10-10-22

WEEKLY UPDATE

Market Performance

MARKET INDEX	CLOSE 10-7-22	WEEK GAIN/LOSS	Y-T-D GAIN/LOSS
DJIA	29,296.25	+2.0%	-19.4%
S&P 500	3,639.84	+1.5%	-23.6%
NASDAQ	10,652.40	+0.7%	-31.9%

The stock market broadly retreated at the end of last week as strong employment numbers supported a further increase in interest rates to tame inflation. However, the stock market ended the week with overall gains thanks to the rousing rally earlier in the week from deeply oversold conditions with the Dow gaining 2.0%, the S&P 500 rising 1.5% and NASDAQ up 0.7% for the week.

Economic Releases

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

For the week ending October 1, initial jobless claims increased by 29,000 to 219,000, while continuing jobless claims for the week ending September 24 increased by 15,000 to 1.361 million.

U.S. employers hired more workers than expected in September as nonfarm payrolls increased by 263,000 jobs, while the unemployment rate dropped to 3.5%, matching a 50-year low. Wage inflation concerns remain as average hourly earnings rose 5% year-over-year, one of the fastest increases since the early 1980's. The tight labor market will likely lead to further aggressive interest rate hikes as the Federal Reserve has indicated a softening labor market will be needed to get inflation back to its 2% goal. Higher rates are expected to reduce economic growth and raise unemployment.

The September ISM Manufacturing Index dropped to 50.9% from 52.8% in August. A number above 50.0% is indicative of expansion, yet the lower reading versus August points to a deceleration in overall manufacturing activity which may be due to rapidly rising interest rates. September marked the 28th consecutive month of expansion in the manufacturing sector, yet it was the lowest reading since May 2020.

Total construction spending declined 0.7% month-over-month in August due to the continued downturn in residential spending. Rising interest rates have weakened homebuilder sentiment, as higher mortgage rates have also worsened affordability for prospective buyers. On a year-over-year basis, total construction spending was up 8.5%.

The ISM Non-Manufacturing Index for September dipped to 56.7% from 56.9% in August. Business activity for the non-manufacturing sector held steady in September and was stronger than expected. The September reading marks the 28th straight month of growth for the services sector.

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:

Nike-NKE reported first quarter revenues rose 4% to $12.7 billion with net income treading 22% lower to $1.5 billion and EPS down 20% to $.93. On a geographic basis, double-digit revenue growth in North America reflected strong consumer demand for the company's footwear and equipment, while revenues in Greater China declined 16%, impacted by Covid lockdowns. Nike Direct sales rose 8% to $5.1 billion on a reported basis and jumped 14% on a currency-neutral basis while Nike Digital sales increased 16% on a reported basis or 23% on a currency-neutral basis, led by 46% growth in EMEA. The company's competitive advantages, including its strong brand and pipeline of innovative products, helped the company manage through economic volatility. Gross margin declined 220 basis points to 44.3% due to elevated freight and logistics costs, foreign currency headwinds and higher markdowns in Nike Direct as excess inventory was liquidated. Operating costs increased due to higher wages and other costs. The tax rate also increased significantly during the quarter. Inventories jumped 44% over the prior year period to $9.7 billion driven by elevated in-transit inventories from ongoing supply chain volatility. Nike continues to have a strong track record of investing to fuel growth and consistently increasing returns to shareholders, including **20 consecutive years of rising dividend payouts**. In the first quarter, **Nike returned $1.5 billion to shareholders, including dividends of $480 million, up 11% from the prior year, and share repurchases of $1 billion, reflecting 9 million retired shares.** Nike expects to continue to liquidate excess inventories, primarily apparel, in the second quarter in what is expected to be a highly promotional retail environment. As a result, markdowns will lead to gross margin declines in the second quarter between 350-400 basis points. Higher freight costs, higher taxes and foreign exchange headwinds are also expected to persist in the second quarter. **Nike has managed through cycles like this before and will continue to focus on leveraging its strong brand and financial position to meet strong consumer demand for its products.** Nike currently does not see any economic slowdown and **expects to gain market share** in the next year despite uncertain macro conditions.

Paychex-PAYX reported first quarter sales increased 11% to $1.2 billion with net income and EPS increasing 14% to $379.2 million and $1.05, respectively. By segment, Management solutions revenue increased 12% to $905.5 million due to increases in client base and higher product penetration, including strong demand for HR Solutions, retirement, and time and attendance solutions. PEO and Insurance Solutions revenue increased 8% to $282.8 million due to the increase in number of worksite employees and an increase in PEO health insurance revenue**. Interest on funds held for clients increased 24% to $17.9 million due to higher average interest rates.** Paychex's financial position remains strong with cash and corporate investments of $1.2 billion, long-term debt of $797.8 million and shareholders' equity of $3.1 billion. Free cash flow decreased 6% during the quarter to $333.7 million, due to increased working capital needs. During the quarter, the company paid $284.6 million in dividends and generated an impressive 46% return on equity. **Management increased its adjusted EPS outlook for fiscal 2023, now expecting growth of 11% to 12% compared to 9% to 10% growth in previous guidance.** Total revenue is still expected to grow 7% to 8% in fiscal 2023. Management noted changes in the macroeconomic environment could alter guidance. Paychex believes they are well-positioned for growth in fiscal 2023 and beyond as they experienced record revenue retention levels in the first

quarter, bolstered by their leading-edge technology platform and continued investments in product development. In addition, interest rate increases will provide a tailwind for float income and management is balancing long-term investments with near-term cost discipline to navigate through uncertainty.

BERKSHIRE HATHAWAY INC.

Berkshire Hathaway-BRKB bought another 5,985,190 shares of **Occidental Petroleum** at $57.52 - $61.595 per share **worth about $352.5 million.**

In other news, **Berkshire Hathaway disclosed that Vice Chairman Greg Abel purchased 168 Class A shares of the company for a total of $68.3 million which works out to an average cost per share of $406,730.** This is a strong signal that he finds the stock attractively valued at current price levels.

Starbucks-SBUX announced that its Board of Directors has approved an 8.2% increase in the company's quarterly cash dividend from $0.49 to $0.53 per share, which raises the company's annual dividend rate to $2.12 per share. **Starbucks initiated its dividend in 2010 and has increased it in each of the past 12 years.**

According to **Mastercard SpendingPulseTM, U.S. retail sales, excluding automotive, increased +11% year-over-year in September.** E-commerce sales continue to grow, up +10.7% year-over-year, highlighting the ongoing demand for the convenience of digital commerce. Mastercard SpendingPulse measures in-store and online retail sales across all forms of payment and it is not adjusted for inflation. Reflecting the broader contraction of the housing market, spending in and around the home is slowing. Furniture & Furnishing and Hardware sectors experienced minimal year-over-year growth, up +1.4% and +1.7% respectively. On the other hand, spending at Restaurants was up +10.9% year-over year, as consumers continue to enjoy eating out. Further, **travel remains a priority as spending on Airlines and Lodging experienced double-digit year-over-year growth.** This is consistent with the past several months.

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The Dow started the week with a strong 1500-point rally as stocks rebounded broadly from deeply oversold conditions only to end the week with a 630-point drop as further interest rate hikes appeared more prominently on the horizon given strong employment numbers. Amid high inflation, rising interest rates, recession fears and geopolitical tensions, it is no wonder that the stock market volatility this year has felt like riding in an airplane during a turbulent storm. While a bumpy ride and air pockets may make even the seasoned traveler queasy, bailing out during stormy weather is not generally a good idea. By staying buckled in even during less-than-ideal conditions, the plane will make it to its destination 99.9% of the time. The same can be said for long-term investing. By staying the course with a prudent and suitable asset allocation, investors will reach their investment goals even with periodic stock market and economic volatility.

Third quarter earnings season will begin next week, and we will carefully monitor how the management teams of our ***HI***-quality companies are navigating through challenging economic conditions. We received a preview as Nike and Paychex reported fiscal 2023 first quarter financial results. **Nike** reported solid revenue growth on strong consumer demand, but earnings declined as the company is facing wage inflation, foreign currency headwinds, elevated freight costs and supply chain challenges leading to excess inventory markdowns. Nike has successfully managed past periods of economic challenges given its strong brand and financial strength which has enabled the company to increase its dividend for 20 straight years. Despite the challenges of the past quarter, Nike returned $1.5 billion of cash to shareholders through dividends and share repurchases and continued to gain market share. **Paychex** is a business that is benefiting from the tight labor market and higher interest rates as more payrolls are processed and float income increased 27% during the quarter thanks to the higher interest rates. As a result, Paychex reported double-digit revenue and earnings growth in the first fiscal quarter and increased its adjusted EPS growth outlook for fiscal 2023 to a range of 11%-12% growth.

In other company news, **Starbucks** brewed up an 8% dividend increase, marking its 12th consecutive year of dividend increases. **Mastercard** reported that retail sales grew at double-digit rates during September with consumer spending shifting towards eating out at restaurants and travel. **Berkshire Hathaway** is taking advantage of lower stock prices by adding to its position in Occidental Petroleum while Vice Chairman Greg Abel made a personal significant $68.3 million purchase of Berkshire Hathaway stock, signaling he finds Berkshire's stock attractively valued. We agree.

If you have any questions, please let us know.

Sincerely,
Ingrid R. Hendershot, CFA
President