

Q3 - 2022

## Strategy Overview

In Q3, the Large Cap Equity Income strategy returned -5.64% (-5.89% on a net basis), versus the S&P 500 index, which returned -4.88%. Security selection drove the underperformance, with asset allocation a modest benefit. Underperforming stock selections in Health Care and Consumer Discretionary were partially offset by outperforming selections in Financials and Industrials. Being underweight Communication Services and overweight Consumer Discretionary helped performance, while being overweight Consumer Staples and underweight Energy hurt. At the end of Q3, the strategy's dividend yield was 2.34%.

As seen in the table below, the top contributors to Q3 performance were Charles Schwab, Starbucks, Waste Management, Target and Hershey. The bottom contributors to Q3 performance were Medical Properties, Pfizer, Microsoft, Church & Dwight, and Verizon.

Top Contributors in Q3		
Company	Avg. Weight	Contribution
Charles Schwab	3.40%	0.41%
Starbucks	2.35%	0.22%
Waste Management	4.24%	0.17%
Target	3.18%	0.15%
Hershey	2.58%	0.06%

\*\*Please see last page for important disclosures.

Bottom Contributors in Q3		
Company	Avg. Weight	Contribution
Medical Properties	1.81%	-0.36%
Pfizer	2.35%	-0.39%
Microsoft	6.4%	-0.57%
Church & Dwight	2.71%	-0.64%
Verizon	3.06%	-0.81%

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## Top Contributors

*charles* SCHWAB

Charles Schwab reported solid Q2 earnings as it began to benefit from rising interest rates, partially offset by weakness in stock and bond fees. Schwab's biggest segment, Interest Revenue, consists primarily of money market funds held at the bank, and these funds should continue to benefit from increased rates into next year. In addition, Schwab continues to gather assets, despite volatile markets.



Starbucks reported in-line fiscal Q3 results, but investor sentiment improved following the company's Analyst Day in September, where Starbucks laid out an attractive long-term growth outlook. Starbucks also appointed Laxman Narasimhan, the former CEO of Reckitt Benckiser, as CEO in a move that we view favorably given his experience managing global consumer brands.



Waste Management reported strong Q2 results and raised guidance reflecting continued strength in pricing and better volumes. The solid performance speaks to the essential nature of waste services, and we believe the business will remain resilient through economic cycles.

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Target's business showed signs of incremental improvement in Q2 following a difficult Q1 driven by elevated inventory levels. Target is working through the excess inventory that has negatively impacted results and appears well-positioned for solid back-to-school and holiday shopping seasons.



Hershey reported solid Q2 results and raised FY22 guidance, as price increases help margins, and consumers continue to show a willingness to spend more for small indulgences like the company's chocolate and snack brands.

## Bottom Contributors



Medical Properties reported better than expected funds from operations (FFO) in Q2 and guidance was essentially inline. Elective surgeries have returned post-Covid, improving the financial position of its network of hospitals. However, a rising dollar does impact the company given a large portion of operations are U.K. based. Also, as interest rates rise, MPW's borrowing costs on its variable debt increase is a headwind to FFO. We believe the headwinds will soon normalize and the underlying health of its hospital operator partners continues to improve as restrictions on procedures ease. The company's large dividend remains intact and well supported by cash flows.



Pfizer reported very strong Q2 growth, driven by COVID vaccines and Paxlovid treatment. However, its base business was weaker than expected. In addition, COVID vaccine uptake appears to have stalled and the forecasts for 2023 are coming down. Pfizer has made some attractive acquisitions recently that will help long term growth but the massive initial growth in COVID vaccines will be hard to top.



Microsoft's fiscal Q4 was hampered by a strong dollar, as well as by headwinds in China and Russia. Despite these issues, its Azure cloud business remained strong (+46% y/y) and overall commercial bookings were up 35% y/y. Microsoft saw no slowdown in large corporate deals but some slowing in PCs and gaming (Xbox) drove overall mixed results. We remain bullish on Microsoft given the healthy commercial business and demand for digital transformation projects which is driving the company's outlook for double-digit revenue growth and steady margins in FY23.



Church & Dwight missed earnings estimates in Q2 and lowered earnings guidance as cost pressures and weakness in the company's more discretionary products (Water-Pik and Flawless hair removal) weighed on growth. Church is also facing very difficult comparisons in its gummy vitamin business, which benefitted from the pandemic last year. However, Church derives 50% of its revenue from non-discretionary value brands, such as laundry and pet litter, which should make up for any weakness elsewhere in the portfolio in a difficult economic environment.

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Macro concerns have weighed on Verizon's stock over the past few months, as investors purchased Treasuries as rates rose to gain similar yields. Verizon's subscriber growth has slowed, and the company continues to offer healthy promotions to attract and retain customers in a competitive environment for mobile providers. The company's Fios broadband division continues to post strong growth, adding 256K subscribers in Q2. Despite the macro concerns, we believe the overall wireless business remains solid with low churn and rising ARPU. Verizon still produces tremendous cash flow and thus we believe the dividend remains healthy.

## **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](mailto:katharine@amiassetmanagement.com).