01-30-23

WEEKLY UPDATE

Market Performance

MARKET INDEX	CLOSE 01-27-23	WEEK GAIN/LOSS	Y-T-D GAIN/LOSS
DJIA	33,978.08	+1.8%	+2.5%
S&P 500	4,070.56	+2.5%	+6.0%
NASDAQ	11,621.71	+4.3%	+11.0%

Digesting solid fourth quarter corporate earnings reports and a better-than-expected fourth quarter GDP report, the stock market cheered the news with the Dow gaining 1.8%, the S&P 500 surging 2.5% and NASDAQ jumping 4.3% during the past week.

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—decreased by 6,000 to 186,000 for the week ended January 21 while continuing claims—a proxy for the number of people with ongoing unemployment benefits—increased to 1.675 million, up 20,000 from the previous week. New claims running below 200,000 reflects a tight labor market.

The Advance Q4 GDP Report showed real GDP increasing at an annual rate of 2.9% following a 3.2% increase in the third quarter. The Q4 PCE Price Index was up 3.2% versus 4.3% in the third quarter. While consumer spending (and inflation) did moderate, the economy was a long way from a recession in the fourth quarter. This is reinforced by solid fourth quarter earnings for most of our ***HI***-quality companies.

Durable goods orders in December increased 5.6% month-over-month on strong transportation orders. Excluding transportation, durable goods orders were down 0.1% month-over-month with manufacturing activity soft in December.

New home sales increased 2.3% month-over-month in December to a seasonally adjusted annual rate of 616,000 units. On a year-over-year basis, new home sales were down 26.6%. The pullback in mortgage rates has spurred some renewed demand among home buyers; however, affordability and supply pressures remain for many prospective buyers and that is holding back overall sales. The median sales price increased 7.8% to $442,100 while the average sales price jumped 7.6% to $528,400.

Personal income was up 0.2% month-over-month in December and personal spending was down 0.2% month-over-month. The PCE Price Index was up 0.1% month-over-month and the core-PCE Price Index, which excludes food and energy, was up 0.3%. That left the year-over-year changes at 5.0% and 4.4%, respectively, versus 5.5% and 4.7% in November, reflecting a continued moderation of inflation pressures. However, inflation rates are still too high -- particularly services inflation which was up 0.5% month-over-month following a 0.3% increase in November.

The final January University of Michigan Index of Consumer Sentiment was 64.9 increasing from the final reading for December of 59.7. In January 2022, the index stood at 67.2. Consumer sentiment picked up in January on better feelings about personal finances that stemmed from higher incomes and easing inflation, although it is also worth noting that two-thirds of consumers expect an economic downturn during the next year. Year-ahead inflation expectations dipped to 3.9% from the final reading of 4.4% for December. The current reading is the lowest since April 2021. Long run inflation expectations were 2.9% unchanged from the final reading of 2.9% for December.

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:

Gentex-GNTX reported fourth quarter revenues rose 18% to $493.6 million with net income up 2% to $86.2 million and EPS up 6% to $.37 as the company gained market share. For the year, revenues increased 11% to a record $1.9 billion with net income dropping 12% to $318.8 million and EPS down 9% to $1.36 due to a difficult operating environment impacted by customer order volatility, supply constraints and cost inflation in raw materials, labor and almost every other facet of the business. **2022 Full Display Mirror unit shipments grew by 49% year over year to 1.68 million units despite significant supply chain issues. Return on shareholders' equity was a shiny 15.4%.** Free cash flow declined 35% during the year to $191.8 million due primarily to capital expenditures more than doubling as the company invests for the future. Capital expenditures are expected to increase further in 2023 to a range of $200 million to $225 million. **Gentex repurchased 4.04 million shares of its common stock at an average price of $28.19 per share during the year for a total of $113.9 million with 20.8 million shares remaining authorized for future share repurchases.** Gentex expects 2023 revenues to approximate $2.2 billion with gross margin of 32%-33% and operating expenses of $260-$270 million with a tax rate in the range of 15%-17%. While margins are expected to improve in 2023, the expansion is expected to occur in the second half of the year. For fiscal 2024, revenues are expected to increase an additional 10% over 2023's revenues with margins continuing to improve as gross margin is targeted in the 35%-36% range by the end of 2024. The improving revenue environment will be driven by expected 4% growth in light vehicle production each year over the next two years and the company's expanding product portfolio**. Improving margins will result from a better supply environment and internal cost controls, which should lead to increasing shareholder returns over the next two years.**

T. Rowe Price-TROW reported fourth quarter revenues declined 22% to $1.5 billion with net income and EPS plunging 64% to $266 million and $1.16, respectively. For the full year, revenues declined 15% to $6.5 billion with earnings and EPS dropping 49% to $1.6 billion and $6.70, respectively. **Given the sharp earnings drop, return on equity declined to a still respectable 17.6% for the year.** Net client outflows were $17.1 billion in the fourth quarter and $61.7 billion for the full year largely driven by growth equity strategies. The company's ending assets under management as of year end declined 25% to $1.275 billion as stocks closed out their worst year since 2008 and the Bloomberg U.S. Aggregate Bond Index suffered its worst year since its inception in 1976. Recession worries and warnings of further rate hikes continued into year end. **Whether central banks can**

achieve "soft landings" and tame inflation remains to be seen with the consensus expecting at least a modest economic downturn in the U.S. with perhaps deeper slumps ahead in Europe. The company's balance sheet remains cash-rich and debt-free. **T. Rowe Price paid an annual dividend of $4.80, which represents a 4.1% dividend yield at the current market price. During the year, the company repurchased 6.8 million shares for $855.3 million at an average cost of $125.78 per share, reducing its average shares outstanding to 224.3 million, the lowest year-end level since its IPO. Over its 85-year history, T. Rowe Price has successfully navigated uncertainty and market volatility.** While headwinds are expected to persist in 2023, T. Rowe Price expects more constructive markets, improved performance, and traction in its growth initiatives to return the firm to positive organic growth over time.

SEI New ways. New answers.®

SEI Investments Company-SEIC reported fourth quarter revenue decreased 9% to $456.6 million with net income decreasing 23% to $112.2 million and EPS down 19% to $.83. Revenues from Assets under management (AUM), administration, and distribution fees declined primarily from the significant market depreciation during 2022. Average AUM decreased 11% from last year to $789.9 billion and AUM excluding LSV decreased 19% to $162.4 billion. **During the fourth quarter**, SEI generated $137.6 million in operating cash flow, or $1.01 per share, and free cash flow of $120.3 million with the **company repurchasing $79.6 million of its shares at an average cost of $59.36 per share.** For the full-year, SEI reported sales increased 4% to $1.99 billion with net income decreasing 13% to $475.5 million and EPS down 9% to $3.46. **SEI generated an impressive 24% return on shareholder equity during 2022. SEI ended the year with $853 million in cash, no long-term debt and $1.95 billion in shareholders' equity on its pristine balance sheet.** Management believes the current environment presents growth opportunities and SEI remains focused on growth through new client signings, important recontracts, and successful delivery of solutions to their markets.

MasterCard

Mastercard-MA reported fourth quarter revenues rose 12%, or 17% on a constant currency basis, to $5.8 billion with net income up 6% to $2.5 billion and EPS up 9% to $2.62. During the fourth quarter, gross dollar volume grew 8%, on a local currency basis, to $2.1 trillion driven by cross-border volume growth of 31%. Switched transactions grew 8%. Other revenues increased 11% during the quarter, driven primarily by the company's Cyber & Intelligence and Data & Services solutions. Rebates and incentives increased 14% primarily due to increased volumes and transactions and new and renewed deals. **As of year end, the company's customers had issued 3.1 billion Mastercard and Maestro-branded cards. For the full year, revenues charged 18% higher to $22.2 billion with net income up 14% to $9.9 billion and EPS up 17% to $10.22.** Return on shareholders' equity was greater than 100% thanks to strong earnings and a shrinking equity base reflecting substantial share repurchases. **During the year, Mastercard repurchased 25.7 million shares at a cost of $8.8 billion or $342.21 per share and paid $1.9 billion of dividends. Free cash flow increased 19% during the year to $10.8 billion. Mastercard has $11.6 billion remaining authorized for future share repurchases.** Mastercard ended the year with strong financial results and notable wins with banks such as Citizens, Citi, Bank of America, and Chase, which will help them continue to capitalize on **the tremendous secular shift to digital payments**. Low unemployment, elevated consumer savings, moderating energy costs and the opening of China, with global cross-border travel volume up 59% last year, has led to **"remarkably resilient consumer spending" despite macroeconomic and geopolitical uncertainty. Mastercard will "manage with agility" if macroeconomic conditions change**. For the full year 2023, the company expects

revenues to grow at low double-digit rates with operating expenses up in the high-single digit range which should lead to operating margin expansion for the year.

Visa-V reported first quarter revenues rose 12% to $7.9 billion with net earnings increasing 6% to $4.2 billion and EPS up 8% to $1.99. During the first quarter, **Visa saw stable payments volume and processed transaction growth and a continued cross-border travel recovery.** Key business drivers during the quarter included a 7% increase in payments volume, a 22% jump in cross-border volume and a 10% increase in processed transactions. Excluding Intra-Europe, cross-border volume charged ahead 31%. **During the quarter**, Visa generated $4.2 billion in operating cash flow and $3.9 billion in free cash flow with **the company returning over $4 billion to shareholders through dividend payments of $945 million and share repurchases of $3.1 billion** at an average cost per share of $198.74. **Visa has $14 billion remaining authorized for future share repurchase.** Visa ended the quarter with $18.9 billion in cash and investments, $20.5 billion in long-term debt and $36.9 billion in shareholders' equity on its sturdy balance sheet. For the second quarter, Visa expects constant dollar revenue growth in the mid-teens.

Bank of Hawaii - BOH reported fourth quarter revenues increased 7.7% to $181.9 million with net income declining 4.2% to $59.3 million and EPS slipping 3.2% to $1.50. The net income decline reflects a small provision for credit losses during this year's fourth quarter versus a $9.7 million benefit last year. **Net interest income increased 11.4% from last year to $140.7 million on strong loan growth and a 26-basis point increase in net interest margin to 2.6%, boosted by the higher rate environment.** Noninterest income declined 3.3% to $41.2 billion, pinched by market volatility and higher mortgage rates. Asset quality remains strong with 80% of the bank's loan portfolio secured with high-quality real estate with a combined weighted average loan to value of 56%. Total deposits increased 1.3% from last year to $20.6 billion. While Bank of Hawaii's total deposit cost increased 40-basis points to 0.46%, its deposit mix of low cost, long-tenured, sticky core deposits helped mitigate the cost associated with rising rates. **During the quarter, Bank of Hawaii returned $15.0 million to shareholders through share repurchases at an average cost per share of $77.77. The Board increased the share repurchase authorization by $100 million with $135.9 million currently approved for future share repurchases.** With the current $0.70 dividend, the stock yields an attractive 3.57%. For the year, total revenue increased 4.4% to $698.1 million with net income falling 13% to $217.9 million and EPS down 12.3% to $5.48. **During 2022, Bank of Hawaii generated a solid 16.5% return on shareholders' equity** and 0.98% return on average assets. During the quarterly conference call, Peter Ho, CEO, stated, "As we enter into 2023, the forward view on the economy is somewhat cloudy. Economic conditions, while buoyant currently, may possibly be tested in the coming days by the continued effects of tighter Fed policy. Asset values may also be challenged by higher rates. Bank of Hawaii remains well geared for potentially choppier waters. Our credit portfolio is the beneficiary of conservative underwriting standards not just of late, but over the course of many years. Our deposit base is a great source of strength, diversified, granular and long tenured. Our investment assets are both abundant, high quality and highly liquid."

Western Alliance Bancorporation-WAL banked a 25% increase in fourth quarter revenue to $701.2 million with net income up 19.1% to $289.8 million and EPS up 15.1% to $2.67. Net interest income increased 42% to $639.7 million on a 28% increase in total loans to $51.8 billion and a 65-basis point increase in net interest margin to 3.98%. Total deposits grew by 13% to $53.64 billion. Non-interest income declined 44% from last year's fourth quarter to $61.5 million, pressured by lower mortgage loan production with the rise in interest rates. For the year, Western Alliance Bancorporation reported revenue of $2.54 billion, up 30.1% from 2021, with net income up 16.6% to $1.04 billion and EPS up 11.9% to $9.70. Net interest income increased 43% to $2.2 billion driven primarily from interest income on loan growth and higher loan yields, partially offset by increased interest expense from deposits, short-term borrowings and credit linked notes issued during the year. Non-interest income declined nearly 20% to $324.6 million due to an 18% drop in mortgage production. The bank's provision for credit losses totaled $68.1 million, up from a $21.4 million benefit recorded last year, due to continued economic uncertainty and loan growth during the year. Non-performing loans to total assets were 0.14% and the bank's still stellar efficiency ratio of 44.9% increased 4.7% from last year**. During 2022, Western Alliance generated an impressive 19.5% return on shareholders' equity** and 1.62% return on average assets. Tangible book valued increased 6.4% to $40.25 and CET1 capital at 9.3% continued to exceed "well capitalized" levels. Asset quality remains strong with 27% of loans insured. **Looking ahead to 2023, net interest margin is expected in the 4% to 4.1% range with net interest income expected to grow 20% to 25%.** Loan growth is expected in the 10% to 15% range while deposits are expected to increase 13% to 17%. CET1 capital is expected to reach 9.75% to 10% and net charge-offs are expected to normalize given economic uncertainties.

Automatic Data Processing-ADP reported fiscal second quarter revenues increased 9% to $4.4 billion with the company processing a 17% jump in net income to $813.1 million and an 18% gain in EPS to $1.95. These results reflected the strong growth in new business bookings, client revenue retention near record levels and **continued healthy employment trends** within ADP's client base. Interest earned on funds held for clients (float income) increased 77% to $187 million, reflecting a 4% increase in the average client funds balance to $33.4 billion and a 90 basis points increase in the average interest yield to 2.2%. **During the first half of the year, free cash flow increased 34% to $1.5 billion with the company paying $865.5 million in dividends and repurchasing $553.5 million of its common stock. ADP maintained its full year guidance for fiscal 2023 for 8% to 9% revenue growth and 15% to 17% adjusted EPS growth** with margin expansion of 125 to 150 basis points. **While ADP notes that job growth is slowing, the company does not see any broad-based softness in the labor market despite more than 50,000 layoffs announced recently in the technology sector.**

General Dynamics-GD reported fourth quarter revenue increased 5.4% to $10.85 billion with net income increasing 4.2% to $992 million and EPS increasing 5.6% to $3.58. **Boosted by Russia's invasion of Ukraine and the increased threat environment, General Dynamics ended the quarter with a record backlog of $91.1 billion** on a book-to-bill ratio of 1.2 times for the quarter and an estimated contract value of $127.7 billion.

For the year, General Dynamics reported a 2.4% increase in revenue to $39.41 billion with net income up 4.1% to $3.4 billion and EPS up 5.5% to $12.19. By business segment, Aerospace, which includes Gulfstream and global aviation services, generated a 5.3% increase in revenue to $8.57 billion with operating margins of 13.2%. Segment backlog has increased for eight consecutive quarters and ended the year at $19.9 billion on a book-to-bill ratio of 1.5 times. Marine Systems revenue increased 4.9% from last year to $11.04 billion with operating margins of 8.1%. Segment backlog rose to $45.7 billion on a book-to-bill ratio of 1.1 times and included $5.1 billion for follow-on Columbia-class submarines and $535 million related to the Virginia-class submarines, both significant contracts awarded during the quarter. Combat Systems, producer of the Abrams tank, Stryker combat vehicles and weapons systems for naval, air and ground forces, reported revenues of $7.31 billion, flat compared to last year, with operating margins above 14% for the 10th consecutive year. Segment backlog declined slightly to $13.3 billion on a book-to-bill ratio of 1.1 times. Despite substantial supply chains disruptions, General Dynamics Technology segment reported flat revenue of $12.5 billion with operating margins of 9.8%. Segment backlog dipped slightly from last year to $39.6 billion on a book-to-bill ratio of 1.1 times. **During 2022, General Dynamics generated a powerful 18.3% return on shareholders' equity and free cash flow of $3.47 billion**, or 102% of net income, up 2.4% from last year despite a 26% jump in capital expenditures related to timing of project spending. **The company returned nearly $2.6 billion to shareholders during 2022 through dividends of $1.37 billion and share repurchases of $1.23 billion at an average cost per share just under $226.** General Dynamics ended the quarter with $1.2 billion in cash, $9.2 billion in long-term debt and $18.6 billion in shareholders' equity on its combat-ready balance sheet. **Looking ahead to 2023, management expects revenues in the range of $41.2 billion and $41.3 billion, up 4.7% from 2022, and EPS between $12.60 and $12.65, up 3.6% from 2022 at the mid-range.**

Raytheon Technologies-RTX reported fourth quarter revenue rose 6% to $18.1 billion with net income and EPS more than doubling to $1.4 billion and $.96, respectively. On an adjusted basis for acquisition costs and non-recurring charges, EPS was up 18% in the fourth quarter**. For the full year, revenues rose 4%, or 6% organically, to $67.1 billion with net income up 34% to $5.2 billion and EPS up 36% to $3.51. These solid results reflected the rapid commercial aerospace recovery with commercial aftermarket sales up 25%.** During the year, Raytheon received $86 billion of new awards with a full year book-to-bill ratio of 1.28. The company **ended the year with a near record backlog of $175 billion,** of which $106 billion was from commercial aerospace and $69 billion was from defense. Return on shareholders' equity for the year was 7.2%. Free cash flow dipped 3% during the year to $4.9 billion with **the company paying $3.1 billion in dividends and repurchasing $2.8 billion of its common stock. Raytheon is well positioned to capture growing demand in the aerospace and defense markets in 2023 and expects to deliver sales growth and margin expansion along with strong free cash flow generation.** Supply chain and labor inflation costs of about $2 billion are expected to be offset by increased pricing and cost reductions during the year. For the full year 2023, revenues are expected in the range of $72 billion to $73 billion, representing 7% to 9% organic growth, with adjusted EPS expected in the range of $4.90-$5.05, representing 3%-6% growth. Strong expected 20% operating profit growth will be partially offset by higher pension, tax and interest costs. **Free cash flow for 2023 is expected to approximate $4.8 billion with the company targeting $3 billion in share repurchases for the year.** Raytheon remains committed to returning at least $20 billion to shareholders post-merger through early 2024. During the second half of 2023, Raytheon plans to reorganize into three focused business segments which will be Collins Aerospace, Pratt & Whitney and Raytheon.

Microsoft-MSFT reported second quarter revenues increased 2% to $52.7 billion with net income declining 12% to $16.4 billion and EPS down 11% to $2.20. Revenue in Business Processes increased 7% to $17 billion driven

by Office 365 and 21% growth in Dynamics 365 products. **Revenue in Intelligent Cloud jumped 18% to $21.5 billion driven by Azure and other cloud services revenue growth of 31%.** Revenue in More Personal Computing decreased 19% to $14.2 billion, primarily driven by a 39% decrease in Windows OEM and Devices revenue. Microsoft cloud revenue was $27.1 billion, up 22% year-over-year. Free cash flow during the first half of the year decreased 20% to $21.8 billion with the **company paying $9.7 billion in dividends and repurchasing $11 billion of its common stock.** The decrease in free cash flow was due to a 23% decline in working capital during the quarter. Excluding 16 points for a tax payment, working capital declined 7% as strong cloud billings and collections were more than offset by higher employee and supplier payments. Microsoft ended the quarter with $99.5 billion in cash, $44.1 billion in long-term debt and $183.1 billion in shareholders' equity on its strong balance sheet. For the third quarter, Microsoft expects revenues in the range of $50.5 billion to $51.5 billion with cost of goods in the range of $15.65 billion and $15.85 billion and operating expenses in the range of $14.7 billion to $14.8 billion. For the full 2023-year, operating margin is expected to decrease roughly 2 points year-over-year, excluding the employee severance expenses of $800 million, impairment charges resulting from changes to Microsoft's hardware portfolio, and costs related to lease consolidation activities. **Management believes they are well positioned to be a leader in artificial intelligence (AI) and recently announced that they will be the exclusive cloud provider for OpenAI.** Microsoft will soon add support for OpenAI's ChatGPT, enabling customers to use it in their own applications for the first time. **Microsoft** said **it is making a multiyear, multibillion-dollar investment in OpenAI, which could approximate $10 billion according to media reports. This will substantially increase its investment in the popular ChatGPT chatbot as Microsoft looks to expand the use of artificial intelligence in its products.** Microsoft said the latest partnership builds upon the company's 2019 and 2021 investments in OpenAI. Microsoft plans to incorporate artificial-intelligence tools into all its products and make them available as platforms for other businesses to build on, Chief Executive Satya Nadella said. Microsoft is incorporating artificial-intelligence software into its suite of products, ranging from its design app Microsoft Design to search app Bing. It also will help finance the computing power OpenAI needs to run its various products on Microsoft's Azure cloud platform.

Texas Instruments-TXN reported fourth quarter revenues declined 3% to $4.7 billion with net income declining 8% to $2 billion and EPS down 6% to $2.13. As expected, these results reflected weaker demand in all end markets except for automotive. **For the full year, revenues rose 9% to $20.0 billion with net income up 13% to $8.7 billion and EPS chipping in 14% growth to $9.41. Return on shareholders' equity was an impressive 60% for the year.** Free cash flow dropped 6% during the year to $5.9 billion which represented 30% of revenue and reflected the quality of the company's product portfolio as well as the efficiency of its manufacturing strategy. **During 2022, the company paid $4.3 billion in dividends and repurchased $3.6 billion of its common stock. The dividend was increased 8% in the fourth quarter, marking the 19th consecutive year of dividend increases.** As customers continue to reduce inventory, Texas Instruments expects weaker demand for its products to persist in the first quarter of 2023 with revenue expected in the range of $4.17 billion to $4.53 billion and EPS in the range of $1.64 to $1.90.

The Justice Department, along with the Attorneys General of several states, filed a civil antitrust suit against Google for monopolizing multiple digital advertising technology products. Google's parent, **Alphabet-GOOGL**, responded that, "DOJ is doubling down on a flawed argument that would slow innovation,

raise advertising fees, and make it harder for thousands of small businesses and publishers to grow." This litigation will likely take years to resolve.

Canadian National Railway-CNI reported fourth quarter revenue steamed 21% higher to C$4.54 billion with net income chugging ahead 18.2% to C$1.42 billion and EPS up 23.5% to C$2.10. Solid bulk volumes offset weakness in the Merchandise and Consumer Products segments while management's **disciplined approach to pricing** led to rail-inflation-plus pricing on renewals. During the quarter, softness from the economic slowdown deepened in lumber, intermodal, chemicals and plastics. Canadian National's new management team ushered in improvements in key operating metrics including a 6% increase in revenue ton miles (RTMs), a 15% increase in total freight revenue per RTM and a 20% increase in total freight revenue per carload. Reported operating efficiency improved by 40 basis points to 57.9%. For the full year, revenues increased 18% to C$17.1 billion with net income up 4.5% to C$5.12 billion and EPS up 7.8% to C$7.44. **Canadian National delivered a stellar 23.9% return on shareholders' equity during 2022 and free cash flow of C$3.9 billion with the company returning C$6.7 billion to shareholders through dividends of C$2.0 billion and share repurchases of C$4.7 billion. The company increased its dividend 8% for 2023, marking the 27th consecutive annual increase, and initiated a new share repurchase program to repurchase up to 32 million shares for about C$4 billion** through the end of January 2024, reflecting a prudent repurchase approach amid a softening economy. The company ended the year with C$328 million in cash and equivalents, C$14.4 billion in long-term debt and C$21.4 billion in shareholders' equity on its sturdy balance sheet. Looking ahead to 2023, **management expects a mild recession with negative North American industrial production.** On the conference call, **Tracy Robinson, CEO, stated, "Canadian National has dealt with recessions in the past and will deal with them in the future" and is well-positioned to increase volume greater than the change in industrial production. The company expects to deliver a low-single-digit adjusted EPS growth during 2023 by focusing on growing with customers, driving further operating efficiencies and pricing above rail-inflation.**

3M-MMM posted a 6.2% decline in fourth quarter sales to $8.08 billion with net income skidding 59.6% to $541 million and EPS sliding 57.7% to $0.98. Sales declined in all four 3M business segments during the fourth quarter compared to last year. 3M's slower than expected sales growth was due to rapid declines in consumer-facing markets, such as consumer electronics and retail, a dynamic that accelerated in December as consumers sharply cut discretionary spending and retailers adjusted inventory levels. 3M also saw significant slowing in China due to COVID-related disruptions along with moderating demand among some industrial markets. Health care continue to be challenged in its recovery to pre-pandemic levels amid labor shortages and constrained hospital budgets. Fourth quarter earnings include an $800 million pre-tax charge related to the company's decision to exit the PFAS forever chemical business by the end of 2025 that will ultimately result in total exit costs of between $1.3 billion to $2.3 billion. **For the full year, 3M reported sales declined 3.2% to $34.2 billion with net income slipping 2.4% to $5.78 billion and EPS flat at $10.21. During 2022, 3M generated a remarkable 39.1% return on shareholders' equity and free cash flow of $3.8 billion**, down 34.4% from last year. **3M returned $4.8 billion to shareholders during 2022 through dividends of $3.37 billion and share repurchases of $1.46 billion.** 3M ended the year with $3.89 billion in cash and investments, $14.0 billion in long-term debt and $14.8 billion in shareholders' equity. In 2022, management made continued progress in its planned health care spinoff, which will create two world-class public companies better positioned to drive growth and value creation. In addition, management continued working through PFAS related litigation and toward a mediated resolution for Combat Arms litigation. Looking ahead, 3M expects market and macroeconomic challenges to persist in 2023. While supply chains are improving, management still sees headwinds for material

availability and inflation, albeit at a lower level. Based on this outlook, organic sales growth is expected in the range of -3% to flat which includes price increases in the low-single-digits with adjusted EPS of between $8.50 to $9.00, down 13.4% from 2022 at the midpoint. Adjusted free cash flow conversion of 90 to 100% is expected for 2023. Given the outlook, 3M announced it will reduce about 2500 global manufacturing roles to further align the business with expected production volumes.

Johnson & Johnson-JNJ reported fourth quarter revenues declined 4% to $23.7 billion, with net income decreasing 26% to $3.5 billion and EPS down 25% to $1.33. The decline in fourth quarter revenues was primarily driven by unfavorable foreign exchange and reduced COVID-19 vaccine sales. **For the full year, revenues rose 1% to $94.9 billion with net income and EPS each down 14% to $17.9 billion and $6.73, respectively.** Worldwide Pharmaceutical sales increased 2% during the year to $52.6 billion; MedTech sales increased 1% to $27.4 billion; and Consumer Health sales were relatively flat at $15 billion. **During 2022, Johnson & Johnson generated approximately $17 billion in free cash flow** and ended the year in a net debt position of $16 billion. The company invested $14.6 billion in research and development to advance its promising product pipeline and **paid $11.7 billion in dividends during the year. In addition, JNJ repurchased $2.5 billion of its common stock**, with approximately 50% of the repurchase program completed. The board of directors recently declared a cash dividend for the first quarter of 2023 of $1.13 per share, payable on March 7, 2023. The dividend currently yields a healthy 2.69%. **For fiscal 2023, JNJ expects to report sales in the range of $96.9 billion to $97.9 billion, representing 4.5% to 5.5% growth, with adjusted EPS expected in the range of $10.45 to $10.65, representing 3% to 5% growth.**

Tractor Supply-TSCO rang up a 20.7% increase in fourth quarter sales to $4.0 billion with net earnings plowing ahead 22.4% to $270.9 million and EPS jumping 25.9% to $2.43. Fourth quarter sales included an extra week as part of the 53-week 2022 calendar which accounted for about 6.8 points of the 20.7% sales growth. Comparable store sales increased 8.6%, driven by comparable average ticket growth of 6.3% and comparable average transaction count increase of 2.3%. Comparable store sales growth reflects continued strength in every day, needs-based merchandise, including consumable, usable and edible “C.U.E.” products, winter seasonal goods and year-round product categories. Comparable store sales in the quarter benefited by about two percentage points from Elliott, the late December winter storm. **During the quarter, the company saw a significant moderation in the rate of price increases from vendors and moderation in transportation costs that management believes peaked in the fourth quarter.** For the year, Tractor Supply reported an 11.6% increase in sales to $14.2 billion with net income increasing 9.2% to $1.09 billion and EPS up 12.8% to $9.71. **The company drove an impressive 53.3% return on shareholders’ equity during 2022 and generated $583.6 million in free cash flow. Tractor Supply returned $1.11 billion to shareholders in 2022 through dividends of $409.6 million and $700.1 million in share repurchases.** The company ended 2022 with $202.5 million in cash, $1.16 billion in long-term debt and $2.04 billion of shareholders’ equity on its sturdy balance sheet. Looking ahead to 2023, management anticipates it will continue to operate in an ever challenging and changing macro environment. It **expects the economy in the near to medium-term to remain resilient with flat to modestly positive real growth. Wages are increasing and consumers continue to tap pent-up savings to support spending.** For fiscal 2023, management forecasts net sales of $15 billion to $15.3 billion with EPS in the $10.30 to $10.60 range. Comparable store sales growth is anticipated to be in the range of 3.5% to 5.5%. Capital expenditures are forecasted to be $700 million to $775 million, with about 80% for growth initiatives. The company remains committed to returning cash to shareholders through the combination of a growing dividend and share repurchases. For 2023, share purchases are expected in a range of $575 million to $675 million, estimated to reduce the weighted average shares outstanding by about 2%. During the earnings conference call, **Hal Lawton, CEO, remarked, “Whatever economic environment plays out this year or any**

year for that matter, we're confident that our business will remain resilient and build on our strong track record of consistent and stable growth across all economic environments."

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Most of our ***HI***-quality companies delivered solid financial results with growing revenues and earnings and above average returns on shareholders' equity. In addition, strong free cash flow growth enabled the businesses to return cash to shareholders through growing dividends and substantial share repurchase programs.

Our diversified portfolio of businesses provided insights into the overall economy. **Gentex** pointed out that the auto sector should see renewed growth in the next two years as supply constraints have eased. As a result, improving margins will result from the better supply environment and internal cost controls, which should lead to increasing shareholder returns over the next two years.

Mixed results were reported by our financial stocks. **T. Rowe Price** and **SEI Investments** were adversely impacted as stocks closed out their worst year since 2008 and the Bloomberg U.S. Aggregate Bond Index suffered its worst year since its inception in 1976. However, both companies still generated solid returns on shareholders' equity for the year while growing their dividends and repurchasing shares. **Mastercard and Visa's** revenues both charged 12% higher during the latest quarter thanks to strong cross-border volume growth as travel has recovered. Low unemployment, elevated consumer savings, moderating energy costs and the opening of China has led to **"**remarkably resilient consumer spending" despite macroeconomic and geopolitical uncertainty. Net interest income at both **Bank of Hawaii** and **Western Alliance** benefited from strong loan growth and the higher interest rate environment.

Another company which benefits from higher interest rates is **Automatic Data Processing** as interest earned on funds held for clients increased 77% to $187 million. While ADP notes that job growth is slowing, employment trends continue to be healthy. The company does not see any broad-based softness in the labor market despite more than 50,000 layoffs announced recently in the technology sector.

Boosted by Russia's invasion of Ukraine and the increased threat environment, both **General Dynamics** and **Raytheon Technologies** ended the quarter with record backlogs.

On the technology side, **Microsoft's** management believes they are well positioned to be a leader in artificial intelligence (AI) and recently announced that they will be the exclusive cloud provider for OpenAI. Microsoft will soon add support for OpenAI's ChatGPT, enabling customers to use it in their own applications for the first time. Microsoft said it is making a multiyear, multibillion-dollar investment in OpenAI, which could approximate $10 billion. **Texas Instruments** is currently seeing weaker demand for its chips in all end markets except for automotive. At the same time, the company paid $4.3 billion in dividends and repurchased $3.6 billion of its common stock during 2022. The dividend was increased 8% in the fourth quarter, marking the 19th consecutive year of dividend increases. **Alphabet** was hit with an antitrust suit last week claiming Google is monopolizing multiple digital advertising technology products. The litigation will likely take years to resolve.

Other companies reported mixed results. **Canadian National Railway** reported double-digit growth in sales and earnings during the fourth quarter and increased its dividend 8% for 2023, marking the 27th consecutive annual increase. With sales and earnings declining for the year**, 3M** faced many macroeconomic challenges in 2022 which are expected to persist in 2023. Despite all the headwinds, 3M returned $4.8 billion to shareholders during 2022 through dividends of $3.37 billion and share repurchases of $1.46 billion. Unfavorable foreign exchange and reduced Covid-19 vaccine sales led to lower sales and earnings for **Johnson & Johnson** in the fourth quarter. For the year, JNJ generated $17 billion in free cash flow and paid $11.7 billion in dividends and repurchased $2.5 billion of its common stock.

Tractor Supply plowed up impressive results in 2022 with double-digit growth in sales and earnings during the fourth quarter while generating a stellar 53% return on shareholders' equity for the year. Tractor Supply returned $1.11 billion to shareholders in 2022 through dividends of $409.6 million and $700.1 million in share repurchases. The company expects the economy in the near to medium-term to remain resilient with flat to modestly positive real growth. Wages are increasing and consumers continue to tap pent-up savings to support spending. As Hal Lawton, CEO, remarked, "Whatever economic environment plays out this year or any year for that matter, we're confident that our business will remain resilient and build on our strong track record of consistent and stable growth across all economic environments."

If you have any questions, please let us know.

Sincerely,

Ingrid R. Hendershot, CFA
President