AMI Equity Income Quarterly Update

Growth Through Stability

Q2 ▪ 2022

Strategy Overview

In Q2, the Large Cap Equity Income strategy returned -11.19% (-11.44% on a net basis), versus the S&P 500 index, which returned -16.10%. Stock selection drove most (approx. 2/3) of the outperformance, with asset allocation contributing the balance. Outperforming stock picks in Consumer Discretionary and Communication Services were offset by picks in Consumer Staples and Real Estate. Being overweight Communication Services and Consumer Staples helped performance. This was offset by being underweight Energy and Utilities. At the end of Q2, the strategy's dividend yield was 2.16%.

As seen in the table below, the top contributors to Q2 performance were Merck, General Mills, Pfizer, Verizon, and Johnson & Johnson. The bottom contributors to Q2 performance were Broadcom, Schwab, Microsoft, Target, and Apple.

Top Contributors in Q2		
Company	**Avg. Weight**	**Contribution**
Merck	2.72%	0.29%
General Mills	1.45%	0.16%
Pfizer	2.41%	0.06%
Verizon	3.39%	0.04%
Johnson & Johnson	2.71%	0.03%

**Please see last page for important disclosures.

Bottom Contributors in Q2		
Company	**Avg. Weight**	**Contribution**
Broadcom	3.54%	-0.85%
Schwab	3.33%	-0.91%
Microsoft	6.46%	-1.09%
Target	3.73%	-1.35%
Apple	6.18%	-1.43%

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Top Contributors

Merck's Q1 Pharmaceutical sales were strong on the heels of much better Keytruda (+27% y/y) and Gardasil (+60% y/y) sales. Merck sees strength in the core business (ex-molnupiravir) and raised guidance despite lowering the top end of the guide for its COVID-19 treatment. Animal health was better than expected.

General Mills reported strong Q4 results, buoyed by strong pricing in the company's snacks and cereal business. General Mills also issued FY23 guidance that was above expectations. The company is viewed as one that will perform well in times of economic weakness, which supported the stock throughout the quarter.

Pfizer outperformed as the company's COVID-19 vaccine and new Paxlovid treatment continue to generate good sales with a solid outlook for the full year. For reference, Pfizer generated approximately $12 billion in revenue pre-vaccine and generated approximately $26 billion in Q1 with the difference almost all due to vaccines and Paxlovid.

Verizon's Q1 was essentially inline as phone subscriber losses were not as bad as some estimates. Broadband adds were good, especially in the new fixed wireless segment. Average revenue per user rose as more consumers move to unlimited plans. The company noted that they are planning for potential price hikes due to offset some inflationary pressures.

Johnson & Johnson's Q1 was good despite revenue missing slightly due to lower-than-expected vaccine sales and a bigger than expected currency impact. Pharmaceutical sales were strong, driven by Darzalex up 40% y/y. Med Tech made a comeback (+9% y/y) as elective procedures returned after a lull due to Omicron fears. Vision, Hip and Knee were all much higher than expected. The company's strong cash flows and steady business allowed it to increase its dividend in April.

Bottom Contributors

Broadcom reported a very strong fiscal Q2 with strength across the enterprise (though wireless was a little slow and expected to be flat in Q3). The quarter's results were overshadowed by the announcement that it would acquire VMWare for over $60B in cash and stock. VMWare is a good asset, and when the deal closes, Broadcom will be a 50% software business which gives it a nice recurring revenue stream to go along with its semiconductor business. The deal, plus overall malaise in the Tech and Semiconductor industry, drove the stock lower.

Charles Schwab's Q1 EPS missed analyst estimates as Schwab should benefit from higher interest rates, but it typically takes several quarters to materialize. Also weighing on the stock was the decline in the overall stock market, which will impact asset fees. We remain bullish on Schwab as yields on its balance sheet should start to move higher and the stock market should eventually recover.

Microsoft's fiscal Q3 topped estimates as the company's cloud server division (Azure) posted 49% y/y growth. All business units reported strong growth including the More Personal Computing division (Windows) despite some supply chain struggles. The stock declined amid broader Tech sector woes and on news that the strength of the U.S. Dollar vs. major currencies would be a headwind to top-line growth.

Target's Q1 was fine from a sales perspective (comp sales beat estimates) but margins took a big hit on inventory markdowns on high ticket discretionary items. In addition, higher staffing in warehouses, wages, and freight cost inflation impacted gross margins. The company doesn't see this abating soon and took down full-year margin guidance. Company noted that sales in the weeks after quarter end remain strong and overall consumer spending is fine.

Apple's fiscal Q2 was good despite shutdowns in China crimping the supply chain and having an impact on demand in the region. iPhone revenue rose 6% y/y and Mac sales continued to show strength, up 14% y/y. Services revenue rose but slowed below the 20% growth rate over the past several quarters. The China shutdowns, plus overall weakness in the Technology sector, drove shares lower. We view these issues as temporary and see upside as China reopens.

Portfolio Additions & Deletions

In Q2 we added Hershey and exited the position in Reynolds.

Hershey is the market leader in indulgent snacking, with iconic brands including Reese's and Hershey's chocolate. Hershey operates in an attractive category, as snacking has seen strong growth above that of broader packaged food for the past few years. We also like Hershey's pricing power and favorable cost setup, as cocoa is one of the few commodities that has actually deflated over the past year. We believe the company should continue to generate strong free cash flow to support robust cash returns to shareholders.

We became increasingly concerned with Reynolds' exposure to underlying commodities (aluminum and resins derived from oil) and saw opportunities with less earnings and cash flow risk elsewhere.

Disclosures

* Performance Disclosures: AMI Asset Management (AMI) is an independent investment management firm registered with the Securities and Exchange Commission since 1994. Registration does not imply a certain level of skill or training. AMI provides discretionary asset management services to institutional and individual clients through separately managed accounts using seven equity and fixed income strategies. The Domestic Large Cap Equity Income Composite includes all fully discretionary, fee-paying and non-fee-paying, taxable and nontaxable accounts with at least $400,000 in large cap equity income securities on the last day of each previous quarter. The composite was created on January 1, 2015. Returns are presented gross and net of management fees and include the reinvestment of all income. Gross returns are presented before management fees but after all trading expenses. Net returns are calculated by deducting 1/4th of the highest applicable annual fee of 1.00% from the gross composite returns on a quarterly basis. Clients should not assume that managed accounts will attain similar investment performance in the future. All accounts are individually managed; therefore, returns for separate accounts may be higher or lower than the average performance stated above. The benchmark we use is the S&P 500® Total Return Index which is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. It includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The S&P 500® Total Return focuses on the large cap segment of the market with over 80% coverage of U.S. equities. Index performance is provided as a point of reference only and does not imply that a Strategy will achieve returns, volatility, or other results similar to the index. The total returns for the index do not reflect the deduction of any fees or expenses which would reduce returns. Indices are unmanaged, and one cannot invest directly in an index.

** Source: AMI and Bloomberg. The top five and bottom five contributors information is based on a representative account taken from the AMI Large Cap Equity Income composite. The representative account was selected because it closely reflects the AMI Large Cap Equity Income investment strategy. Due to factors such as portfolio size, specific investment guidelines and inception dates of individual accounts, there will be dispersion between the weight, returns, and contributions of this account and other accounts in the composite. The Contribution is calculated by multiplying the weight (i.e., percentage of the total account) invested in each holding times the rate of return for that holding during the measurement period. The holdings identified do not represent all of the securities purchased, sold or recommended for AMI's clients. Actual client holdings and characteristics may vary and holdings are subject to change. The reader should not assume that (1) an investment in the securities identified was or will be profitable or (2) that the AMI Large Cap Equity Income Strategy will hold these stocks in the future. References to specific securities are not intended as representative of past recommendations by AMI. The securities shown should not be considered recommendations or solicitations and may not have been, or in the future be, profitable. Nothing presented herein is or is intended to constitute investment advice, and no investment decision should be made based on any information provided herein. Past performance is not an indication of future returns. There is a risk of loss from an investment in securities, including the risk of loss of principal.

To obtain free of charge (1) a complete list of composite descriptions, (2) the calculation's methodology and a list showing every holding's contribution to the overall account's performance during the measurement period, and/or (3) a complete list of all buy and sell recommendations for this strategy within the last 12 months, please contact Katharine Kim at (424) 320-4003 or katharine@amiassetmanagement.com.