Reaves Asset Management

Market Commentary
Second Quarter 2020

REVIEW AND OUTLOOK

Performance as of 6/30/20	Q2 2020	YTD 2020
Reaves LTV Strategy Wrap Composite[1], Gross of Fees	8.85%	-10.19%
Reaves LTV Strategy Wrap Composite, Net of Fees	8.19%	-11.33%
S&P 500 Index[2]	20.54%	-3.08%
Russell 1000 Value Index[3]	14.29%	-16.26%

INTRODUCTION

In the second quarter, the Reaves LTV Strategy Wrap Composite recovered a portion of last quarter's COVID-induced decline. The advance was uneven, with growth stocks substantially outperforming defensive and value-oriented companies. Companies with visible long-term growth and economic re-opening stories were the winners.

Traditionally, defensive companies in the utilities and integrated telecom industries lagged as the market rotated from fear to exuberance, giving back some of the gains made over the past six quarters. During the 18-month period ended 3/31/2020, the utilities sector[4] outperformed the S&P 500 Index by more than 1,935 basis points.

Looking forward, the underperformance in this past quarter has created compelling opportunities for utilities. The sector, on average, is now trading at the biggest discount on forward earnings estimates relative to the S&P 500 since 2010. The spread between the dividend yield on the S&P 500 Utilities Index and the U.S. 10-Year Treasury Note[5] is the highest since at least 1988. In a world starved for yield, utilities seem likely to be in demand.

ENERGY SECTOR

Before getting to the performance review, we would like to update you with our view on the energy sector. The portfolio allocation to energy during the second quarter was the lowest weighting in our Firm's history. We believe that the declining costs for renewable energy, the electrification of transportation, and the potential for additional climate legislation represent major hurdles that will be hard for the industry to overcome. We have been reducing the allocation over the last few years, from about 29% at the end of 2016, more than 13% at the end of 2019, to about 0% as of the quarter end.

Our Firm began researching and investing in the energy sector in the 1970s. Demand for energy was growing steadily, underwriting long-term profitability and the ability to increase dividends consistently. Today, the picture is murkier. Demand is still rising, but governments around the world are aggressively incentivizing electric transportation, causing long-term growth to be in doubt. Without the confidence of steadily increasing demand, investors are focused on near-term cash flows, significantly increasing volatility. Production cuts enacted by OPEC[6] seem to have stabilized prices, but even with the help, at current prices most energy companies are barely profitable. The near-term challenges facing these companies was highlighted by Royal Dutch Shell's decision to cut its dividend, the first payout reduction since World War II. In the press release, the Chairman of the Board commented that because of "the risk of a prolonged period of economic uncertainty, weaker commodity prices, higher volatility, and uncertain demand outlook … the Board has also decided to reduce the first quarter 2020 dividend..."[7]

With near-term uncertainty and the likelihood of long-term declines in demand, we will continue to evaluate the sector for future consideration.

COMMUNICATIONS SECTOR

The sector, which includes both communications services and REITs[8] holdings, generated a return of 12.5% for the second quarter of this year. We think the recently closed merger of T-Mobile US and Sprint is transformational for the industry – the new entity has an unmatched wireless arsenal, and management boasts a strong track record. Investors, understandably distracted by other global happenings, seemed slow to react to the deal. We believe we were able to acquire shares before deal-related cost savings were appropriately priced.

We made an investment in an interactive media and services company which contributed positively to portfolio performance. Originally part of the technology sector, the company increasingly competes within the traditional communications industry and has many similar characteristics to our existing core holdings with non-discretionary services, high barriers to entry, low volatility, and a compelling valuation. The defensiveness exhibited by the stock in the first six months of the year gives us confidence in the position.

Communications REITs generated a return of about 11.3% in the second quarter. Wireless towers led the group as investors began pricing in the positive characteristics of the landmark T-Mobile deal. The wireless merger brought improved clarity on the deployment timeline for the currently dormant spectrum owned by Sprint and DISH Networks. As wireless spectrum is deployed on towers, rent revenues increase and returns improve. Some tower stocks continue to favorably price the certainty of new business during the quarter.

Lastly, cable stocks were mostly outperformers during the quarter. The ongoing work-from-home dynamic has created an attractive investment backdrop for the dominant provider of in-home broadband and communication.

UTILITIES SECTOR

Utilities performance, on the other hand, was disappointing with a total return of approximately 0.7%. Fundamentally, utilities are in good shape and continue to be one of the least negatively impacted industries in America by the pandemic. Dividends are rising as we expected, and those dividends continue to look attractive versus record low government bond yields. The market generally ignored the good news in the sector, opting to buy growth stocks and those that benefit from the economy reopening, but the utility business is as strong as ever.

Long-term growth potential has improved, driven by the replacement of fossil fuel-based power with renewable sources. Management teams have largely confirmed guidance given prior to the pandemic, reiterating what utilities are: non-discretionary, essential service companies with consistent growth, underwritten by the need for safety and reliability, while keeping bills low. The pandemic has not accelerated or decelerated growth or stressed balance sheets. The fact that the companies can maintain guidance, keep growth plans, and access capital markets during the harshest economic environment in our lifetimes gives us confidence. We think the consistency and stability will be beneficial to investors over the long term.

OTHER SECTORS

In addition to the communications and utilities holdings, we invest in companies that have similar characteristics to those sectors. Those include durable business models, steady growth profiles, pricing power, and rising dividends. Railroads currently make up the biggest part of this and generated a return of 17.5% in the second quarter.

Rail volumes recovered in May and June in some of the hardest-hit sectors, such as autos and cross-border container shipping, but remained about 20% lower than the same period in 2019. Despite the decline, operators have been quick to cut costs commensurately, mitigating the worst of potential negative earnings impact. The fast reaction by management teams reinforced our conviction that the sector remains attractive over the long term. Accordingly, we have increased our allocation to the sector from about 6% one year ago to today's weight of over 12%.

Recently, we initiated a position in an industrial logistics REIT with a global, highly occupied property portfolio concentrated in gateway markets. The company has achieved strong organic growth as the supply chain has moved closer to urban cores, a result of consumer demand for faster delivery times. The growth should continue as long-term leases are adjusted to current market rents and the substantial space demand benefits from e-commerce growth accelerate amid the pandemic. The REIT also has a top-notch balance sheet that positions it well for future growth.

IN CLOSING

More than 86% of the portfolio is invested in utilities, communications, and communications-based REITs. We believe companies in these sectors will benefit from the long-term trends of increasing data usage and renewable power growth, and we believe that future risk-adjusted returns produced by these companies will rival most other investment options in U.S. equities. For the remaining portion of the portfolio, our goal is to find securities that complement those securities. We believe select companies in the rail and real estate industries have those characteristics with durable business models, steady growth profiles, pricing power, and rising dividends.

If you have any questions about our investment management services, please do not hesitate to contact us at any time.

[1] Reaves' Long Term Value (LTV) Strategy Wrap Composite contains those Long Term Value Strategy discretionary SMA portfolios with wrap (bundled) fees. This bundled fee includes the wrap sponsor fee, as well as, Reaves' investment advisory fee. We are unable to identify the transaction costs included in the fee; therefore, net-of-fees returns would be net of the highest wrap fee provided to Reaves (300 basis points through 12/31/16 and, effective 1/1/2017, 250 basis points). The inception date of the composite is December 2002; however, the composite was created in January 2013. This composite has been managed in a similar manner to the Reaves Long Term Value Strategy ERISA Composite which ended in December of 2019. The LTV Wrap Composite does not represent all of Reaves' assets under management.

[2] The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The typical Reaves portfolio includes a significant percentage of assets that are also found in the S&P 500. However, Reaves' portfolios are far less diversified, resulting in higher sector concentrations than found in the broad-based S&P 500 Index.

[3] The Russell 1000 Value Index a broadly diversified index predominantly made up of value stocks of large U.S. companies.

[4] The utilities sector is represented by the S&P 500 Utilities Index a capitalization-weighted index containing 28 electric and gas utility stocks (including multi-utilities and independent power producers) in the S&P 500 Index that are classified as members of the utilities sector.

[5] The U.S. 10-Year Treasury Note is a debt obligation issued by the United States government with a maturity of 10 years upon initial issuance. A 10-Year Treasury Note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity.

[6] OPEC is the Organization of the Petroleum Exporting Countries is an intergovernmental organization of 13 nations.

[7] First Quarter 2020 dividend announcement comments by Chad Holliday, Chairman of the Board of Royal Dutch Shell April 30, 2020.

[8] REITs are Real Estate Investment Trusts.

Reaves' portfolio characteristics, holdings and sector weightings are subject to change at any time and are based on our Long Term Value Strategy SMA Wrap Composite portfolio. Holdings, sector weightings and portfolio characteristics of individual client portfolios may differ, sometimes significantly, from those shown. This information does not constitute, and should not be construed as, investment advice or recommendations with respect to the securities and sectors listed.

An investor cannot invest directly in an index.

Past performance is no guarantee of future results.

Reaves Asset Management

10 Exchange Place, 18th Floor
Jersey City, NJ 07302
www.reavesam.com

For further information, please contact:
Thomas M. Grimes, Director of Investor Relations
Email: tgrimes@reavesam.com • Phone: 201.793.2384