8-22-22

WEEKLY UPDATE

Market Performance

MARKET INDEX	CLOSE 8-19-22	WEEK GAIN/LOSS	Y-T-D GAIN/LOSS
DJIA	33,706.74	-0.2%	-7.2%
S&P 500	4,228.48	-1.2%	-11.3%
NASDAQ	12,705.71	-2.6%	-18.8%

The stock market pulled back last week as several Fed officials suggested the central bank would maintain its path of interest rate hikes to combat inflation with the Dow dipping 0.2%, the S&P 500 slipping 1.2% and NASDAQ tripping 2.6% lower.

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

The weekly initial unemployment claims decreased by 2,000 to 250,000 for the week ending August 13, while continuing claims for the week ending August 6 increased by 7,000 to 1.437 million. The low unemployment levels are a long way from recession levels which will likely result in the Fed increasing interest rates further.

Housing starts in July decreased 9.6% month-over-month to a seasonally adjusted annual rate of 1.446 million while building permits -- a leading indicator -- were down 1.3% month-over-month to a seasonally adjusted annual rate of 1.674 million. Housing starts are now at their lowest level since early 2021 while building permits are also receding from a high that was seen earlier this year.

Existing home sales decreased 5.9% month-over-month in July to a seasonally adjusted annual rate of 4.81 million. That is the sixth straight month that existing home sales have fallen. Total sales in July were down 20.2% from a year ago. Higher mortgage rates are curtailing existing home sales, having compounded affordability pressures that persist with still high (although moderating) prices.

Total industrial production increased 0.6% month-over-month in July. The capacity utilization rate increased to 80.3%. Total production growth was supported by a solid increase in motor vehicle assemblies, which is fueling hopes that the semiconductor shortage is easing its grip on auto production.

Total retail sales were flat month-over-month in July dragged down by declines in motor vehicle sales (-1.6%), gasoline station sales (-1.8%), and general merchandise sales (-0.7%). Excluding autos, retail sales were up 0.4%. Consumer spending persisted in July across most discretionary categories, aided by some relief in falling gas prices.

International economic reports echo domestic indicators in terms of inflation, unemployment and consumer confidence. Eurozone CPI was up 8.9% reflecting global inflation concerns. German PPI was up 37.2% in July, the highest in more than 70 years, pointing to the need for more interest rate hikes. UK consumer confidence fell to the lowest level since 1974 as inflation hit a 40-year high and as energy bills are expected to increase 80% in October. Australia's 3.4% unemployment rate is the lowest since 1974. On the other hand, weaker-than-expected economic data out of China led the country to cut interest rates and renewed global growth concerns.

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:

Cisco Systems-CSCO reported fourth quarter revenues remained flat at $13.1 billion with net income decreasing 6% to $2.8 billion and EPS down 4% to $.68. Cisco had continued progress on their business model transformation with total Annualized Recurring Revenue (ARR) at $22.9 billion in the fourth quarter of fiscal 2022, up 8% year over year. Total revenue exceeded management's expectations in the fourth quarter, due to strong execution and numerous initiatives to reduce the impact of the global supply situation. Management's operational discipline was reflected in their healthy operating margin and strong cash flow generation, enabling Cisco to return nearly $4 billion to shareholders in the fourth quarter. During the quarter, product revenue and service revenue remained flat. By product segment, growth was led by End-to-End Security up 20% to $984 million, Optimized Application Experiences up 8% to $185 million, and Collaboration up 2% to $1.2 billion. Growth in these segments was offset by Secure, Agile Networks down 1% to $6.1 billion and Internet for the Future down 10% to $1.3 billion. For the full fiscal 2022 year, revenues increased 3% to $51.6 billion with net income increasing 12% to $11.8 billion and EPS up 13% to $2.82. **Cisco experienced strong demand for its products and service during the year, with record full year product orders and backlog. Return on shareholders' equity was an impressive 30% for the year.** Free cash flow was down 14% to $12.7 billion, due to higher working capital needs. **During fiscal 2022, Cisco returned $13.9 billion to shareholders through dividends of $6.2 billion and share repurchases of $7.7 billion**. Cisco ended the year with a strong financial position with more than $19 billion in cash and investments, $8.4 billion in long-term debt and $39.8 billion in shareholders' equity. Management's outlook for the first quarter of fiscal 2023 is for revenue growth of 2%-4% and EPS in the range of $.64 to $.68. Guidance for the full fiscal year 2023 is for revenue growth of 4%-6% and EPS in the range of $2.77 to $2.88.

Ross Stores-ROST reported a 4.6% decline in second quarter sales to $4.6 billion with net income falling 22% to $384.5 million and EPS down 20% to $1.11. Same store sales fell 7% on top of last year's robust 15% same store sales increase, which was the strongest period last year. Operating margins declined 280 basis points to 11.3%, reflecting the deleveraging effect of the same store sales decline, higher markdowns, and ongoing headwinds from increased freight costs that began increasing during the second half of 2021. These expenses were partially offset by lower incentive and COVID costs. At quarter end, total inventories jumped 55% to $2.7 billion. Packaway merchandise represented 41% of total inventory versus 30% in the same period last year when the company used a substantial amount of packaways to meet robust consumer demand. **Supply chain congestion continued to ease during the second quarter**, resulting in above-plan early receipts of merchandise now stored in packaway that will flow to stores throughout the fall season. The company added 21 new Ross and 8 dd's DISCOUNTS locations during the quarter ending the period with 1,980 stores. Ross remains on track to open a total of about 100 locations in 2022, comprised of 75 Ross and 25 dd stores. During the first half of 2022, Ross Stores used $56 million cash in its operating activities and invested $243 million in capital expenditures. **Ross Stores returned $692.2 million to shareholders during the first half of fiscal 2022, consisting of $217 million in dividends and $475 million in share repurchases**, including $235 million during the second quarter at an average cost of $81.03 per share. **The company expects to repurchase a total of $950 million of its stock during 2022 under its two-year $1.9 billion share repurchase program that**

extends into 2023. Ross Stores ended the quarter with $3.9 billion in cash, $2.5 billion in long-term debt and $4.1 billion in shareholders' equity on its sturdy balance sheet. Given the disappointing first half results, the increasingly challenging and unpredictable macro-economic landscape and today's more promotional retail environment, the company expects same store sales for the third quarter to decline 7% to 9% versus the strong 14% increase last year. Fourth quarter same store sales are expected to decline 4% to 7% on top of last year's 9% increase. EPS for 2022 are expected in the $3.84 to $4.12 range, down 18% from last year at the mid-point.

The TJX Companies-TJX reported net sales declined 1.9% during the second quarter to $11.8 billion with net income up 3% to $809.3 million and EPS up 7.8% to $.69. U.S. comparable store sales declined 5% as a higher average ticket was offset by lower traffic as **customers were impacted by high inflation, especially in gas and food prices, which curtailed consumer discretionary spending. With gas prices easing, this should help second half results** along with increased marketing programs focused on the value TJX provides its customers. TJX saw softness in the home categories with positive growth in the overall apparel business. The international businesses experienced constant currency sales growth with improved profitability. The company's pre-tax margin of 9.2% was above the company's plan as the company generated strong merchandise margins and had less freight and wage pressures. **The strong profitability on lower sales speaks to the company's strength and flexible business model** with sharp team execution and good expense discipline. Inventories jumped 39% during the quarter to $7.1 billion but management is comfortable with its inventory levels, noting that inventory turnover is better than pre-Covid days. During the second quarter, the company generated $641 million of operating cash flow and paid $346 million in dividends and repurchased 11.8 million shares for $700 million at an average price of about $59.32 per share. **During the first half, the company returned $2 billion to shareholders through $653 million in dividends and $1.3 billion of share repurchases. TJX expects to repurchase approximately $2.25 billion to $2.50 billion of TJX stock for the full fiscal year.** For the full 2023 fiscal year, TJX lowered its expectation for U.S. comparable sales growth to a decrease of 2% to 3% versus its previous guidance of an increase of 1% to 2% while increasing its outlook for pre-tax profit margin to a range of 9.3% to 9.5%, which should generate EPS in the range of $2.87 to $2.95.

Berkshire Hathaway-BRKB received approval from the Federal Energy Regulatory Commission (FERC) to acquire up to 50% of Occidental Petroleum. The approval was necessary as Occidental owns FERC assets. Berkshire Hathaway Energy (BHE) also owns energy assets that are FERC-regulated and needed regulatory approval to ensure that further Occidental purchases would not have an adverse impact on competition. Berkshire currently owns more than 20% of Occidental. While some speculate that Berkshire is planning to acquire the remaining shares of Occidental it does not own, the filing also could just be a regulatory formality. Time will tell.

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3M-MMM recently spun off its food safety business to Neogen-NEOG. As part of the transaction, 3M is offering shareholders the ability to exchange shares of 3M for Neogen. Hendershot Investments has reviewed the transaction and has elected NOT to participate in the offer as Neogen does not meet our investment criteria. Accordingly, you may disregard any notices you receive as no further action is required, and your 3M shares will remain in your account.

Apple-AAPL users have been advised to immediately update their iPhones, iPads and Macs to protect against a pair of security vulnerabilities that can allow attackers to take complete control of their devices.

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We are working on the September quarterly newsletter, which will be released soon.

If you have any questions, please let us know.

Sincerely,
Ingrid R. Hendershot, CFA
President