8-8-22

**WEEKLY UPDATE**

***Market Performance***

| MARKET INDEX | CLOSE 8-5-22 | WEEK GAIN/LOSS | Y-T-D GAIN/LOSS |
|---|---|---|---|
| **DJIA** | 32,803.47 | -0.1% | -9.7% |
| **S&P 500** | 4,145.19 | +0.4% | -13.0% |
| **NASDAQ** | 12,657.55 | +2.2% | -19.1% |

The stock market reported mixed results last week following a red-hot employment report with the Dow inching down 0.1%, while the S&P 500 edged up 0.4% and NASDAQ gained 2.2%.

***Economic Releases***
A summary of economic releases during the past week which may impact the financial markets:

The weekly initial unemployment claims increased by 6,000 to 260,000 for the week ending July 30 while continuing claims for the week ending July 23 increased by 48,000 to 1.416 million.

U.S. job growth surged much more than expected in July as nonfarm payrolls increased by a blockbuster 528,000. This compares to pre-pandemic average monthly job gains of 190,000. Average hourly earnings increased 0.5% in July with the year-over-year increase up 5.2%. The unemployment rate ticked lower to 3.5%. The labor participation rate fell to 62.1%, which indicates higher wages will persist. The strong employment report will likely lead the Fed to continue to raise interest rates to combat wage inflation.

The ISM Non-Manufacturing Index for July increased to 56.7. The July reading marks the 26th straight month of growth for the services sector. Business activity for the non-manufacturing sector accelerated in July at the same time there was a deceleration in the pace of price increases.

The July ISM Manufacturing Index decreased to 52.8% from 53.0% in June. July marked the 26th consecutive month of expansion in the manufacturing sector, although the July reading was the lowest reading since June 2020. The report pointed to a clear slowdown in manufacturing activity, highlighted by the contraction in new order activity, employment, and the biggest monthly drop in the prices index (inflation) since June 2010 (and fourth steepest decline on record going back to 1948).

Factory orders for manufactured goods increased 2.0% in June.  Shipments of manufactured goods rose 1.1%. Order activity accelerated in June for both durable and nondurable goods.

Total construction spending declined 1.1% month-over-month in June. Total private construction was down 1.3% month-over-month while total public construction decreased 0.5%. On a year-over-year basis, total construction spending was up 8.3%. Residential spending featured a 3.1% decline in new single family home construction. This is consistent with weak homebuilder sentiment, which has deteriorated on the back of higher mortgage rates crimping affordability for prospective buyers.

***HI-Quality Company News***

A summary of important earnings and/or capital allocation news announced during the past week from the high-quality companies held in most client portfolios. For new clients, these companies may become investment candidates as valuations appear attractive and cash is available:

**Booking Holdings-BKNG reported strong second quarter results with revenues flying 99% higher to $4.3 billion** with the company reporting $857 million in net income and EPS of $21.07 compared to losses last year. Second quarter gross travel bookings increased 57% to $34.5 billion as room nights booked in the quarter increased 56% from the prior year period to 246 million. Rental car days booked motored 22% higher while airline tickets booked soared 31%. U.S. booking increased 30% with European bookings up 20% while Asia remained a weak spot given Covid restrictions. About 38% of bookings were processed through the company's payments platform, which delivers more seamless, frictionless service. Alternative accommodations were up 25%, representing 32% of the overall mix. **Bookings' recovery from the pandemic reached another milestone with room nights booked for the second quarter surpassing 2019 levels for the first time. Free cash flow during the first half of the year was up fivefold to $4.2 billion with the company repurchasing $2.3 billion of its common stock.** Booking accelerated its share repurchases given the share price pullback and repurchased an additional $811 million of stock in July with $7.4 billion remaining authorized for future share repurchases. Despite growth moderating and significant foreign exchange headwinds, Booking Holdings expects record third quarter revenues given an extremely busy summer travel season. Fourth quarter bookings currently are 15% higher than 2019 levels although are subject to cancellations. Current cancellation rates have been below 2019 levels. Despite macroeconomic challenges, Booking Holdings' strong cash flow generation and solid balance sheet position the company well for long-term growth given the strong demand for travel.

**Maximus-MMS** reported third quarter revenue decreased 9% to $1.13 billion with net earnings and EPS down 66% to $31.3 million and $.51, respectively. The decline in revenue was offset by a combination of organic growth and acquired growth from the U.S. Federal Services Segment acquisitions. **Adjusting for COVID-19 response work, normalized organic growth would be approximately 21% over the prior year period.** By segment, U.S. Services Segment revenue decreased 8% to $399.3 million, primarily due to the expected reduction in short-term COVID-19 response work. Adjusting for this work, normalized organic growth in the segment was nearly 40% driven by ramping of new core work and COVID-19 response work that has evolved into longer term work with new customers gained during the pandemic. U.S. Federal Services Segment revenue decreased 15% to $525.5 million, driven by expected reductions in short-term COVID-19 response work, partially offset by contributions from the acquisitions of VES and Aidvantage. Adjusting for COVID-19 response work, normalized organic growth in the segment was approximately 6% over the prior year period. Outside the U.S. segment revenue increased 6% to $200.9 million. Results were net of a 9% currency headwind. Adjusting for COVID-19 response work, normalized organic growth in the segment was approximately 21% over the prior year period and driven primarily by ramping of the U.K. Restart Programme. Year-to-date signed contract awards totaled $4.02 billion and contracts pending totaled $476 million. During the quarter, Maximus generated free cash flow of $44.8 million compared to a negative free cash flow of $41.6 million in the prior year period and returned $65.1 million to shareholders through **dividend payments of $17.1 million and share repurchases of $48 million.** After quarter-end, the company repurchased an additional $22.3 million shares of common stock. Given the decline in revenues due to reductions in COVID-19 response work and earnings negatively impacted by the write-down in Outside the U.S. Segment, Maximus updated its guidance for the full fiscal year. Revenues are expected in the $4.55 billion to $4.65 billion range, compared to $4.5 billion to $4.7 billion, with EPS in the $2.85 to $3.05 range, down from prior guidance of $3.00 to $3.50. Free cash flow is expected in the $170 million to $210 million range, down from $175 million to $250 million previously guided. Looking ahead to fiscal 2023, management expects revenue to more than overcome $300 million year-over-year reductions in short-term

COVID response work, meaning a positive organic growth projection. For earnings, a lift in profitability is expected over fiscal 2022.

**Starbucks Corporation-SBUX** reported fiscal third quarter revenues increased 9% to $8.15 billion with net earnings falling 21% to $912.9 million and EPS declining 18.6% to $0.86. Same store sales growth increased 3%, driven by a 6% increase in average ticket partially offset by a 3% decline in comparative transactions. Starbucks opened 318 net new stores during the quarter, ending the quarter with 34,948 stores. Active Starbucks Rewards Membership increased 13% in the U.S. during the third quarter to 27.4 million members. By region, U.S. revenues increased 13% to $6.1 billion with operating margins declining 230 basis points to 22% on inflationary pressures, increased labor costs, partially offset by price increases. U.S. same store sales increased 9% on a 1% increase in transactions and an 8% change in ticket. International sales declined 6% to $1.58 billion on an 18% drop in comp store sales, primarily related to pandemic-related shutdowns in China where same store sales fell 44%. Excluding China, international segment revenues increased 33%. Excluding China and the impact of foreign currency headwinds, international revenues increased 50%. Net international operating margins dropped to 8.5% from 19.4% last year, mainly related to the COVID shutdowns in China. Channel Development sales increases 16% to $479.7 million, driven by growth in the Global Coffee Alliance and ready-to-drink business. During the first nine months of the fiscal year, Starbucks generated $2.0 billion in free cash flow, down 42.5% from last year with the company returning $5.7 billion to shareholders year-to-date through **cash dividends of $1.7 billion and share repurchases of $4.0 billion.** Starbucks suspended share repurchases during the quarter. The company ended the quarter with $3.5 billion in cash and investments and nearly $14.0 billion in long-term debt. Although Starbucks has suspended forward guidance, it expects fourth quarter margins to decline from the third quarter due to continued uneven store reopenings in China and a step-up in investments in the company's reinvention initiates including an expected doubling of compensation expenses from last year's fourth quarter.

**PepsiCo-PEP and Celsius Holdings**, Inc., maker of a leading global fitness energy drink, CELSIUS®, announced a definitive agreement forging a **long-term strategic distribution arrangement.** The distribution agreement initially transitions Celsius' current U.S. distribution to PepsiCo's best-in-class capabilities. As part of the transaction, PepsiCo will also make an investment in Celsius in support of its growth agenda and will nominate a director to serve on Celsius' Board of Directors. **As part of the transaction, PepsiCo will make a net cash investment of $550 million to Celsius in exchange for convertible preferred stock.** Shares underlying the transaction were priced at $75 per share, or approximately 7.33 million shares, which equates to **an estimated 8.5% ownership in Celsius on an as-converted basis. The preferred shares are entitled to a 5% annual dividend.**

**NVR, Inc.-NVR** announced today that its Board of Directors has **authorized the repurchase of $500 million of its outstanding common stock.** The company indicated that the authorization is a continuation of the stock repurchase program that began in 1994 and is consistent with NVR's strategy of maximizing shareholder value.

According to Mastercard SpendingPulseTM, which measures in-store and online retail sales across all forms of payment, **U.S. retail spending excluding automotive increased a hot 11.2% year-over-year in July**, while retail sales excluding automotive and gas rose 9.0%. Notably, e-commerce sales were up 11.7% year-over-year, a sharp increase after months of softer growth. Spending increases in July outpaced monthly year-over-year growth experienced thus far in 2022, with demand and higher prices both contributing factors. Consumers continue to navigate high inflation as they spend on wants and needs. The Grocery sector, for instance, saw sales up +16.8% in July due primarily to food price increases. On the other hand, Apparel (+16.6%) and Jewelry (+18.6%) sales saw strong demand-driven year-over-year growth, well outpacing sector-specific inflation. Travel remains a priority, with Lodging up 29.6% and Airline sales up 13.3%. Fuel & Convenience spending remains elevated (+32.3%), though the growth rate is down compared to June – reflecting price declines at the pump. After heating up during the pandemic, the U.S. housing market has cooled considerably since the beginning of 2022, slowing consumer spending on home-related goods.

**Berkshire Hathaway-BRKB** reported the company's net worth during the first half of 2022 decreased by 9%, or $45 billion, to $461.2 billion with book value equal to about $314,082 per Class A share as of 6/30/22.

Berkshire Hathaway reported second quarter revenues increased 10% to $76.2 billion with the company reporting a net loss of $43.8 billion compared to $28.1 billion in earnings in the prior year period. Investment gains and losses from changes in the market prices of Berkshire's equity investments will produce significant volatility in earnings. Excluding investment and derivative losses of $53 billion, **operating earnings jumped 39% to $9.3 billion in the second quarter, which better reflects the underlying strength of the business.**

The investment losses of $53 billion were primarily paper losses from changes in unrealized gains of equity holdings during the second quarter given the stock market's sharp pullback. Berkshire's five major equity investment holdings which represent about 69% of total equities held, include **American Express** at **$21.0 billion** (which charged 15% lower during the first half of 2022 or $3.8 billion); **Apple** at **$125.1 billion** (which dropped 22% during the first half or $36.1 billion with Buffett taking another bite of Apple as the price declined); **Bank of America** at **$32.2 billion** (which posted a 14% decline during the first half or $30.0 billion); and **Coca-Cola** with the stock popping 6% higher, or $1.5 billion, to **$25.2 billion** at the end of the first half. **Chevron** rounds out the top five at **$23.7 billion** after Buffett purchased more than $20 billion of Chevron during the first quarter.

During the second quarter, Berkshire's insurance businesses generated earnings from underwriting of $581 million, which increased 55% over the prior year period due to increases in reinsurance activities more than offsetting ongoing increases in claims frequencies and severities at GEICO due to significant cost inflation in automobile markets. Insurance investment income increased 56% during the quarter to $1.9 billion, reflecting higher dividend and interest income. The float of the insurance operations approximated $147 billion as of quarter end, relatively unchanged from year end. The average cost of float was negative during the quarter as the underwriting operations generated earnings.

Burlington Northern Santa Fe's revenues chugged 15% higher during the second quarter to $6.5 billion with net earnings rolling 10% higher to $1.7 billion reflecting higher revenue per car/unit partly offset by lower overall freight volumes and higher average fuel costs. The volume decreases were in all business groups reflecting supply chain disruptions, network challenges, lower demand for crude by rail and lower grain exports.

Berkshire Hathaway Energy reported revenues rose 7% during the second quarter to $6.5 billion with net earnings up 4% to $766 million. The earnings increase reflected higher earnings from tax equity investments and from the natural gas pipeline and Northern Powergrid, partly offset by the regulated utilities and real estate brokerage business.

Berkshire's Manufacturing businesses reported revenues rose 14% to $19.8 billion with operating earnings up 12% to $3.0 billion for the second quarter. The Buildings Products segment led the way for the quarter with revenues rising 20% to $7.7 billion and operating earnings jumping 34% to $1.3 billion thanks to strong demand for residential housing construction. Significant increases in mortgage interest rates will likely slow demand for new housing construction over the balance of the year. Berkshire's operations also continue to be negatively impacted by persistent supply chain disruptions and significant cost increases for raw materials, energy, freight and labor.

Service and Retailing revenues increased 8% during the quarter to $22.9 billion with pre-tax earnings relatively flat at $1.3 billion. The Service group led the way as revenue increased 19% to $4.7 billion with pre-tax earnings up 4% to $756 million thanks to strong growth from TTI, reflecting strong demand across all electronic component markets, and the aviation business services due to higher training hours at FlightSafety and significantly higher customer flight hours at NetJets.

**Berkshire's balance sheet continues to reflect very significant liquidity and a very strong capital base of $461.2 billion as of 6/30/22.** Excluding railroad, energy and utility investments, Berkshire ended the quarter with $467.6 billion in investments allocated approximately 70.0% to equities ($327.7 billion), 4.6% to fixed-income investments ($21.1 billion), 3.7% to equity method investments ($17.5 billion), and 21.7% in cash and equivalents ($101.3 billion).

Free cash flow declined 39% during the first half of the year to $8.5 billion due to lower earnings and higher capital expenditures. During the first half, capital expenditures approximated $6.8 billion, which included $4.8 billion for BNSF and BHE, its railroad and utility and energy units. Berkshire expects capital expenditures for the balance of 2022 for BNSF and BHE to approximate $6.6 billion.

**During the first half, Berkshire paid cash of $57.3 billion to acquire equity securities and received proceeds of $12.0 billion from the sale of stocks.** The stock purchases included about $21 billion in Chevron, about $11 billion in Occidental Petroleum, about $6 billion in Activision Blizzard as an arbitrage play, $5 billion in German stocks and Japanese stocks, $4 billion in HP, Inc. and an undisclosed additional amount of Apple. In addition, Berkshire purchased a net $22 billion in Treasury Bills and fixed-income investments. Berkshire also announced an agreement to acquire Alleghany, a property and casualty reinsurance and insurance business, for $11.6 billion in cash with the deal expected to close in the fourth quarter of 2022. In June 2022, Berkshire Hathaway Energy (BHE) acquired the BHE common stock held by Greg Abel, Berkshire's Vice Chairman, for $870 million.

Berkshire repurchases its shares at prices below Berkshire's intrinsic value, as conservatively determined by Warren Buffett and Charlie Munger. **During the first half, Berkshire repurchased $4.2 billion of its common stock, including $1 billion in the second quarter.** These repurchases included 25,462 Class B shares acquired at an average price of $276.75 per share and 2,397 Class A shares purchased at an average price of $425,870 per share during June 2022. No shares were repurchased in April or May. After quarter end, Berkshire repurchased an additional $500 million of its common stock in July.

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Earnings reports from our ***HI***-quality companies this past week were mixed like the stock market. **Booking Holdings** business soared thanks to the strong demand for travel which is continuing into the third quarter. **Maximus** faced difficult comparisons as they lapped significant Covid-19 response work last year, although normalized organic growth was a healthy 21%. **Starbucks** brewed up solid results domestically while its business in China was bitter due to continued Covid-related shutdowns. **Berkshire Hathaway,** with its multitude of diversified businesses, performed well with operating earnings up 39% to $9.3 billion during the past quarter thanks to growth in all major business units from insurance to the railroad and from utilities and energy to manufacturing and services. The financial strength and strong cash flows of all the ***HI-***quality businesses enables the companies to continue to reward shareholders with dividends, share repurchases and acquisitions and investments to drive future long-term growth.

Sincerely,

*Ingrid R. Hendershot, CFA*

President