12-27-22

WEEKLY UPDATE

Market Performance

MARKET INDEX	CLOSE 12-23-22	WEEK GAIN/LOSS	Y-T-D GAIN/LOSS
DJIA	33,203.93	+0.9%	-8.6%
S&P 500	3,844.82	-0.2%	-19.3%
NASDAQ	10,497.86	-1.9%	-32.9%

The stock market posted mixed results last week with the Dow gaining 0.9%, the S&P 500 declining 0.2% and NASDAQ falling 1.9%. As we end a challenging year for the markets given macroeconomic headwinds and rising rates, the Dow has proven the most resilient index with losses less than 10% while the broader S&P 500 has dropped 19% and the tech-heavy NASDAQ has suffered a nearly 33% swoon.

Economic Releases

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

On the employment front, first-time claims for state unemployment benefits—a proxy for layoffs—increased by 2,000 to 216,000 for the week ended December 17 while continuing claims—a proxy for the number of people with ongoing unemployment benefits—declined to 1.672 million, down 6,000 from the previous week. The labor market remains tight which will likely result in further Fed tightening.

The third estimate for Q3 GDP revealed that consumer spending increased 2.3%. That upward revision helped drive an upward revision for Q3 GDP growth to 3.2% from the second estimate of 2.9% reflecting that growth in the third quarter was stronger than previously expected, which is also why the Fed continued to raise rates aggressively in the third quarter.

Durable goods orders in November declined 2.1% month-over-month which was more than expected. However, excluding transportation, durable goods orders were up 0.2% which is a better proxy of business spending.

Total housing starts declined 0.5% month-over-month in November to a seasonally adjusted annual rate of 1.427 million units as single-unit starts fell by 4.1% to 828,000. Total building permits declined 11.2% month-over-month to a seasonally adjusted annual rate of 1.342 million with permits for single-unit dwellings dropping by 7.1%. The weakness in building permits is a leading indicator of the slowdown for homebuilders given the affordability constraints for prospective buyers due to building cost inflation and much higher mortgage rates.

Existing home sales decreased 7.7% month-over-month in November to a seasonally adjusted annual rate of 4.09 million. That is the tenth straight month that existing home sales have fallen. Total sales in November were down 35.4% from a year ago. While home price growth has slowed, the median existing home price for all housing types increased 3.5% year-over-year to $370,700, representing the 129th consecutive month of year-over-year gains. That is the longest-running streak on record. All-cash sales comprised 26% of transactions in November, unchanged from October, and up from 24% in November 2021. Approximately 61% of homes sold in November were on the market for less than a month.

New home sales increased 5.8% month-over-month in November to a seasonally adjusted annual rate of 640,000 units thanks to a pullback in mortgage rates in November. On a year-over-year basis, new home sales were down 15.3%. The median sales price for a new home increased 9.5% year-over-year to $471,200.

Personal income increased 0.4% month-over-month and personal spending increased 0.1% in November. The PCE Price Index was up just 0.1% month-over-month and the core-PCE Price Index, which excludes food and energy, was up 0.2%. On a year-over-year basis, the PCE Price Index was up 5.5%, versus 6.1% in October, and the core-PCE Price Index was up 4.7% versus 5.0% in October. Inflation is moderating but is still higher than the Fed's 2% inflation target which indicates further interest rate hikes by the Fed.

The Conference Board's Consumer Confidence Index took a surprising turn for the better in December, jumping to 108.3 from an upwardly revised 101.4 in November driven by improved views of the economy and jobs, as well as declining gas prices. Year-ahead inflation expectations dropped to 6.7%, the lowest level since September 2021.

The final December University of Michigan Index of Consumer Sentiment improved to 59.7 from the final reading of 56.8 for November. In the same period a year ago, the index stood at 70.6. Consumer sentiment is improving as inflation is easing.

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:

Paychex-PAYX reported record second quarter revenues rose 7% to $1.2 billion with net income up 8% to $360.3 million and EPS up 9% to $.99. These solid results reflect the strong demand the company is seeing for its comprehensive suite of human resource solutions in a tight labor market. Higher client employment levels drove growth as wage inflation has been moderating and holding steady at about 5% over the last quarter. Paychex's revenue retention is remaining above pre-pandemic levels with the company's HR Outsourcing now serving over two million employees hitting a new milestone**. Free cash flow increased 26% to $620 million during the first half of the year with the company paying $569 million in dividends at an industry-leading dividend payout rate.** The company maintains a strong liquidity position with no net debt. **Return on equity on a rolling 12-month basis was a stellar 46%.** Despite lower-than-expected revenue growth in its insurance solutions, **Paychex raised its overall outlook for revenue growth for the full year to 8% and raised its adjusted EPS guidance from 11%-12% growth to 12%-14% growth** given the solid performance in the first half of the year. Rising interest rates are serving as a tailwind for float income. Despite a challenging macroenvironment, Paychex's small and mid-sized business customers have proven resilient. **Paychex's leading indicators are currently not pointing to any downturn for its customers.**

NIKE-NKE reported fiscal 2023 second quarter revenues jumped 17% to $13.3 billion with net income coming in flat at $1.3 billion and EPS increasing 2% to $0.85. By geography, North America sales increased 30% to $5.8 billion, Europe, Middle East & Africa sales increased 11% to $3.5 billion, Greater China sales decreased 3% to $1.8 billion and Asia Pacific & Latin America sales increased 19% to $1.6 billion. Gross margin decreased

300 basis points to 42.9%, primarily due to higher markdowns to liquidate inventory, particularly in North America; continued unfavorable changes in net foreign currency exchange rates, elevated freight and logistics costs and increased product input costs; partially offset by strategic pricing actions. NIKE Direct sales were up 16% to $5.4 billion, Nike Brand digital sales increased 25% and wholesale revenues increased 19%. NIKE continued its strong track record of investing to fuel growth and consistently increasing returns to shareholders, including **21 consecutive years of increasing dividend payouts**. During the second quarter, **NIKE paid dividends of $480 million to shareholders, up 10% from the prior year. In addition, the company repurchased $1.6 billion of its common stock**, reflecting 16.5 million shares retired as part of the four-year, $18 billion program approved by the Board of Directors in June 2022. As of November 30, 2022, a total of 19 million shares have been repurchased under the program for a total of approximately $1.9 billion. Nike ended the quarter with $10.6 billion in cash and short-term investments, down approximately $4.5 billion from last year, as free cash flow was offset by share repurchases and cash dividends. Nike expects fiscal 2023 revenue to rise in the mid-single digit range and expects revenue to grow in the low-teen range on a currency-neutral basis.

FactSet-FDS reported first fiscal quarter revenue rose 18.9% to $504.8 million with net income jumping 27.1% to $136.8 million and EPS up 26.2% to $3.52. The revenue increase included the addition of the CUSIP Global Services (CGS) acquisition. Organic revenue grew 8.3% to $459.9 million. Annual Subscription Volume (ASV) plus professional services was $2.0 billion at 11/30/22 compared to $1.7 billion a year ago. **The company's operating margin expanded to 34.1% compared with 28.9% a year ago** driven by higher revenue, lower personnel cost as a percentage of revenue, lower third-party content costs and reduced facilities expenses. Client count increased by 93 clients in the past three months to end the quarter at 7,631 clients, primarily driven by an increase in corporate and wealth clients. User count increased by 977 to 180,959, primarily driven by an increase in wealth management, institutional asset management and asset owner users. Annual ASV retention was greater than 95%. **When expressed as a percentage of clients, annual retention was 92%. Free cash flow increased 38% during the first quarter to $88.7 million with the company paying $33.7 million in dividends**. Share repurchases have been suspended until at least the third quarter as the company is prioritizing repaying debt in connection with the CGS acquisition. The company still has $181.3 million authorized for future share repurchases. FactSet reaffirmed its financial outlook for fiscal 2023 with revenue expected in the range of $2.1 billion to $2.115 billion and EPS expected in the range of $12.70-$13.10. Despite an uncertain and challenging market, FactSet has been a consistent performer with a resilient business model.

General Dynamics-GD Electric Boat announced the **U.S. Navy has awarded a $5.1 billion** contract modification of the previously awarded Columbia Integrated Product and Process Development **Contract** for the Columbia class of submarines, the nation's next-generation sea-based strategic deterrent.

Johnson & Johnson-JNJ completed its $16.6 billion cash acquisition of Abiomed, Inc., which allows Johnson & Johnson's MedTech unit to expand its portfolio in the high growth cardiovascular markets, adding solutions for heart recovery to its global market leading Biosense Webster electrophysiology business. The transaction will not have a material impact on financial results for 2022. As previously announced, the transaction

will accelerate pro forma MedTech and Johnson & Johnson enterprise revenue growth. It is also expected to be slightly dilutive to neutral to adjusted earnings per share in the first year, considering the impact of financing, and then accretive by approximately $0.05 in 2024, and increasingly accretive thereafter.

Alphabet

The National Football League announced a multi-year agreement with Google-GOOGL granting YouTube TV and YouTube Primetime Channels the right to exclusively distribute NFL Sunday Ticket to consumers in the United States starting with the 2023 NFL season. The Wall Street Journal reported that Google will pay approximately $2 billion a year for the rights. The NFL and Google have been partners since the League first launched its official NFL channel on YouTube in 2015. Since then, the NFL YouTube channel has grown to more than 10 million subscribers who enjoy clips, highlights, game-day compilations and exclusive original content series like NFL Follies and NFL Film's two-time Emmy winning flagship series Gameday All-Access, a mic'd up players show bringing fans inside the huddle and on the sidelines for exclusive access during the game.

3M Science. Applied to Life.™

3M-MMM announced it will exit per- and polyfluoroalkyl substance (PFAS) manufacturing and work to discontinue the use of PFAS across its product portfolio by the end of 2025. The current annual net sales of manufactured PFAS are approximately $1.3 billion, which is a relatively small percentage of overall revenues. **Over the course of the exit from PFAS manufacturing, 3M expects to incur related total pre-tax charges of approximately $1.3 billion to $2.3 billion**, including an estimated fourth quarter 2022 pre-tax charge in a range of $0.7 billion to $1.0 billion, **primarily non-cash** and related to asset impairments. Approximately 70-80% of the total charges are expected to be non-cash.

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Last week, Congress passed a $1.7 trillion spending bill which includes the **Secure 2.0 Act of 2022**, a collection of retirement provisions to build upon the Secure Act of 2019. Some of the provisions include requiring automatic enrollment in some workplace plans, increasing "catch-up" contributions that older workers can make and boosting part-time workers' access to retirement plans.

The provisions also increase the age when required minimum distributions (RMDs) would need to start. In 2023, the age increases from 72 to 73 and then to age 75 in 2033.

Under current law, you can put an extra $6,500 annually in your 401(k) once you reach age 50. Secure 2.0 will increase the limit to $10,000 (or 50% more than the regular catch-up amount) starting in 2025 for savers ages 60 to 63. Catch-up amounts also would be indexed for inflation. Additionally, all catch-up contributions will be subject to Roth treatment (i.e., not pretax) except for workers who earn $145,000 or less.

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This will be the last Weekly Update of 2022. We thank you for your confidence and trust in allowing us to serve your investment needs and wish you a Happy, Healthy and Prosperous New Year!

Sincerely,

Ingrid R. Hendershot, CFA
President