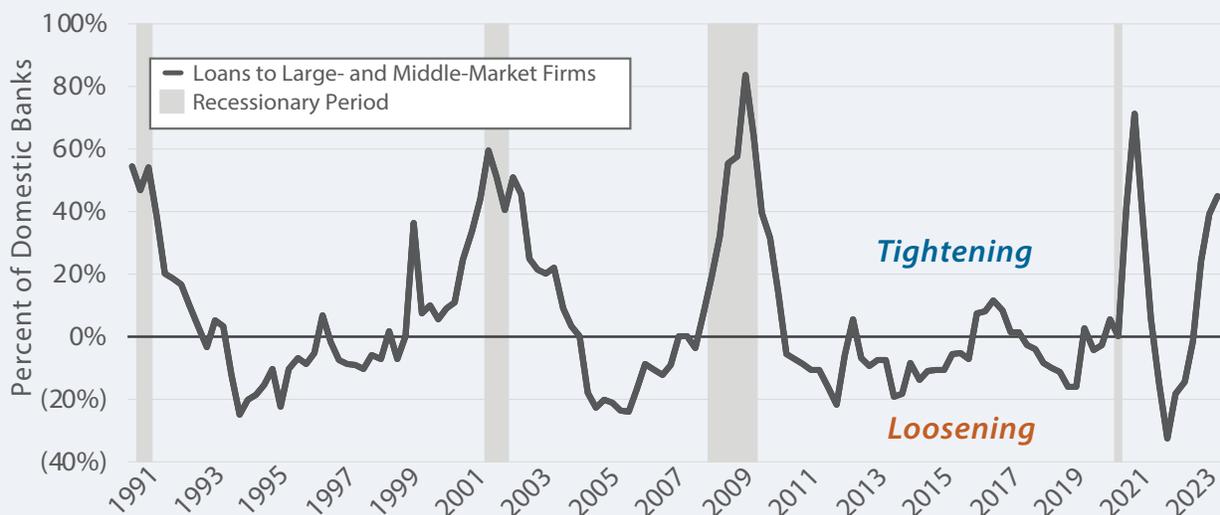
### Recession More Likely than Not

Currently, the interest rate on a 2-year Treasury bond is roughly 1% below the Fed funds rate—meaning the bond market is predicting that the Fed will begin cutting interest rates within a year. In essence, the bond market believes that economic growth will turn negative soon, and it suggests that we’ll see at least some evidence that inflation is coming under control—the two conditions the Fed would require before reducing rates. A mild recession, like a spring rain, could create the conditions for economic growth to resume

without causing undue hardship. In that scenario, unemployment would rise moderately, suppressing wage inflation. Capital spending and consumer spending would slow, without an abrupt stop. The banking sector would have narrower net interest margins and modestly higher credit losses. The best argument for a mild recession is that we would begin with buffers that we did not have in 2008: higher personal saving and lower debt loads for both consumers and businesses.

The more unnerving scenario would be a flurry of bankruptcies that have an unpredictable domino effect on other aspects of the economy. In 2008, the banking sector was first to tip over, so naturally, it remains suspect. However, we believe that the regulatory systems and capital requirements adopted following the financial crisis make it unlikely that bad credit performance would undermine the US banking system. Bank runs are a different issue, triggered by a loss of confidence and fear, rather than the cold calculation that a loan cannot be repaid. We believe that, following the SIVB failure, the Fed provided depositors with reassurance that their money is safe, but it is impossible to completely rule out another bank run.

## US Banks are Tightening Lending Standards



As of March 31, 2023. Based on the net percentage of US banks tightening standards for commercial and industrial loans. Large- and middle-market firms are defined as having annual sales of \$50 million or more. Source: Federal Reserve Bank of St. Louis.

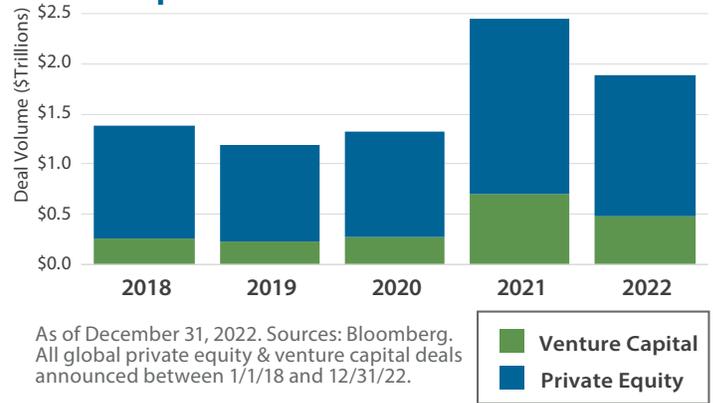
## High Leverage Lurks in Private Equity

Historically, the typical company has operated profitably through a recession, and so we expect that most dividend-paying companies will continue to make regular dividend payments, with a significant fraction even raising the dividend. Our concern should not be with the average company, but with outliers. Just as Silicon Valley Bank had unusual characteristics that made it more vulnerable in the current environment, companies in other industries may be similarly at risk.

Debt is always the leading cause of financial fragility, in our view. Talking heads on TV will occasionally bemoan the amount of leverage at US companies, but we view this as largely a private equity problem. Leverage at most public companies is substantially lower than exists in private equity. Flows into private equity have been massive over the past two decades, creating a large swath of highly-levered companies that could create vulnerabilities for the economy as a whole.

As originally conceived, private equity was meant to allow for messy restructurings away from the prying eyes of the public market. In our view, however, much of the attraction over time came from a perceived lack of volatility and the

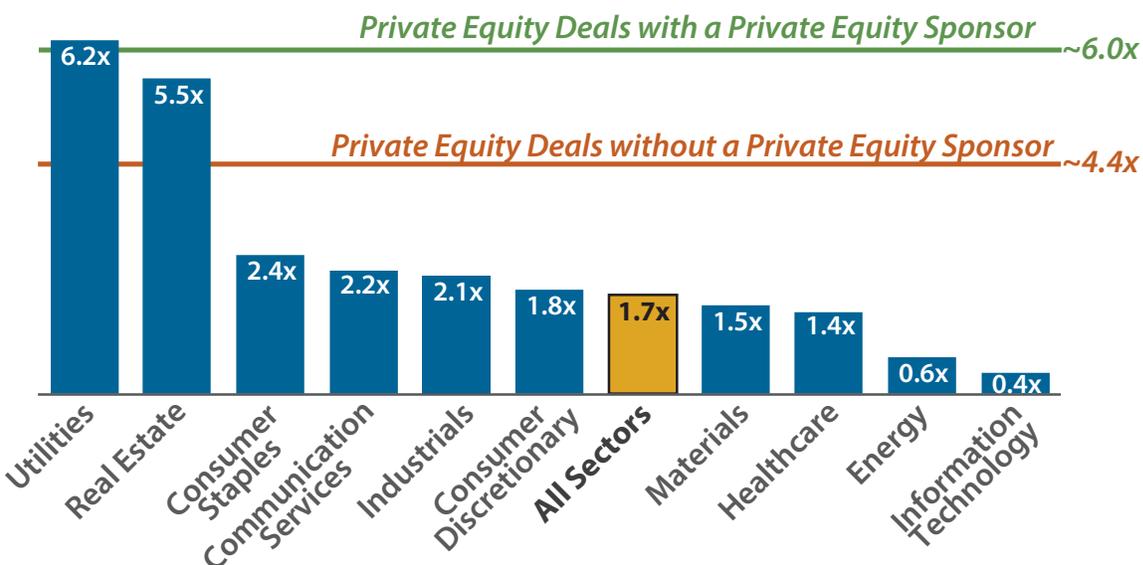
## High Private Equity & Venture Capital Deal Volume Drive Risk



ability to lever up using low-interest rate debt. For companies with private equity sponsors, leverage reportedly averages six times net debt to EBITDA, well above the levels seen in public equities. Today's higher interest rates will make similar deals hard to initiate, and will make it difficult to roll debt when it matures.

Excessive leverage can lead to bankruptcy, but more frequently, it forces asset sales or capital raises at unfavorable terms. Companies flush with cash can take advantage of these situations, making one firm's crisis another's opportunity. We view companies with low or no leverage and strong free cash flow as best positioned to prosper through difficult times.

## Average Public Company Leverage is Well-Below Typical Private Equity Levels



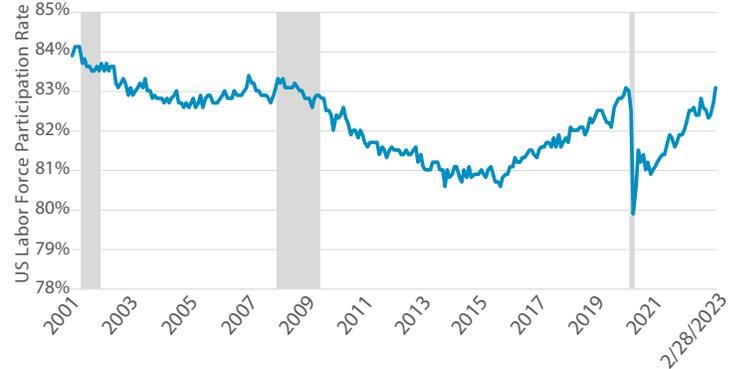
As of December 31, 2022. Source: Bloomberg. Leverage is based on 2022 net debt to EBITDA. Net debt and EBITDA are aggregate for the trailing 12-month period. Sector members are based on members of the S&P 500 Index. GICS sector financials has been excluded. Private equity deals with and without a private equity sponsor are as of calendar year 2021 per Bloomberg News report "Private Equity's Latest Deal Wave Brings More Leverage Than Ever" published January 13, 2022.

# US Labor Market Remains Strong

## Low Unemployment Rate



## High Labor Force Participation Rate



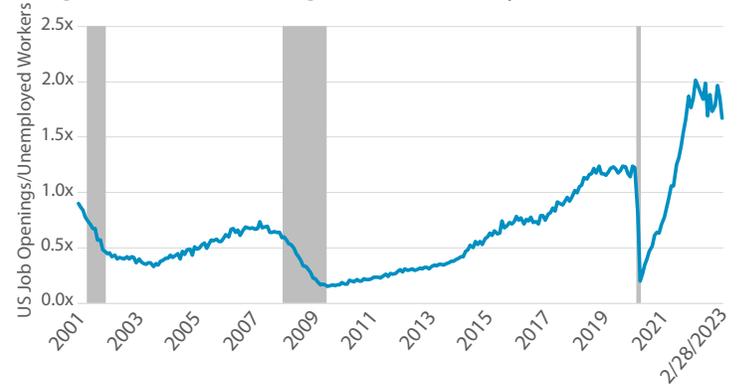
As of February 28, 2023. Source: Bloomberg. The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey. The labor force participation rate is the total labor force as a percent of the working age population (25-54 years).

■ Recessionary Period

## High Quit Rates



## High Job Openings/Unemployed Workers



As of February 28, 2023. Source: Bloomberg. Quits Rate: This concept tracks voluntary job separations initiated by the employee. Job Openings is measured using the US Job Openings By Industry Total seasonally adjusted. This concept tracks the number of specific job openings in an economy. Job vacancies generally include either newly created or unoccupied positions (or those that are about to become vacant) where an employer is taking specific actions to fill these positions. Unemployed Workers is measured using US Unemployment Unemployed Workers Total in Labor Force. Unemployment measures the number of people who are without work (not in paid employment or self-employed), currently available for work and seeking work (taking specific steps to find work).

## The Optimistic Economic View

While we believe that a recession is now more likely than not, a declining number of analysts are still arguing for a soft landing. The unemployment rate is very low at 3.6%, but past recessions have started with low unemployment rates. Labor force participation is still rising off the pandemic bottom. If this trend continues, it could serve to dampen wage growth—the Fed’s key inflation concern.

The best measure of job market tightness is the number of job openings per unemployed person. Historically, there are fewer openings than

unemployed, but currently, there are roughly two jobs for every unemployed person. This creates a buffer, allowing for continued employment even when some companies announce large layoffs. The high frequency of quits indicates that workers remain confident that a better job is out there.

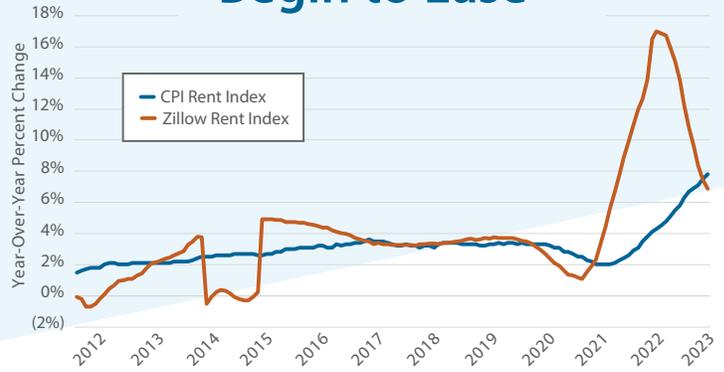
The Fed is determined, however, to force inflation down to 2% and is willing to drive up unemployment to achieve that end. It seems like the only escape from the recession scenario is for some major categories of inflation to prove “transitory,” the Fed’s favorite word back when they were dovish.

While it feels overly optimistic to predict that overall inflation will, at long last, prove to be transitory, housing is one category where the description may be apt. Rising housing costs have been a major contributor to inflation this cycle. For owner-occupied units, the Consumer Price Index (CPI) is based on a survey question that asks what owners think they could get in rent if they decided to be landlords. Frankly, it's a poor metric. Zillow constructs a much better index based on what people actually pay for rent. The Zillow Home Value Index (ZHVI) shot up during 2021 and early 2022, but it has since been moderating. In contrast, homeowners in the CPI survey are belated in recognizing that rents are higher, but we should expect their answers to roll over soon, following the Zillow index to lower inflation levels.

The energy and food components of the Consumer Price Index also have the potential to drop in the coming months, driven by lower wholesale prices for certain commodities, including corn, wheat, soy, oil, and natural gas. There is some reason for hope, but overall, high wage inflation seems far from tamed.

Without a doubt the current environment is challenging. Some investors may be tempted to make a heroic move such as going to cash, precious metals, or some other strategy viewed as "risk free." As always, we strongly discourage market timing. Good markets have always followed bad, and missing a sharp upturn can be very costly.

## Housing Inflation Should Begin to Ease

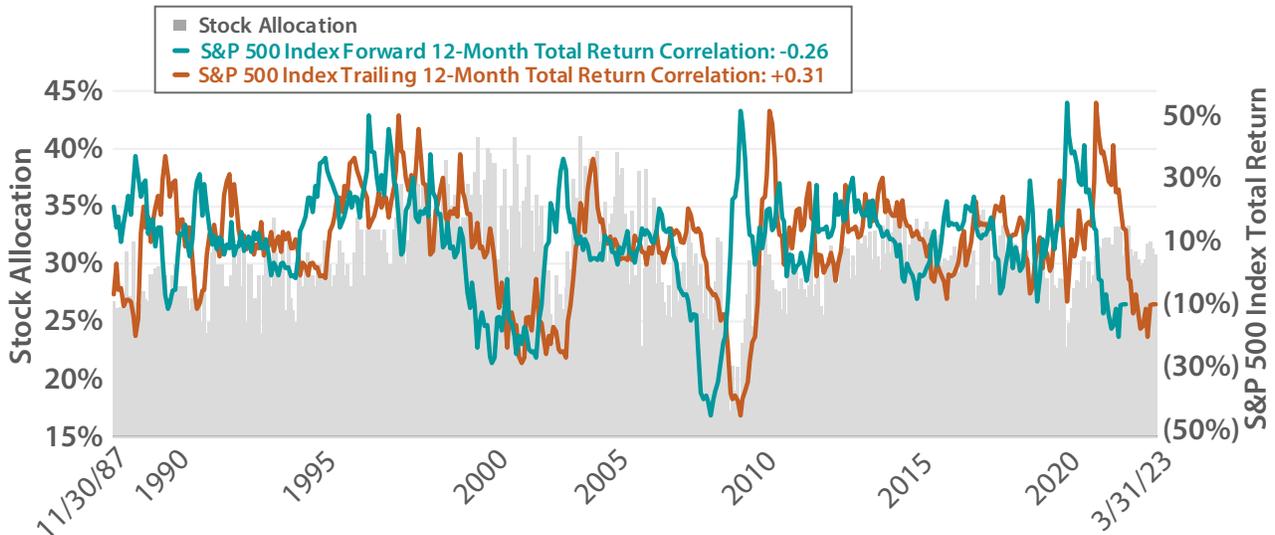


As of February 28, 2023. Sources: Bloomberg; US Bureau of Labor Statistics. Zillow Index begins September 30, 2011.

### The Market Timing Trap

Investors as a whole have not proven themselves adept at market timing. We recently tested this proposition by examining the results of the American Association of Individual Investors monthly survey on asset allocation. Ideally, we would like to see equity allocations rise before stock market returns increase. Unfortunately, the opposite held true—respondents' equity allocations were negatively correlated with forward stock market returns. Even worse, the equity allocations were positively correlated with trailing returns. Human nature causes us to extrapolate what we have just seen, not what is coming. If you feel it defies human nature to stay in the market during turbulent times, we would agree. But it has always been the right thing to do for the long term.

## Stock Allocations Tend to Chase Past Performance



As of March 31, 2023. Sources: American Association of Individual Investors (AII); Morningstar Direct; MHI Research & Analysis. Correlation represents the average stock allocation relative to the S&P 500 Index total returns.

It's easy for investors to become obsessed with short-term market fluctuations. In fact, sometimes TV business shows will allocate serious airtime to cover the vagaries of *intraday* equity prices. Yet long-term investors can be seriously misled by excessive focus on the short term.

In an effort to balance the discussion, let's examine buy-and-hold total returns over the past 30 calendar years. An investor putting \$1,000 in the S&P 500 Index in 1993 would have seen a compound average growth rate (CAGR) of 9.6%, turning \$1,000 into almost \$15,000. Driving the return were annual dividends of 1.9% and earnings growth of 7.7%. The price-to-earnings (P/E) multiple for the S&P 500 gyrated immensely over the course of 30 years, but it ended just a tick below where it started.

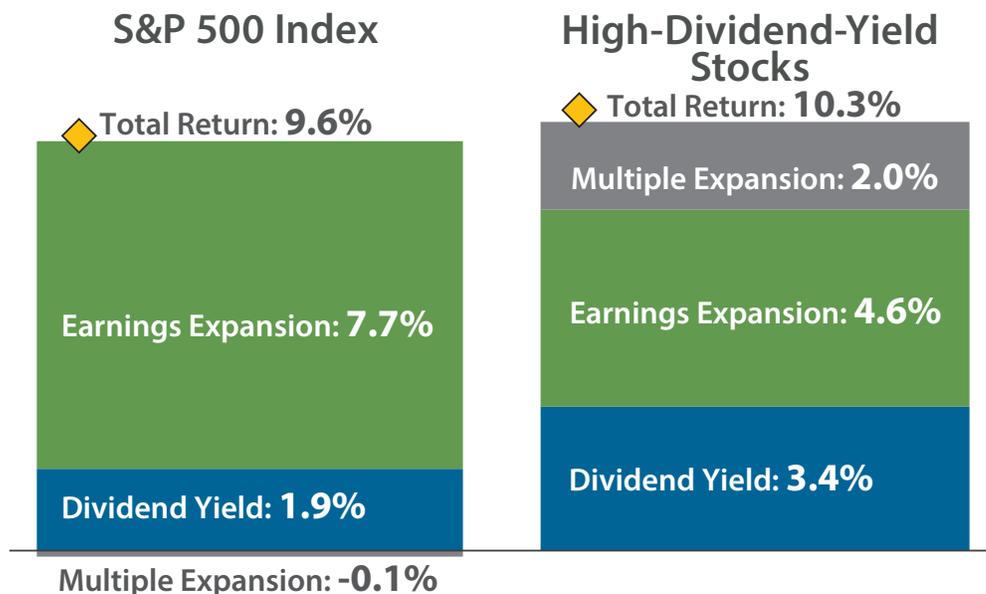
At Miller/Howard, we favor dividend-paying stocks because we like the discipline it imposes on managements to run their businesses for the benefit of shareholders. We also believe that

commitment to a regular dividend represents a signal from management that they actually see their cash flows as safe and stable. But how do total returns stack up?

Over the past 30 calendar years, high-dividend-yield stocks within the S&P 500 had a total return CAGR of 10.3%, turning \$1,000 into almost \$18,000. The composition of returns looks quite different from the S&P 500. Dividends contributed 3.4% annually while earnings growth was lower at 4.6%. P/E multiples expanded modestly for high-dividend stocks over this period, adding 2.0% to annual returns.

Not only did high-dividend-yield stocks outperform the S&P 500 over the past 30 years, they also generated those higher returns with lower volatility. We believe these results demonstrate the immense wealth that can be generated by owning profitable, dividend-paying companies and allowing those investments to compound over long periods.

## Sources of Stock Returns Vary

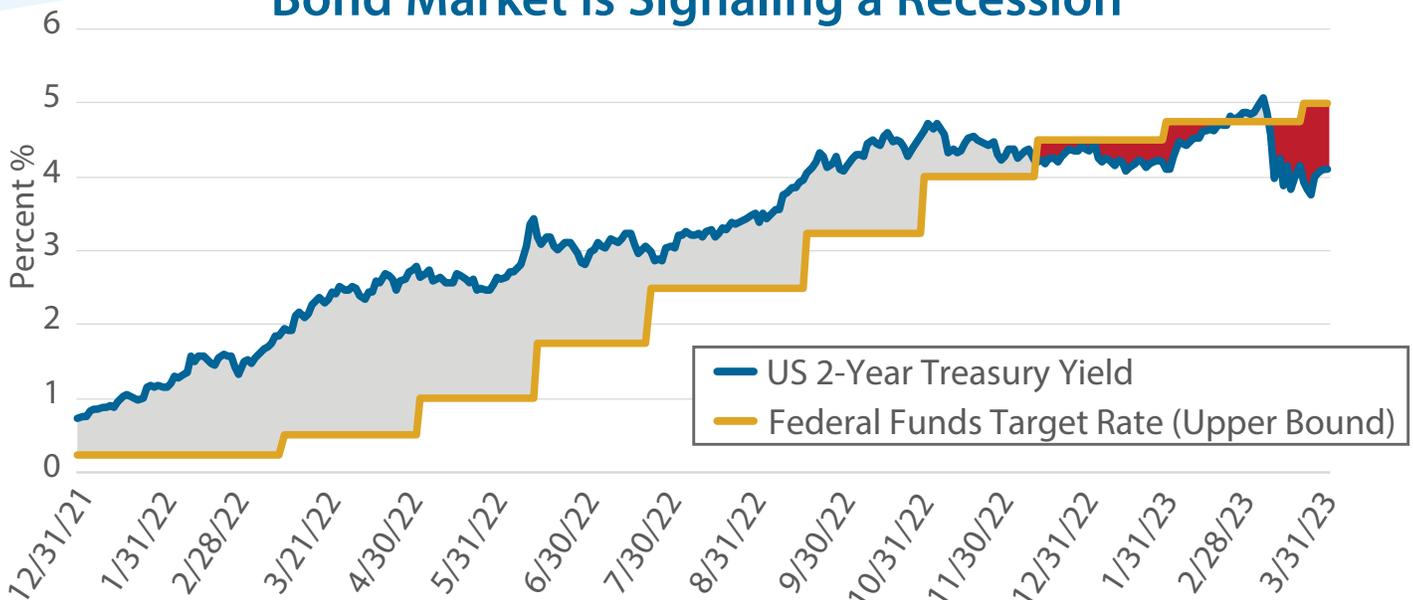


As of December 31, 2022. Sources: Bloomberg; Miller/Howard Research & Analysis. Annualized period is 1993 - 2022 (30 Years). High-Dividend-Yield Stocks are defined as deciles 7 through 9 of S&P 500 Index dividend payers by indicated yield; Members are weighted by market capitalization as of each calendar year end. Members without an available historical estimated forward price-to-earnings ratio have been excluded from the group.

# Income-Equity Strategies

QUARTERLY REPORT 1Q 2023

## Bond Market is Signaling a Recession



As of March 31, 2023. Source: Bloomberg. The red shading highlights periods when the US 2-Year Treasury yielded below the Federal funds target rate.

**THE FED HAS BEEN RATCHETING UP THE** shortest-term rates since March 2022. For most of that period, interest rates on 2-year Treasuries continually marched higher, staying above the Fed funds rate. Finally, in November, bond investors became skeptical, with the interest on 2-year Treasuries slipping just under the Fed funds rate. Bond investors were essentially saying that the Fed might continue jacking up rates in the short term, but a recession would force them to reverse course and begin cutting rates again.

Once the banking turmoil began in mid-March 2023, the bond market made a more emphatic statement, with the 2-year rate dropping almost 1% under the Fed funds rate. Remarkably, investors, who sweat how long to lock in interest rates, are now willing to buy 2-year Treasuries at this lower rate rather than roll shorter-term paper. Unless inflation suddenly disappears, which is not likely in our view, a recession starting within a year or so is the scenario most consistent with prevailing bond prices.

The message coming out of the equity market is a bit more garbled, in our opinion. Lower interest rates mean that investors put more value on earnings forecasted years into the future. Growth stocks did outperform the broad market this quarter, so that part of the equity market sang in harmony with the bond market.

However, what did not quite jibe was the weak performance of the defensive sectors of the equity market, given bond market's recession signals. Utilities, healthcare, and consumer staples trailed the broad market, on average, even though these sectors have historically outperformed during recessions.

### Looking Ahead

Based on the yield curve, fixed income investors expect their income to drop over time. In contrast, our objective with the Income-Equity Strategies is to select stocks with a high likelihood of dividend increases. Despite threats of a looming recession, the broad market had a strong number of dividend increases. In the Income-Equity Strategy,

## Portfolio Highlights

- **Dividend Increases:** Fifteen of our holdings increased their regular dividend this quarter, up from 10 in 1Q 2022. Our dividend increases averaged approximately 6% year-over-year. Dividend increases were announced by **STAG Industrial (STAG)**, **Comcast (CMCSA)**, **United Parcel Service (UPS)**, **CMS Energy (CMS)**, **Gilead (GILD)**, **Camden Property Trust (CPT)**, **TotalEnergies (TTE)**, **Interpublic Group (IPG)**, **Cisco (CSCO)**, **Coca-Cola (KO)**, **Extra Space Storage (EXR)**, **Huntsman (HUN)**, **Genuine Parts (GPC)**, **Old Republic (ORI)**, and **Lamar Advertising (LAMR)**.
- **Sales:** We exited our position in **Everest Re (RE)**. We initiated the position in January 2021 at roughly book value. When we exited two years later, the stock was selling at a relatively expensive 1.8x book. We exited **US Bancorp (USB)** to control our exposure to the turmoil in banking. Lastly, we sold the shares of **Vitesse Energy (VTS)** that we received as a spinout from **Jeffries Financial Group (JEF)**.
- **Buys:** We entered new positions in two multifamily housing REITs, **Mid-America Apartment Communities (MAA)** and **Camden Property Trust (CPT)**. Both REITs own apartment complexes that are largely in the sunbelt and cater to affluent young professionals. In our view, demand for apartments will remain strong as a result of high mortgage rates and home prices, and both companies have minimal risk from an ESG perspective.

almost half of our holdings raised their regular dividend in the first quarter.

Our portfolios are tilted toward stocks that we believe should be recession resilient. Relative to the Russell 1000 Value Index, we are overweight information technology, real estate, healthcare, and utilities. We continue to favor mature tech companies that have revenue growth, high free cash flow, and strong balance sheets. Real estate is a very heterogeneous sector currently, with some risky niches that we do not own, including office building REITs and retail center REITs. Our real estate holdings focus on areas that we believe will prove to be defensive—multifamily housing, warehousing (think e-commerce), billboards, and self-storage. Our healthcare and utility holdings provide non-cyclical exposure while still offering growth potential.

Among our underweight sectors, we do have financial holdings, including banks. Our financial holdings offer attractive dividend yields with history of dividend increases. Currently, financial stocks have low valuations, and we see significant

upside in certain names. We believe we are controlling risk by focusing on money center, trust, and investment banks. We will continue to monitor the risks in this sector and pare the holdings more if needed.

In the first quarter, our Income-Equity Strategies were marginally behind the Russell 1000 Value but significantly trailed the S&P 500 Index. Underperformance relative to the broad market was driven by the rebound in the FAANG stocks\* (Meta, Amazon, Apple, Netflix, and Alphabet) and Microsoft—stocks which pay little or no dividends and are expensive relative to our holdings.

\* Meta, Amazon, Apple, Netflix, Alphabet, and Microsoft were not held in any Miller/Howard strategies.

*See more about  
Income-Equity  
on page 15.*

# MLP Strategy

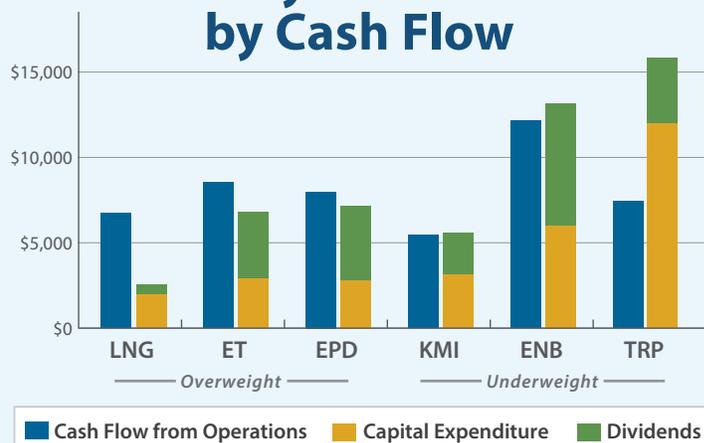
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COMMODITY PRICE VOLATILITY GRABBED THE headlines during the quarter. US crude prices hit \$81/bbl in January and fell to \$67/bbl in March, while seemingly modulating from day to day. Natural gas prices also vacillated, beginning the quarter at \$4/MMBtu and declining closer to \$2/MMBtu by the end of the quarter. These swings were likely driven by fears of a recession, and drove the midstream sector's underperformance relative to the general market.

We believe the sector is better positioned compared with prior downturns. Historically, midstream companies continuously built assets while relying on the capital markets to fund growth. Now, cash flow from operations has grown enough to fund capital expenditures, resulting in rising free cash flow. Also, most companies have a share buyback program in place, which could be used if unit prices decline.

Because of the free cash flow after dividends that midstream generates, there is little need to access the capital markets. Gone are the days of issuing equity at a discount along with issuing billions of dollars of debt. Not only does this ease the

## Capex and Dividends Generally Well-Covered by Cash Flow



As of March 31, 2023. Sources: Refinitiv Eikon and Miller/Howard Research & Analysis. Overweights and underweights are based on the MLP Strategy holdings relative to the Alerian MLP Index. Analysis includes Cheniere Energy (LNG), Energy Transfer (ET), Enterprise Products Partners (EPD), Kinder Morgan (KMI, not held), Enbridge (ENB, not held), and TC Energy (TRP, not held).

amount of volatility around stock prices, it also lowers the midstream industry's exposure to any potential banking crisis.

### Looking Ahead

Besides monitoring commodity prices and economic activity, we are keeping an eye on capital expenditures. We have seen an increase in capex budgets year-over-year from most midstream companies. Some of the higher spending is due to an increase in new projects and some is due to inflation increasing project costs. After years of improving free cash flow, which has resulted in better capital returns to shareholders and lower leverage metrics, higher spending raises concerns. North America still needs energy infrastructure, especially liquefied natural gas (LNG) export facilities and Permian natural gas takeaway. While longer-term projects should be accretive to cash flow, in the near term, free cash flow is likely to decline modestly. We are also seeing more asset acquisitions in the space. We are okay with this, as long as deal multiples are reasonable and accretive to cash flow.

We are tilted towards companies with cash in excess of capex and dividends and seek to avoid those where there is a potential capital need. Over the past few years, we have argued that the shift to prioritize free cash flow was a turning point for the midstream industry. We believe the industry needs to continue to walk that line.

### Portfolio Highlights

- **Distribution Increases:** This quarter, 7 of our 17 holdings announced dividend increases. The average increase was 29% year-over-year.
- **Sales:** In an effort to control risk, we trimmed several gathering and processing companies, including **DCP Midstream (DCP)**, **EnLink Midstream (ENLC)**, **Western Midstream Partners (WES)**, and **Targa Resources (TRGP)**.
- **Buys:** We increased our weights in **Enterprise Products Partners (EPD)**, **Magellan Midstream Partners (MMP)**, and **MPLX LP (MPLX)**, which we believe are better positioned for this uncertain economic environment.

# Infrastructure

QUARTERLY REPORT 1Q 2023

**THE INFRASTRUCTURE STRATEGY FINISHED** roughly flat during a volatile quarter that witnessed a rotation into higher-risk securities, a rise and retrenchment of interest rates, declining commodity prices, and concerns over the health of the banking system.

During the quarter, the Infrastructure Strategy's performance didn't follow the broader market's shift toward expensive stocks. Within the portfolio, higher-multiple sectors—utilities and communication services—were the biggest laggards. Utilities came under pressure in January and February as investors rotated into higher-risk securities and the 10-year Treasury yield temporarily rose above 4%. Negative momentum continued among cell towers, as the group faces near-term growth headwinds. Energy performance was more mixed, with natural gas-focused names underperforming and refineries outperforming. Industrials led the portfolio due to strong performance by airports and parcel carriers, but sector returns were partially offset by weakness among railroads.

## Looking Ahead

In times of economic stress, investors who want to remain in equities may be well served by infrastructure. Our Infrastructure Strategy focuses on essential service providers with high barriers to entry—in other words, an operating environment that is less vulnerable to new entrants or disruptions and that creates a durable economic advantage. This results in a business

## Portfolio Highlights

- **Dividend Increases:** This quarter, the holdings in our portfolio announced 11 dividend increases with an average increase of over 9%.
- **New Position:** We initiated a position in **Comcast (CMCSA)** and expect it to benefit from strong free cash flow generation and an emphasis on returning capital to shareholders through dividends and share repurchases.
- **Trimming Energy:** We slightly reduced our weights in **Kinder Morgan (KMI)** and **Targa Resources (TRGP)**. While these companies remain core holdings, the trims raised capital for other opportunities and were consistent with efforts made over the last year to reduce portfolio beta.
- **Adding on Weakness:** We increased our position in **American Tower (AMT)** after a period of relative weakness. Although rising interest rates have pressured long-duration assets, we continue to believe that cell towers are well positioned to benefit from rising data demand trends.

model capable of generating stable cash flows that, in turn, can provide investors with high current income and growth of income.

Over the last 10 years, the Infrastructure Strategy has provided ~2x the dividend yield, ~1.5x the projected dividend growth, and a beta of ~0.85x compared to the broad market. In an uncertain market environment, we believe lower beta, high current income, and growth of income will prove to be an advantageous combination for investors.

## Infrastructure Strategy: Well-Positioned Over Time

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	1Q23
<b>Infrastructure</b> Yield	2.9	3.1	3.8	3.7	3.8	4.4	3.9	3.5	3.0	3.6	3.6
S&P 500 Yield	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5	1.8	1.7
Ratio	1.5x	1.6x	1.8x	1.8x	2.0x	2.1x	2.1x	2.3x	1.9x	2.0x	2.1x
<b>Infrastructure</b> Projected Dividend Growth	7.6	7.8	5.9	6.9	8.2	7.5	6.5	6.0	8.3	7.2	7.4
S&P 500 Projected Dividend Growth*	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.9	4.8	5.5
Ratio	1.3x	1.7x	1.4x	1.7x	2.0x	1.4x	1.6x	1.8x	1.4x	1.5x	1.4x
<b>Infrastructure</b> Dividend Coverage Ratio	2.5x	2.5x	1.9x	1.6x	1.4x	1.6x	1.5x	1.9x	1.9x	3.4x	3.0x
<b>Infrastructure</b> Beta (3-Year Rolling)**	0.85	0.78	0.87	0.80	0.79	0.74	0.78	0.88	0.95	0.88	0.76

As of March 31, 2023.  
Sources: Bloomberg; S&P; Miller/Howard Research & Analysis. All data are as of year-end, unless otherwise noted. Holdings based on a representative account in our Infrastructure Strategy, and are subject to change. Dividend yields shown for Miller/Howard portfolios exclude cash.  
\*Miller/Howard's 3-year annualized projected dividend growth based on data from various sources, adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.  
\*\*Vs. S&P 500 Index

# Utilities Plus

QUARTERLY REPORT 1Q 2023

UTILITY SECTOR PERFORMANCE TOOK A breather after outperforming the broader market from mid-2021 to mid-2022 and remains below the highs set in September 2022. Utilities finished 1Q 2023 in negative absolute territory and lagging the broader market. Much of the sector's divergence came in January, as investors rotated into higher-risk securities. Utilities remained under pressure as the 10-year Treasury yield rose above 4% before finding support amid the banking system crisis, a retrenchment of rates, and a flattening yield curve.

Relative performance among utilities was not as clearly delineated along the lines of growth and value as the broad market. During the quarter, small- and mid-cap utilities generally outperformed their large-cap peers. Gas local distribution companies (LDCs), utilities with international exposure, and names that underperformed in 2022 led the group, while water utilities and renewable developers lagged.

## Looking Ahead

Although the sector's pullback since late 2022 has surrendered a lot of the ground gained over the previous year, there is reason to be optimistic. Over the last 20 years, there have been seven other times in which the S&P 500 Utilities Index pulled back over 10% (average decline was 23%)

## Utilities Have Rebounded Following Pullbacks



As of March 31, 2023. Sources: Morningstar Direct; Miller/Howard Research & Analysis. Based on the NAV of the Utilities Select Sector SPDR® ETF. Grey shading represents the period of time when the utility sector had a performance pullback of  $\geq 10\%$ , and green shading represents the time to a new index high.

## Portfolio Highlights

- **New Position:** We initiated a position in **Portland General Electric (POR)** on the expectation that incremental generation opportunities related to its 2030 emissions reduction target would support an improved growth profile.
- **Increasing Conviction:** After initiating a position in **Southern Company (SO)** last quarter, we increased our position as the company reached a constructive regulatory agreement in Georgia, and the Vogtle nuclear plant hit additional milestones on its way to completion. We also increased our position in **PPL Corp. (PPL)** for the second quarter in a row with the expectation the company will benefit from a low-risk development plan and top-tier balance sheet.
- **Exiting Position:** We exited our position in **NRG Energy (NRG)** due to its acquisition of Vivint Smart Home. In addition to reducing its near-term free cash flow profile, the step-out into the smart home business increases the company's execution risk.

after reaching a new high. Off of these declines, utilities generally snapped back with average 3-month and 12-month gains of 13% and 23%, respectively. In five out of the seven pullbacks, utilities recaptured new highs in under a year. The global financial crisis and the pandemic were the two outliers, with deeper declines and longer recoveries. However, it is worth noting that utilities traded at a significant premium to the market heading into the pandemic which exacerbated pressure; valuation is more supportive today.

Most importantly, strong sector tailwinds remain intact with state and federal decarbonization targets lending support to the historic levels of capital deployment. Despite an uncertain macro-economic backdrop, we remain confident in our Utilities Plus Strategy's ability to provide investors with a dependable, high, and growing income stream.

# North American Energy

QUARTERLY REPORT 1Q 2023

**ENERGY EQUITIES PULLED BACK MODESTLY**, reflecting crisis in the banking sector and surprisingly resilient Russian exports due to lax sanctions enforcement. One exception was natural gas, which declined 50%, driven by rising oil-associated gas production, a major export facility outage, and a mild winter.

Despite macro headwinds, the latest weekly data indicate that US crude inventories resumed a counter-seasonal decline, suggesting under-supply. Indeed, US drillers idled 5% of active oil rigs during the quarter, dropping activity in 10 of the past 13 weeks. With crude averaging \$75/bbl during the quarter, and a recent high-profile Dallas Fed survey suggesting that median shale wells breakeven below \$60/bbl, exploration and production (E&P) spending discipline appears intact. In fact, current prices appear insufficient to incentivize substantial growth from shale—by far the biggest contributor to global oil supply growth over the past decade—suggesting that the marginal supply side of the equation remains supportive for higher prices.

## Looking Ahead

There are few moments when investors can claim “this time is different” and not justifiably elicit eye rolls or derision. But when it comes to this energy cycle, we believe this time really may be

## Energy Sector Free Cash Flow Setting Record Highs



As of December 31, 2022. Source: Bloomberg. BICS sector classification energy domiciled in North America with a market capitalization greater than or equal to \$200 million USD.

## Portfolio Highlights

- **Energy and Income:** The portfolio currently offers an indicated yield of 4.2%, which we expect to be supplemented by buybacks and special dividends. Most E&Ps now commit to a base quarterly dividend, that we view to be supported to approximately \$40/bbl oil, combined with a formulaic return of capital commitment at higher commodity prices.
- **Along the Energy Value Chain:** In this portfolio, we view the energy sector as more broad-based and dynamic than a simple proxy bet on the price of crude. This quarter, we initiated new positions in downstream refiner **HF Sinclair (DINO)**, which uniquely benefits from inland US refined product pricing. We also bought petrochemical producer **LyondellBasell (LYB)**, which is benefitting from the wide differential between oil and natural gas pricing, as well as strong demand for “circular plastics” recycling initiatives.

different. Looking back at 25-years of companies’ excess annual cash generation as a percentage of market capitalization, there simply has not been a modern parallel to the current regime of high operating cash flows and reinvestment discipline.

We think this is at least partly driven by a permanent new market feature: the looming energy transition. Due to messaging that demand for their product will diminish over time, energy companies are heeding calls to run their businesses for cash, as opposed to pursuing costly investments requiring a decade or more to generate payoffs. Given what we expect to be a protracted transition period, we view this as a winning setup for income-seeking investors, and we feel that our North American Energy Strategy provides an attractive vehicle for investors to participate in this theme over time.

# Small Cap Dividend

QUARTERLY REPORT 1Q 2023

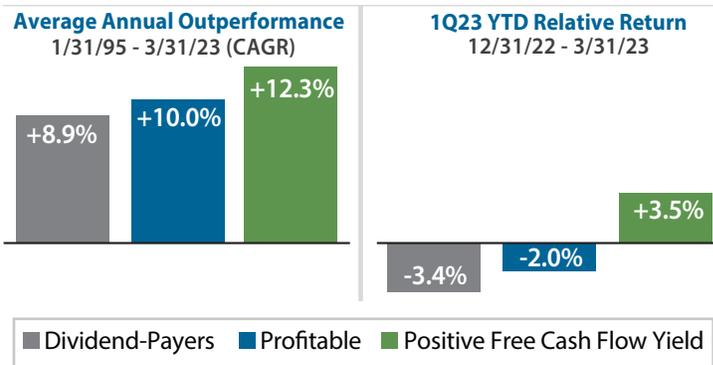
**CONCERNS OF A POTENTIAL RECESSION** caused small-cap investors to shift away from cyclicals toward growth stocks, many of which are unprofitable and don't pay a dividend. Contrary to long-term trends, unprofitable and non-dividend-paying small-caps outperformed during the first quarter.

At Miller/Howard, our long-term investment philosophy continues to prioritize dividends, consistent profitability, and positive free cash flow (FCF), defined as operating cash flow less capital spending. Looking at annualized small-cap returns since 1995, dividend-payers have outperformed non-payers by 9% each year on average; dividends not only contribute to shareholder returns, but can also signal management's confidence in future success. Meanwhile, small-cap companies with positive profits and FCF have averaged an annual outperformance of 10% and 12% each year, respectively, relative to their unprofitable and FCF-negative counterparts. Positive earnings and FCF both indicate that these companies can generate sufficient cash to reinvest and organically grow their business, in our view.

## Portfolio Highlights

- **Dividend Increases:** 21 of our holdings announced dividend increases, including **Bank OZK (OZK)**, **Stag Industrial (STAG)**, **Apogee (APOG)**, **EnLink Midstream (ENLC)**, **LeMaitre (LMAT)**, **Unitil (UTL)**, **Applied Industrial (AIT)**, **Magnolia (MGY)**, **Kforce (KFRC)**, **Washington Federal (WAFD)**, **Radian (RDN)**, **NorthWestern (NWE)**, **Louisiana-Pacific (LPX)**, **Meuller (MLI)**, **Assured Guaranty (AGO)**, **Allison Transmission (ALSN)**, **Academy Sports (ASO)**, **SpartanNash (SPTN)**, **Signet (SIG)**, **Medifast (MED)**, and **Oxford Industries (OXM)**.
- **Special Dividends:** Holding **Movado (MOV)** declared a special dividend.
- **Sales:** We exited **Bank OZK (OZK)**, **Hope Bancorp (HOPE)**, **HomeStreet (HMST)**, **Vishay (VSH)**, and **Harmony Biosciences (HRMY)**.
- **Buys:** We initiated positions in **S&T Bancorp (STBA)**, **Evercore (EVR)**, and **InterDigital (IDCC)**.

## Long-Term Performance Trends were Disrupted in 1Q23



As of March 31, 2023. Sources: Bloomberg; FTSE Russell; Miller/Howard Research & Analysis. Hypothetical relative returns of portfolios invested on January 31, 1995 and December 31, 2022, respectively, and held to March 31, 2023. Stocks in the Russell 2000 Index were divided into six groups (dividend-paying vs. non-paying, profitable vs. unprofitable, positive FCF vs. negative FCF), market-cap-weighted, and rebalanced at month end. Profitable (unprofitable) is defined as positive (negative) trailing GAAP net income at quarter end. GAAP = Generally Accepted Accounting Principles. Free Cash Flow is defined as Cash from Operations less Capital Expenditures. Excludes Real Estate and Financials.

Late in the quarter, the bond market signaled an expectation of Fed rate cuts, bolstering stocks with valuations that depend on projected earnings growth far into the future. Consistent with the overall shift away from profitable, dividend-paying stocks, our Small Cap Dividend Strategy trailed the Russell 2000 Index. Benchmark performance was largely driven by rising stock values for companies with frothy multiples and negative earnings—stocks that we seek to avoid.

Historical trends show a clear correlation between quality-based factors and long-term outperformance among small-cap stocks. We intend to stay disciplined in our investments: healthy, growing small-cap companies with long-term capacity for returning cash to shareholders.

## Looking Ahead

Small-cap stocks are not only characterized by their higher potential for growth, but also their higher potential for risk—roughly 30% of the Russell 2000 Index has failed to turn a profit over the last 12 months. As the odds of a recession continue to build, our view is that passive investments in small-cap indices also grant passive exposure to riskier corners of the market. We believe our active approach to quality small-cap investments not only limits our exposure to risky money-losing ventures, but also highlights the nascent growth stories commonly found among small-caps stocks.

## Yield, Growth, Strength, Stability

- Our Income-Equity Strategies each offer a high dividend yield that is over 2x the yield on the S&P 500 Index, and have ample dividend coverage and reasonable leverage levels (net debt/EBITDA).
- Both portfolios trade at a significant discount to the broad market on price-to-earnings as well.
- We believe the portfolios are well-positioned for dividend growth throughout the full market cycle.

### Income-Equity Strategy (with MLPs)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	1Q23
Income-Equity Yield	4.4	4.2	4.7	4.0	3.7	4.3	3.7	3.6	3.3	3.6	3.7
S&P 500 Yield	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5	1.8	1.7
Ratio	2.3x	2.1x	2.2x	1.9x	2.0x	2.0x	2.0x	2.3x	2.2x	2.0x	2.2x
Income-Equity Projected Dividend Growth*	7.5	7.5	5.8	5.0	6.3	7.8	7.3	5.1	6.0	6.1	5.8
S&P 500 Projected Dividend Growth**	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.9	4.8	5.5
Ratio	1.3x	1.6x	1.4x	1.2x	1.5x	1.5x	1.7x	1.5x	1.0x	1.3x	1.1x
Income-Equity Dividend Coverage Ratio	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.0x	2.7x	2.0x
Income-Equity Net Debt/EBITDA***	2.6x	4.2x	2.8x	2.0x	1.9x	1.4x	1.9x	1.9x	1.2x	2.0x	2.2x
Income-Equity P/E Ratio Trailing	13.4	16.4	14.2	17.2	17.7	12.6	12.8	16.7	14.0	13.6	14.1
S&P 500 P/E Trailing	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	24.1	18.6	18.5
Premium/Discount	-23%	-10%	-24%	-16%	-18%	-23%	-41%	-40%	-42%	-27%	-24%

### Income-Equity Strategy (No MLPs)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	1Q23
Income-Equity (No MLPs) Yield	4.1	4.0	4.6	3.9	3.7	4.2	3.6	3.5	3.2	3.5	3.6
S&P 500 Yield	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5	1.8	1.7
Ratio	2.2x	2.1x	2.1x	1.9x	2.0x	2.0x	2.0x	2.3x	2.1x	2.0x	2.1x
Income-Equity (No MLPs) Projected Dividend Growth*	8.2	7.7	5.9	5.0	6.4	7.9	7.5	5.2	6.0	6.0	5.9
S&P 500 Projected Dividend Growth**	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.9	4.8	5.5
Ratio	1.4x	1.6x	1.4x	1.2x	1.5x	1.5x	1.8x	1.5x	1.0x	1.3x	1.1x
Income-Equity (No MLPs) Dividend Coverage Ratio	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.0x	2.8x	2.1x
Income-Equity (No MLPs) Net Debt/EBITDA***	2.7x	2.6x	2.6x	2.2x	2.1x	1.4x	1.9x	1.9x	1.2x	1.8x	2.0x
Income-Equity (No MLPs) P/E Ratio Trailing	14.6	17.2	16.5	18.2	18.0	12.9	13.5	16.8	14.0	13.8	14.4
S&P 500 P/E Trailing	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	24.1	18.6	18.5
Premium/Discount	-16%	-6%	-12%	-12%	-17%	-22%	-38%	-39%	-42%	-26%	-22%

As of March 31, 2023. Sources: Bloomberg; S&P; Miller/Howard Research & Analysis. The data above are based on representative accounts in our Income-Equity Strategies both with and without MLPs and are subject to change. Median P/E ratio trailing is published for our Income-Equity Strategies.

\* Projected Dividend Growth—Miller/Howard Portfolio Team's 3-year annualized projected dividend growth based on data from various sources, adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

\*\* Bloomberg Dividend per Share 3-year forward estimates.

\*\*\* Excludes financials.

Dividend yields shown for Miller/Howard portfolios exclude cash. All data are as of year-end, unless otherwise noted.

**Common stocks do not assure dividend payments.** Dividends are paid only when declared by an issuer's board of directors, and the amount of any dividend may vary over time. Dividend yield is one component of performance and should not be the only consideration for investment. See definitions and full disclosure on page 16.

# Proxy Voting Is An Investor's Right & Responsibility

We diligently review and vote each item on the ballot according to what we believe best serves our clients.

Spring is proxy voting season, and we are working on behalf of our clients.

We look forward to sharing details of our proxy season in July 2023 in our Shareholder Advocacy & Engagement Report



Miller/Howard Investments Inc. is an independent, research-driven investment boutique with over three decades of experience managing portfolios for major institutions and individuals in dividend-focused investment strategies. The firm is 100% employee-owned through an Employee Stock Ownership Plan (ESOP).

We continue to evolve and develop strategies that strive to provide investors with various levels of current income and dividend growth. With a primary goal of reliable income and long-term returns, coupled with a belief that investors can play an important role in securing a sustainable future, our portfolios include environmental, social, and governance (ESG) research and/or screening, direct engagement with companies, filing shareholder resolutions, proxy voting, coalition building, and/or public policy involvement.

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the only consideration for investment. The returns on a portfolio that utilizes environmental, social, or governance (ESG) criteria for stock selection may be lower or higher than portfolios where ESG factors are not considered, and the investment opportunities available to such portfolios may differ.

**DEFINITIONS: Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)**—A non-GAAP measure used to provide an approximation of a company's profitability. This measure excludes the potential distortion that accounting and financing rules may have on a company's earnings; therefore, EBITDA is a useful tool when comparing companies that incur large amounts of depreciation expense because it excludes these noncash items, which could understate the company's true performance. **Net Debt to EBITDA**—A measure that computes the company's ability to pay off its debt by utilizing the earnings before interest, taxes, depreciation, and amortization (EBITDA). **Price-Earnings Ratio (P/E)**—The ratio of a company's share price to its earnings per share. The ratio is used as a valuation tool and can help determine whether a company is overvalued or undervalued. **Alerian Midstream Energy Select Index** is a composite of North American energy infrastructure companies. The capped, float-adjusted, capitalization-weighted index, whose constituents are engaged in midstream activities. **S&P 500 Index**® widely regarded as the best single gauge of large-cap US equities and serves as the foundation for a wide range of investment products. The Index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. **S&P 500 Transportation Index**, one of the S&P Select Industry Indices, comprises stocks in the S&P Total Market Index that are classified in the GICS transportation sub-industry. **S&P 500 Utilities Index**® is an unmanaged, market-value-weighted total-return index of all utility stocks in the S&P 500 Index. **Russell 1000 Index**® measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000 Index® and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000 Index® represents approximately 92% of market capitalization of the US market. **Russell 2000 Index** measures the performance of the small-cap segment of the US equity universe and is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges. **US Treasury 10-Year Yields** are yield to maturity and pretax. Indexes have increased in precision as of May 20, 2008, to 4 decimal places. The rates comprise Generic US Government on-the-run government bill/note/bond indexes. **REIT** = Real Estate Investment Trust. **MLP** = Master Limited Partnership.

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