Miller Howard INVESTMENTS

Challenges Ahead

MARCH 31, 2022

FEAR OF INFLATION LOOMED OVER THE MARKET from the outset of the first quarter, only to be joined by a new risk in February—fallout from the Russian invasion of Ukraine. Military conflict inserts a new set of risks into the global market, just as investors were anticipating an economic rebound from the easing of COVID restrictions. Despite the new challenges facing the markets, the labor market remains exceptionally strong, providing a counterbalance to surging inflation and the fallout from war.

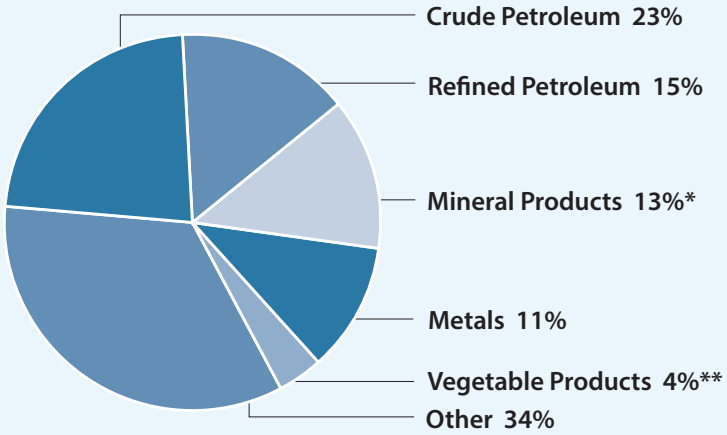
No one has a crystal ball when it comes to the conflict in Ukraine. The stock market's reaction has been mild with the S&P 500 Index actually up 5.8% (as of 3/31/22) since the first day of the invasion, February 24th. The ultimate downside could be significant if the war expands beyond Ukraine. For now, the direct impacts stem from international sanctions, including the barring of Russian banks from much of the global payment system, the freezing of central bank assets, prohibitions on specific imports and exports, restrictions on Russian ships and aircraft, and punitive measures taken against the Russian oligarchs.

In many ways, Russia is a small player in the global economy. Total exports out of Russia account for only 2% of world trade—less than Mexico or Belgium (as of 2020). Russia is, however, the world's third largest exporter of crude oil, and the world's largest exporter of wheat. Ukraine is also a major exporter of wheat, and combined Russia and Ukraine account for 30% of global production. Global prices for both oil and wheat spiked following the beginning of hostilities. Both prices have come off their highs but remain significantly elevated. Food and energy prices were already contributing substantially to inflation prior to the invasion, and these recent increases will add to the pressure.

Overall, we expect the impact of sanctions on energy and grain prices to moderate over time unless all large consuming nations block Russian exports. At this point, both China and India are willing buyers making it hard for the sanctions to keep Russia's supply completely off the market. Both sanctions and the decision by private companies to exit Russia will make life difficult for the average Russian, but in our view, their economy is simply too small to make much of a difference for US investors.

Russia Exports

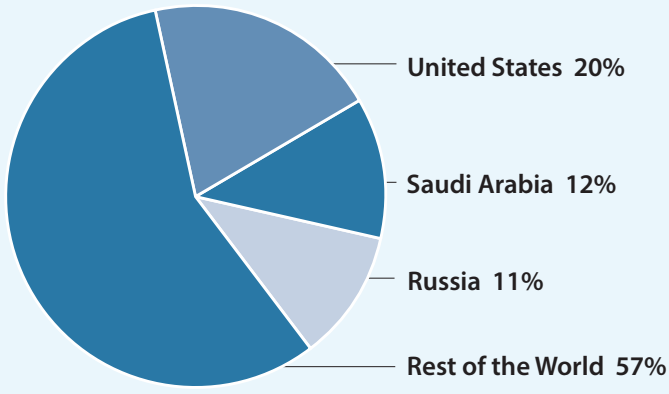
$407 Billion



As of December 31, 2020. Source: The Observatory of Economic Complexity (OEC)
* Excludes Crude and Refined Petroleum ** Includes Wheat

Global Oil Production

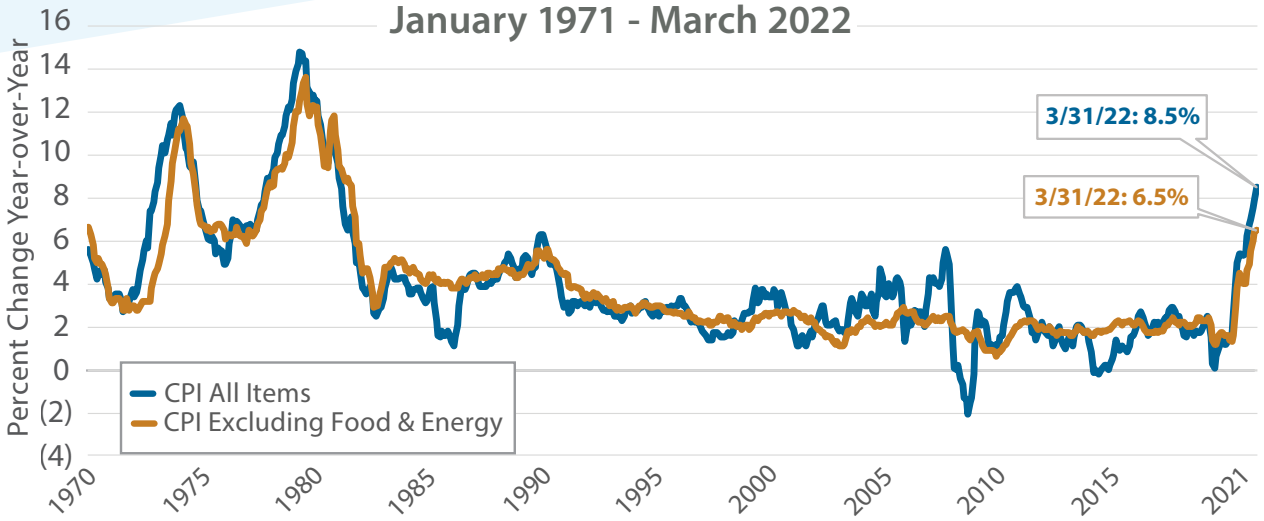
By Country



As of December 31, 2020. Sources: The US Energy Information Administration (EIA)

INVESTMENT PRODUCTS: ARE NOT FDIC INSURED • MAY LOSE VALUE • ARE NOT BANK GUARANTEED

Inflation Continued to Run Hot in 1Q 2022

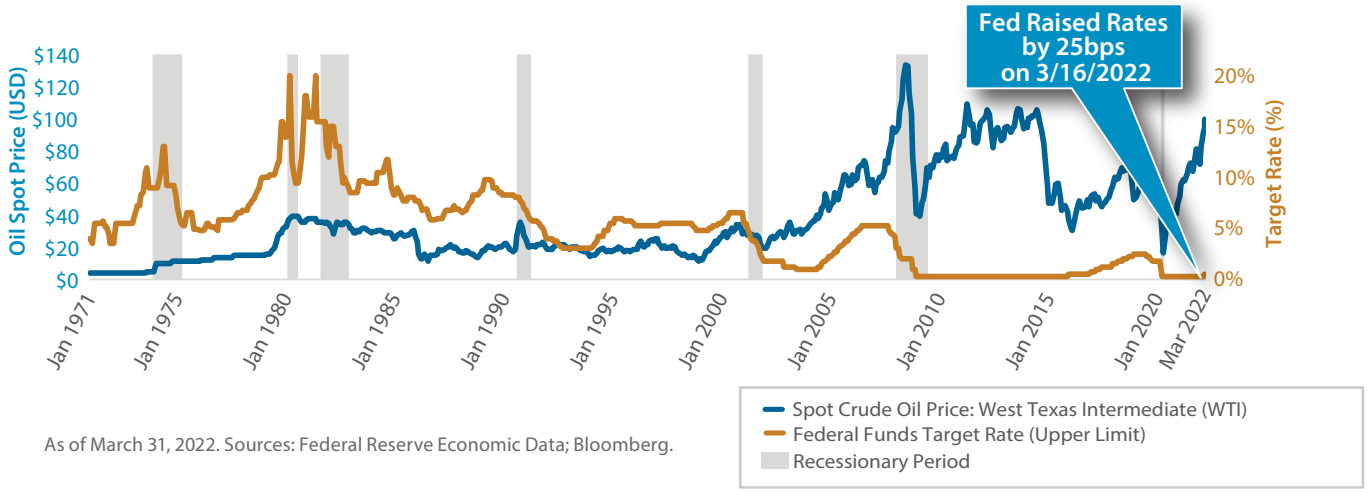


As of March 31, 2022. Source: Bloomberg; Bureau of Labor Statistics. CPI = Consumer Price Index.

Inflation continued to run hot in the quarter, leading the Federal Reserve to raise the upper bound of the federal funds target rate to 0.50% at their March meeting. We can expect further increases with forecasts by the Fed board members and presidents ranging from 1.4% to 3.1% by the end of 2022 and 2.1% to 3.6% by the end of 2023. Even at the upper end of the ranges, federal funds rates would still be substantially below today's level of inflation, so the Fed may have to be more aggressive than they currently admit. The Fed has been widely criticized as being tardy in addressing the surge in inflation and, in our view, will likely continue their tightening program even if the war in Ukraine worsens or another COVID-19 variant wave emerges.

Past recessions have frequently been associated with spiking oil prices and a Fed tightening cycle that the market viewed as going too far. We are not believers in a mechanical relationship between these factors, but we are clearly on a path that has a fair chance of ending in a recession. The arguments for optimism, however, still largely hold—consumer and business balance sheets are strong, credit performance continues to be pristine, and most importantly, the labor market is very tight. Higher unemployment goes hand in hand with recessions, and at this point, we are seeing the exact opposite—the labor market continues to speed forward.

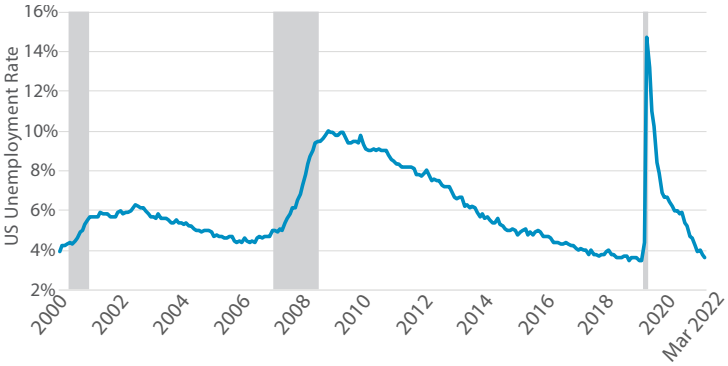
Increasing Oil Prices and Fed Funds Rates Have Frequently Preceded Recessions



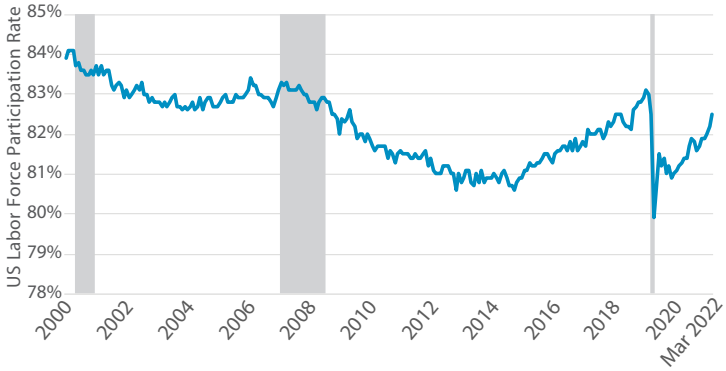
As of March 31, 2022. Sources: Federal Reserve Economic Data; Bloomberg.

US Labor Market

Unemployment Rate



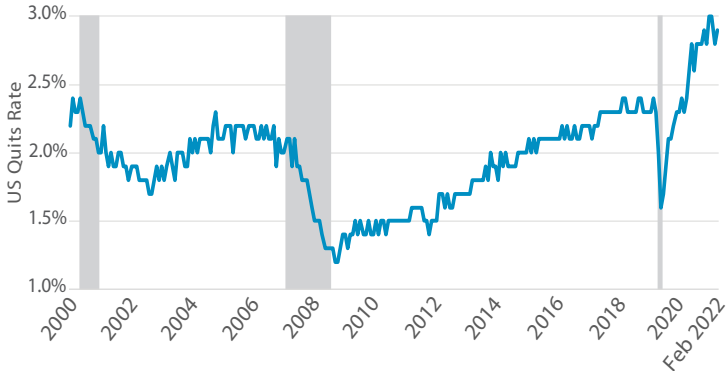
Labor Force Participation Rate



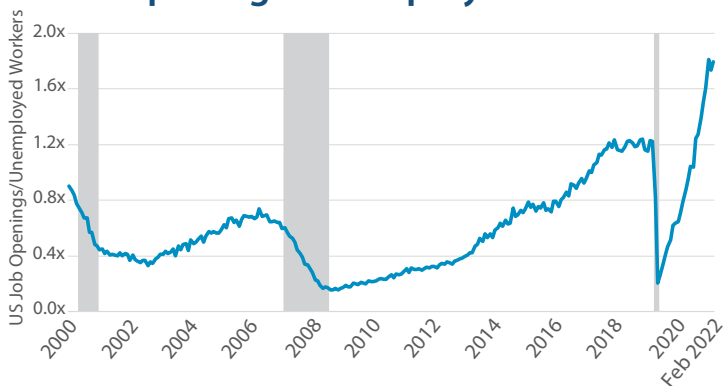
Recessionary Period

As of March 31, 2022. Source: Bloomberg. The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey. The labor force participation rate is the total labor force as a percent of the working age population (25-54 years).

Quits Rate



Job Openings/Unemployed Workers



As of February 28, 2022. Source: Bloomberg. Quits Rate: This concept tracks voluntary job separations initiated by the employee. Job Openings is measured using the US Job Openings By Industry Total seasonally adjusted. This concept tracks the number of specific job openings in an economy. Job vacancies generally include either newly created or unoccupied positions (or those that are about to become vacant) where an employer is taking specific actions to fill these positions. Unemployed Workers is measured using US Unemployment Unemployed Workers Total in Labor Force. Unemployment measures the number of people who are without work (not in paid employment or self-employed), currently available for work and seeking work (taking specific steps to find work).

Bears argue that increasing inflation and interest rates will squeeze spending, causing economic growth to slow and unemployment to rise. While this could come to pass, unemployment is headed full steam in the opposite direction. Unemployment ended the quarter at 3.6%, lower than 96% of months since 2000.

What's remarkable is that the unemployment rate is low despite a massive influx of job seekers. Many people could not or chose not to work during the pandemic. As these workers returned, the US labor market functioned smoothly, matching people with jobs at a rapid pace.

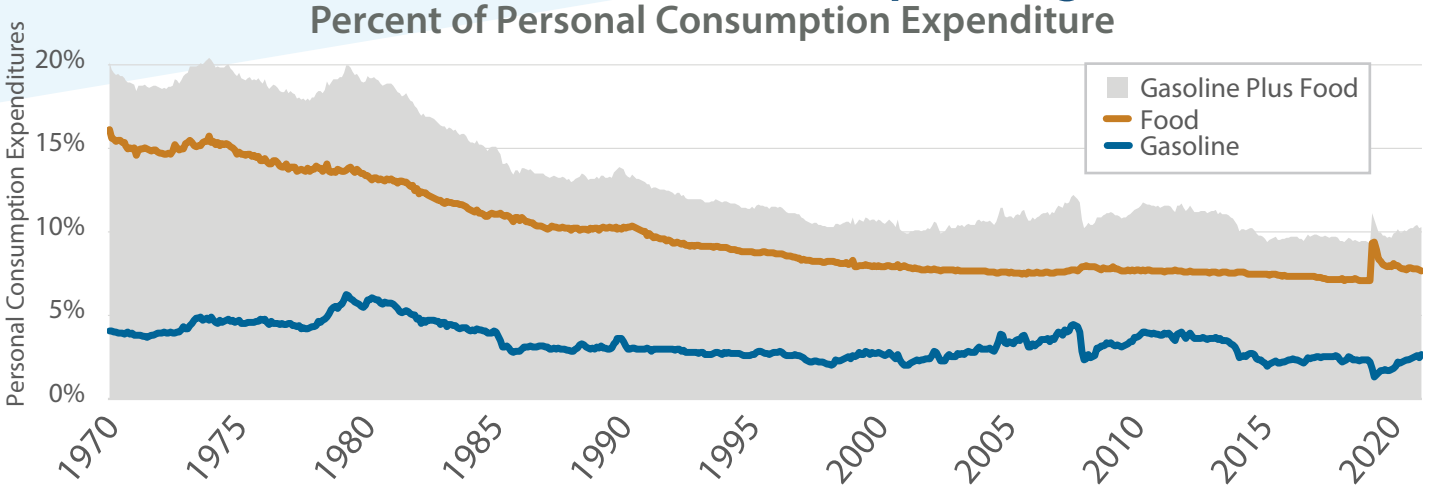
The tightness continues. The Bureau of Labor Statistics has long measured the percent of workers quitting on their own accord. Quits are currently running near the highest level in two decades, suggesting employees are confident they can find a better gig.

The ultimate measure of tightness is the number of new openings for each unemployed person. Typically, there are fewer job openings than unemployed workers, but currently, there are actually more openings than unemployed people—the strongest reading in the past two decades.

From all angles, the labor market still seems very robust. Roughly 70% of GDP is consumer demand, so it's hard to be overly bearish given the solid employment picture.

US Food and Gasoline Spending

Percent of Personal Consumption Expenditure



As of February 28, 2022. Sources: Bloomberg; Bureau of Economic Analysis.

Commentary on inflation invariably makes the argument that it is hardest on those at the bottom of the income ladder. There is often concern for low-wage workers who may not get raises and are inexorably squeezed by higher prices, particularly for food and energy. Currently, we do not see this as representative of the US workforce. According to the Atlanta Fed, the vast majority of workers received a wage increase over the past 12 months. The average wage increase is running at 5.1%—still less than inflation, but positive and trending up.

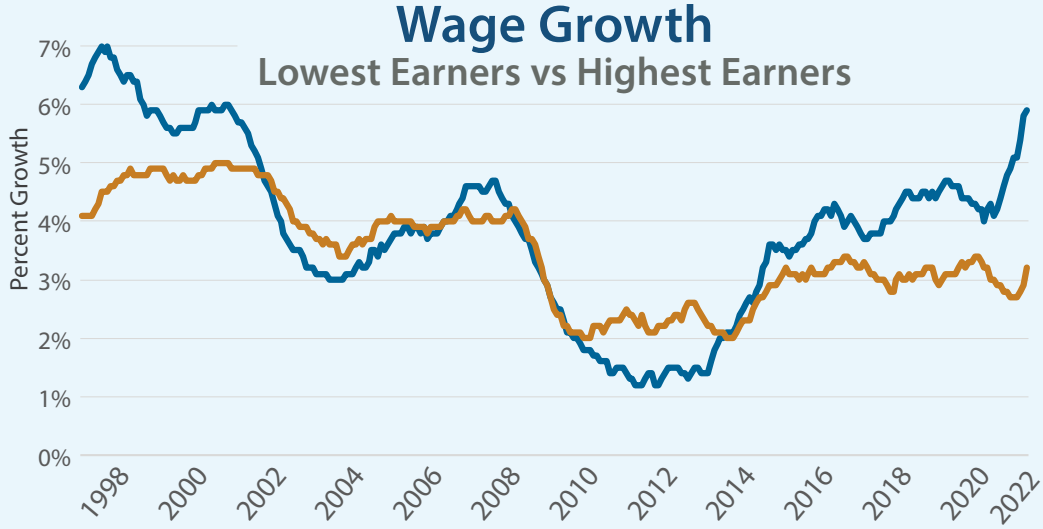
Inflation warnings frequently evoke the 1970s without acknowledging how dramatically our economy has changed. It's true that both the 1970s and early 2022 saw oil and grain price inflation. The difference is that both energy and food are much smaller fractions of consumer spending today, with the combined total dropping from roughly 20% to 10%. Even if we see further spikes in oil and food prices, the categories now matter less.

One underappreciated characteristic of the current situation is that wages are increasing faster for low-wage workers than high-wage workers. The pandemic disrupted many industries that use lower-wage hourly labor. Employers now must pay up to attract these workers back. Inflation matters more to low-income consumers, but their wages are rising faster than average.

Our view is not that inflation does not matter, but that the impact on investors is primarily through its influence on interest rates. Higher rates threaten housing demand, capital spending, and any other spending funded by borrowing. Prices for bread and gasoline matter, but the real risk for the markets is how much the Federal Reserve needs to raise rates to tame aggregate inflation.

Wage Growth

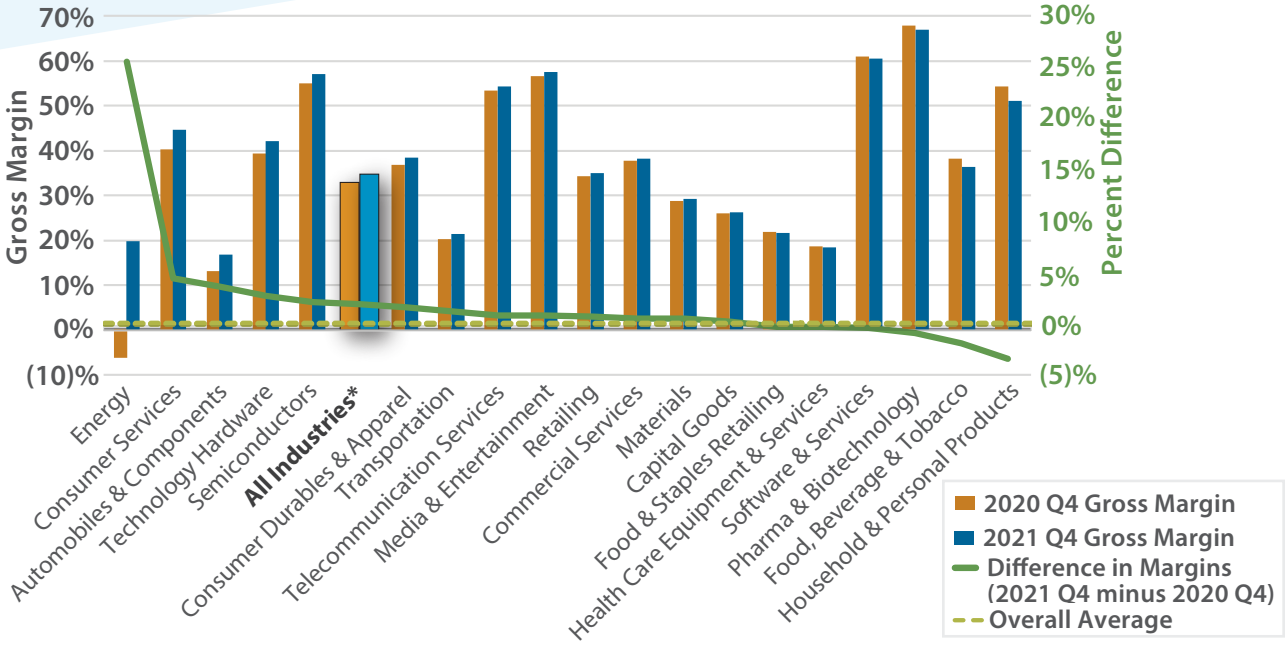
Lowest Earners vs Highest Earners



As of February 1, 2022. Source: Current Population Survey, Bureau of Labor Statistics; Federal Reserve Bank of Atlanta Calculations. The data are 12 month moving averages of monthly median wage growth for each averge wage quartile. Wage computed on an hourly basis.

Ranking based on the distribution of average hourly wage in the current month and a year ago. Those in the lowest 25 percent of average wages are in the 1st quartile and those in the highest 25 percent of average wages are in the 4th quartile.

Change in Gross Margin by Industry



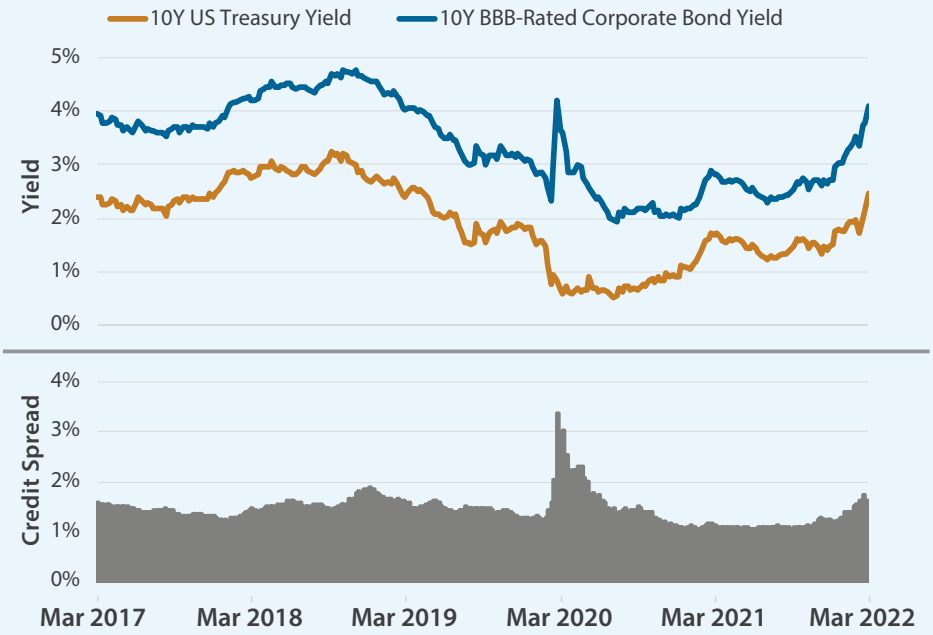
As of December 31, 2021. Sources: Bloomberg; Miller/Howard Research & Analysis. Dotted line represents the overall average. *All Industries excludes members of GICS Sector Classifications Financials, Real Estate, and Utilities as gross margin is less meaningful for these sectors. Industry members are based on members of the S&P 500 Index as of the comparison dates. Industry clasification is based on GICS. Members with missing data have been excluded from totals.

Aside from the risk of a recession, the key inflation question is whether firms will be able to pass along cost increases. Investors tend to view firms as being incapable of raising prices to keep up with cost increases. We should point out that there is a logical fallacy in this argument: One company's products are another company's costs, so it would be virtually impossible to own a diversified portfolio of stocks in which all firms face rising costs but flat prices.

The question still remains how well *on average* companies are maintaining margins in the face of rising costs. Last quarter, we showed that gross margins for companies in the S&P 500 Index expanded by 1.1 percentage points in the third quarter, demonstrating that higher costs were not causing a margin squeeze. Inflation is now even higher, so we checked fourth quarter earnings for signs of margin squeezes. Some sectors are experiencing difficulty passing along higher costs, most notably consumer staples. Gross margins on average, however, rose during the fourth quarter by 1.9 percentage points. Our conclusion is that most firms have been able to raise prices enough to grow margins despite the challenge of inflation.

In our view, for companies, the primary risk posed by inflation is not a margin squeeze but the threat of higher interest rates. Economic activity is more linked to long-term rates and those have started to rise, reflecting higher inflation expectations. One cautionary signal coming out of the bond market is that credit spreads are widening, indicating that bond investors are seeing a potential risk of credit problems.

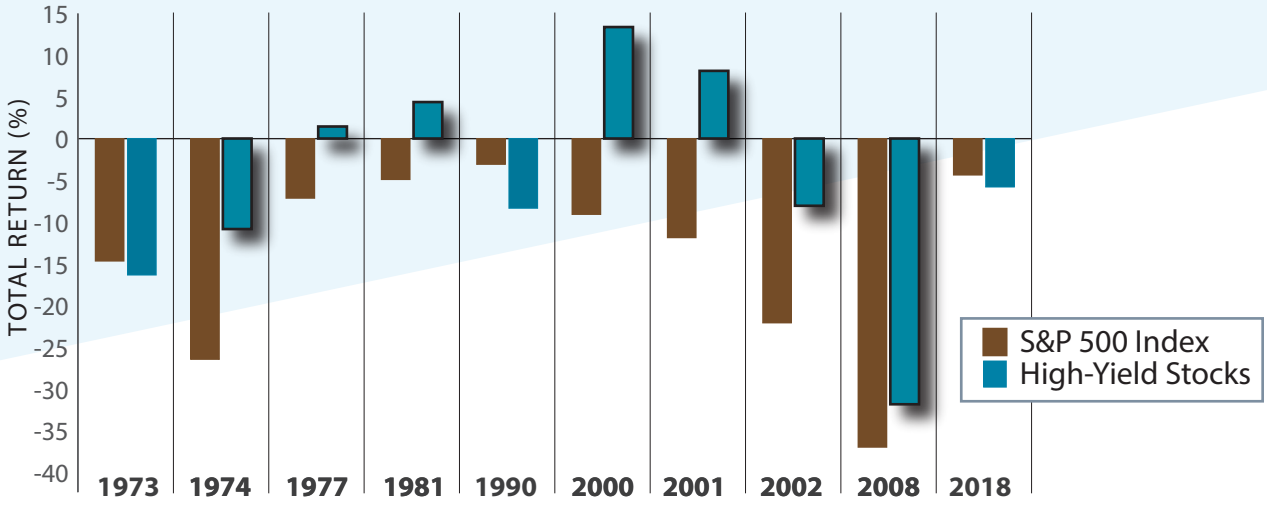
Interest Rates over Time



As of March 31, 2022. Source: Bloomberg. The yield on BBB-rated corporate bonds reflects Bloomberg's estimated yield using unsecured fixed rate bonds issued by US companies with a Bloomberg composite credit rating of BBB+, BBB, or BBB-.

Dividend Stocks in Down Years

(1971-2021)



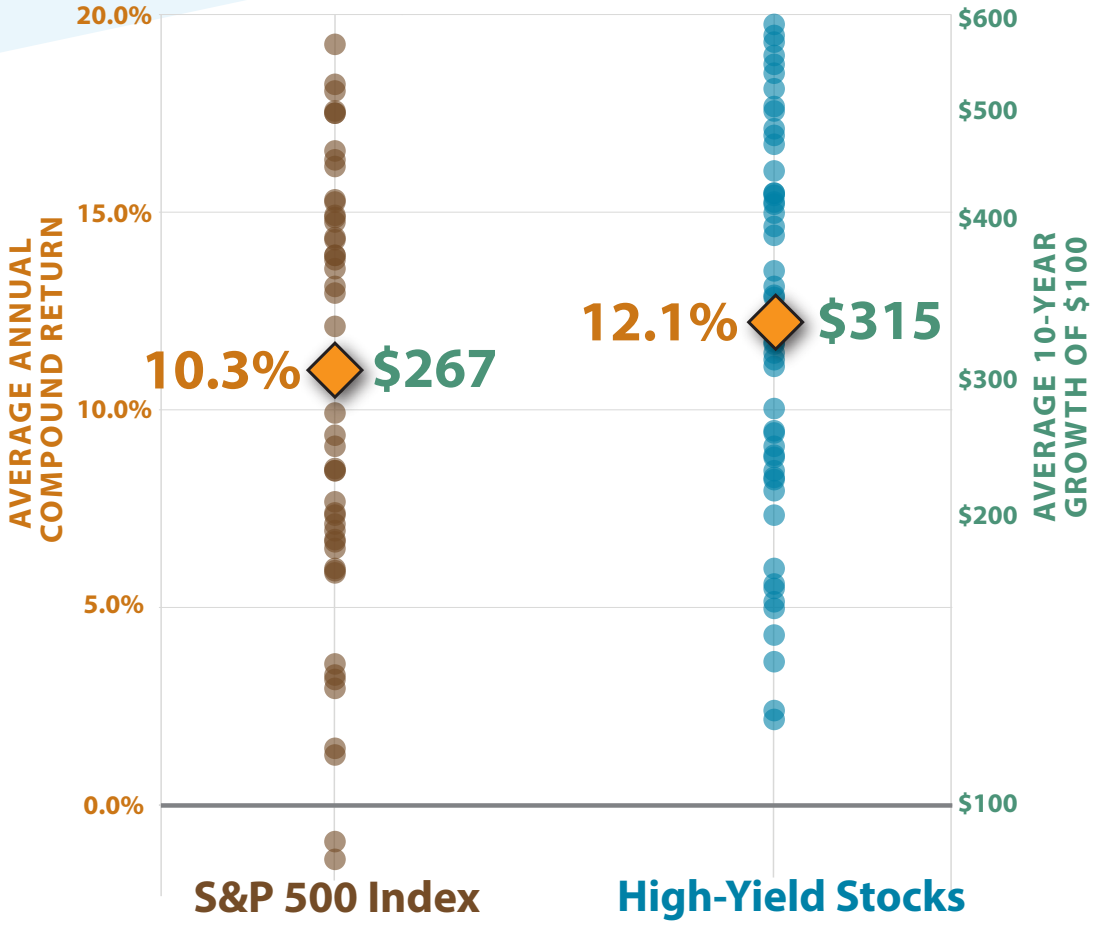
As of December 31, 2021. Sources: Morningstar Direct; Fama/French Research data library; Miller/Howard Research & Analysis. The years listed represent all periods where the S&P 500 Index returned <0%.
*High-Yield Stocks data are provided by the Fama/French Research data library. The High-Yield Stocks portfolio uses Deciles 7 through 9 of portfolios created by dividend yield (value weighted returns), where 1 is the lowest and 10 is the highest.

In addition to inflation and any expansion of the war in Ukraine, the other key risk we are monitoring is COVID-19. Regardless of whether we get another wave in the US, we believe that our population has enough immunity, both natural and vaccine-induced, to mitigate the economic impact of an additional surge. A COVID-19 outbreak in China, in contrast, would present a major hurdle for the global economy. China's "zero-COVID" policy has led to dramatic shutdowns in response to any evidence of new cases. Factories closing in China have reverberated around the world—for example, the current shortage of semiconductors has reduced US auto production. China's zero-COVID policy has kept case counts low, but that is a mixed blessing because now the Chinese population has little natural immunity. Combined with the use of less efficacious vaccines, China is ill-equipped to face a virus that seems to be evolving to be more contagious. There have been reports that the Chinese government is reconsidering its zero-COVID policy, but for now, a widespread Chinese COVID-19 outbreak remains a key risk that we are monitoring.

Given the risks we have discussed and the market's rocky start to the year, a fair question to ask is, "How do income stocks perform in down markets?" Looking back at the last 50 years, the S&P 500 Index has had 10 down years. High-yield stocks* outperformed the S&P 500 in 70% of the down years, and actually had positive absolute returns 40% of the time. Overall, high-yield stocks outperformed the S&P 500 by almost 9% during the down years.

In our view, the fact that high-yield equities have provided better downside protection than the broad market is not a surprise. Committing to a regular dividend requires management to feel confident that their business can endure economic or competitive challenges, yet still generate the cash flow needed to make their dividend commitments. Generally, this implies fairly consistent cash flow and a strong balance sheet. Naturally, some management teams make a commitment when they should not—that is why fundamental research is required. But as we showed in our 2Q 2021 Quarterly Report, dividend cuts happen every year but have always been, even in stressful years, outnumbered by dividend increases. Management teams make a judgment when establishing a regular dividend, sending a useful signal to investors that the company's cash flow should prove to be dependable. Oftentimes, this same resilience that allows the dividend to continue can provide downside protection in tough markets.

Returns on 10-Year Holding Periods
(1971-2021)



As of December 31, 2021. Sources: Morningstar Direct; Fama/French Research data library; Miller/Howard Research & Analysis. Based on the rolling 10-year annualized total returns. Each dot represents the trailing 10-year annualized total return, ending each calendar year. High-Yield Stocks data are provided by the Fama/French Research data library. The High-Yield Stocks portfolio uses Deciles 7 through 9 of portfolios created by dividend yield (value weighted returns), where 1 is the lowest and 10 is the highest.

While it's gratifying to know that income stocks tend to outperform in down years, our view continues to be that it's best not to try to time the market. Fluctuations in the overall market are very unpredictable, but buy-and-hold investors are typically well rewarded.

Looking at the total return for 10-year holding periods ending over the past 50 years, investors in the S&P 500 saw a compound average annual return of 10.3%. But the range of outcomes was large—with the maximum annual return of 19.2% for the 10-year period ending in 1998 and a -1.4% annual return for the period ending in 2008.

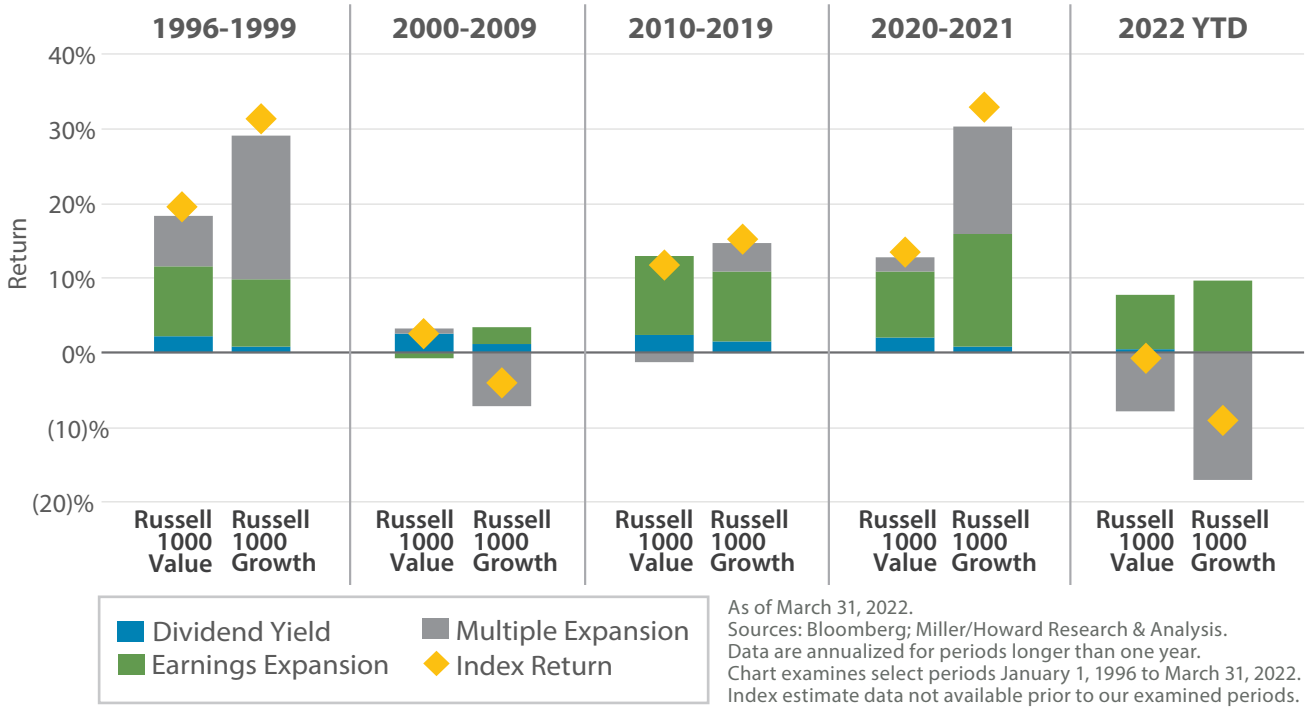
High-yield equities have fared better. The average annual return for high-yield equities held over 10-years was 12.1%, well ahead of the S&P 500 average return. The range of outcomes was also wide with the best 10-year period coming in at 19.8% and the worst period at 2.4%.

While rare, there were two 10-year periods, those ending in 2008 and 2009, in which the S&P 500 produced negative returns. In contrast, over the last 50 years high-yield equities did not have a single 10-year period with a negative return.

Looking at this chart differently, a $100 investment in the S&P 500 grew to $267 on average over 10 years, whereas high-yield stocks grew to $315. While results can vary, high-yield equities have historically offered both better downside protection and higher average returns over long holding periods.

Russell 1000 Value & Growth Indices

Total Return Compositions for Select Periods



As of March 31, 2022.
Sources: Bloomberg; Miller/Howard Research & Analysis.
Data are annualized for periods longer than one year.
Chart examines select periods January 1, 1996 to March 31, 2022.
Index estimate data not available prior to our examined periods.

MARKET LEADERSHIP SHIFTED FROM GROWTH to value in the first quarter. The longer-term story arc for growth versus value can be best understood by decomposing returns into three components: dividends, earnings growth, and changes in the price/earnings (P/E) multiple. Growth stocks zoomed ahead of value stocks in the late 90s entirely due to increased price/earnings multiples. It all came crashing down in 2000, and growth stocks actually had negative returns for the first decade of the century. Value chugged along in the 2000s, producing positive returns, even with taking the losses of 2008 into account.

Both value and growth stocks produced good returns in the second decade of the century, with growth stocks outperforming value entirely due to the swelling of price/earnings multiples. The pandemic years of 2020-21 were very good for growth stocks. Aggressive interest rate cuts by the Fed combined with quantitative easing pushed interest rates lower across the yield curve, causing investors to use lower discount rates when evaluating earnings far into the future. This clearly matters more for growth stocks as their proponents forecast high earnings growth for the 2030s and beyond. In contrast, returns for value stocks in the pandemic years were driven almost entirely from near-term earnings growth and dividends.

In the first quarter, accelerating inflation created fears that the Fed would have to hike interest rates substantially to get inflation under control, raising the possibility of a hard landing. Recession worries combined with higher interest rates depressed price/earnings multiples across the market, with the growth stocks taking the largest hit. Estimates for 2022 earnings grew for both growth and value stocks, but compression in price/earnings multiples dominated returns. The Russell 1000 Value Index was down -0.7% for the quarter while the Russell 1000 Growth Index was off -9.0%.

Miller/Howard's Income-Equity Strategies are not a value strategy per se, but stocks with high price/earnings multiples cannot meet our requirement of a high dividend yield combined with strong earnings coverage for the dividend. As a result of requiring high

Continued on page 9

and well-covered dividends, Income-Equity tends to own value stocks, but with a higher-quality tilt than found in many value strategies.

Consistent with the outperformance of value in the quarter, both versions of our Income-Equity Strategy were well ahead of the broad market in the quarter, and roughly equal to the Russell 1000 Value Index.

Looking Ahead

As we wrote last year, in the Miller/Howard 1Q 2021 Quarterly Report, we believe that investors should depend on dividends and earnings growth for investment returns, as price/earnings multiples are likely to contract over the coming years due to rising interest rates. Consistent with this viewpoint, our Income-Equity Strategies focus on companies with high and growing dividends, funded by earnings growth. We also prefer low price/earnings multiples because, in our view, high P/E stocks are most vulnerable to multiple contraction. Overall, we believe that Income-Equity's focus on dividends, earnings growth, and low valuation is well-suited to the current environment.

We have, however, made some adjustments to account for higher economic risks, shifting towards companies that can grow earnings even if economic growth is lackluster. The recent purchases of utility **CMS Energy (CMS)** and **Extra Space Storage (EXR)** fit this theme. We retain our bias towards high free cash flow and low leverage, as financial resiliency will be even more important if economic growth falters.

We feel that higher interest rates should help our financial holdings, by expanding net interest margins at banks and raising the interest rates earned on bond portfolios at insurance companies. Higher interest rates could, however, eventually slow the economy, potentially raising loan default rates at banks. Currently, credit loss rates are very low, but this could change. We have reduced our weight in financial stocks and will keep a sharp eye on credit performance.

Overall, we expect our portfolio to continue to churn out dividends and dividend increases. Dividend yields were 3.4% and 3.2% for the with-MLP and no-MLP versions, respectively. Similar to last year, we expect the vast majority of our holdings to announce dividend increases in 2022.

Portfolio Highlights

- **Dividend Increases.** Both versions of our Income-Equity Strategies had 10 dividend increases in the first quarter, including double digit increases at **Jefferies Financial Group (JEF), OneMain Holdings (OMF), Whirlpool (WHR),** and **Best Buy (BBY). STAG Industrial (STAG), Gilead Sciences (GILD), Interpublic Group (IPG), Genuine Parts (GPC), Nutrien (NTR),** and **Old Republic International (ORI)** also increased their dividends.

- **Sales.** We sold **Cisco (CSCO)** and **General Mills (GIS)** on concerns that they would not be able to raise prices enough to keep up with increasing costs. We sold **Regions Financial (RF)** because it is struggling to increase its loan balances. We sold **Cummins (CMI)** and **OneMain Financial (OMF)** to control our cyclical exposure. We sold **ONEOK (OKE)** to shift towards energy companies with more direct exposure to the price of oil. We closed out our position in **Target (TGT)** after a long, multi-year run that left its dividend yield well below the portfolio average.

- **Buys.** We found a number of opportunities to buy quality companies at reasonable prices, including **JP Morgan (JPM),** Michigan-based utility **CMS Energy (CMS),** and **Extra Space Storage (EXR)**. Despite having recently announced large dividend increases, we were able to buy **Hewlett-Packard (HPQ), Ally Financial (ALLY),** and **Carter's (CRI)** at exceptionally good valuations. We bought **EOG Resources (EOG)** to take better advantage of strong oil prices. We also added integrated oil and gas company **TotalEnergies (TTE)** to our with-MLP portfolio to diversify our energy holdings (TTE was already a holding in our no-MLP version).

*See more about **Income-Equity** on page 15.*

MLP Strategy

Quarterly Report 1Q 2022

WHAT A DIFFERENCE A FEW YEARS MAKE! IN 2015, midstream energy companies generated $57 billion in cash from operations, yet a whopping $91 billion went to capital spending. Naturally, this required the industry to sell both bonds and equity to fund the gap. Yes, the industry paid significant dividends then, but midstream companies still needed debt and equity issuances for new capital spending projects. Compare that picture to 2021—the industry generated $76 billion in cash flow from operations, yet spent only $28 billion on capital spending. Free cash flow (FCF) was an ample $48 billion last year, allowing the industry to pay $35 billion in dividends while actually reducing debt by $3 billion and buying back a small amount of stock.

Due to the focus on free cash flow, investors are being rewarded—with a number of midstream companies announcing material distribution increases during the quarter. **Plains All American Pipeline (PAA)** and **Plains GP Holdings (PAGP)** stated that they will increase the 2022 distributions by 21%. **Cheniere Energy Partners (CQP)** is now targeting 32% distribution growth, up from previous guidance of 18%. In January, **Energy Transfer (ET)** announced a 15% increase in its quarterly distribution. **Western Midstream Partners (WES)** established a new capital allocation framework, which includes a 53% distribution increase for 1Q 2022 and the potential for special distributions starting in 1Q 2023. **DCP Midstream (DCP)** is targeting an initial distribution increase of approximately 10%.

This turnaround has resulted in more financially sound companies, a much healthier industry, and in our opinion, a compelling investment opportunity.

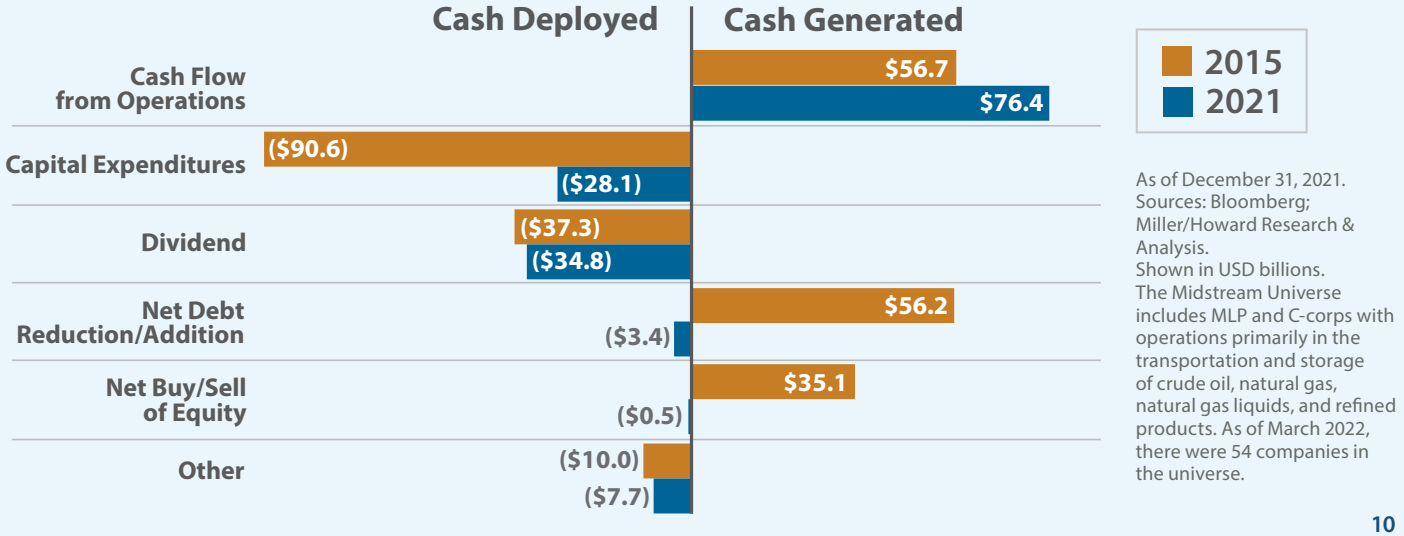
Portfolio Highlights

- **Distributions increases.** This quarter, 5 of our 14 holdings announced dividend increases. The average increase was 56% year-over-year.
- **Sales:** We trimmed **MPLX LP (MPLX),** while still maintaining a healthy position, and sold **Kinder Morgan (KMI)** to add to companies with more attractive valuations. We also exited **Phillips 66 Partners LP (PSXP)** ahead of it being acquired by its sponsor.
- **Buys:** We increased our weight in **Energy Transfer (ET)**, which has an attractive FCF yield, as do both **Crestwood Equity Partners (CEQP)** and **EnLink Midstream (ENLC),** which we also upweighted. These companies should also benefit from higher volumes on their systems. We added to **Enterprise Products Partners (EPD)**, one of the highest quality midstream companies. We increased our weight in **Plains GP Holdings (PAGP),** due to its Permian operations and valuation. Lastly, we also added to **Shell Midstream Partners (SHLX)** as we found its valuation appealing.

Looking Ahead

Commodity and gasoline prices will likely continue to garner the majority of the headlines, and we continue to monitor the potential impact of higher prices on demand. But the midstream industry is very healthy, in our view. Volumes have recovered to pre-COVID levels, leverage continues to decline, and shareholders are being rewarded through the combination of higher distributions and share buybacks. In addition, strong FCF coverage ratios, which we view as being an important indicator, are supportive of current distributions and the potential for distribution increases.

Midstream Universe: Cash Flow



As of December 31, 2021.
Sources: Bloomberg; Miller/Howard Research & Analysis.
Shown in USD billions.
The Midstream Universe includes MLP and C-corps with operations primarily in the transportation and storage of crude oil, natural gas, natural gas liquids, and refined products. As of March 2022, there were 54 companies in the universe.

Infrastructure

Quarterly Report 1Q 2022

OUR INFRASTRUCTURE STRATEGY PROVED MORE resilient than the broader market during the quarter as investors navigated escalating geopolitical tensions and shifting Fed policy.

The portfolio benefitted from rising commodity prices. Following the invasion of Ukraine, crude and natural gas liquids (NGL) prices took another step higher on fears that supply disruptions would exacerbate tightening markets. Amid this strength, midstream energy holdings led the portfolio and accounted for the five top performers during the quarter. The conflict in Ukraine also contributed to the risk-off sentiment in financial markets that bolstered utilities' relative performance. Only three sectors ended the quarter in positive territory—utilities and energy were two of them. Cell towers (classified as real estate on a sector basis) lagged during the quarter as the Fed's hawkish shift put pressure on business models with longer-duration assets. This dynamic was consistent with the market's general preference for value over growth. As usual, industrials were more idiosyncratic although rails outperformed on signs that supply chain bottlenecks were easing and an improved volume outlook.

Looking Ahead

While our portfolio is domestically-focused, we expect the Infrastructure Strategy holdings to help provide solutions to a challenging global energy transition. We have long espoused that US liquefied natural gas (LNG) will play a critical role in this transition.

The US started exporting LNG in early 2016, and by the end of 2022, the US is expected to have the world's largest LNG export capacity. This capacity has taken center stage as Europe looks to reduce its reliance on Russian gas which accounted for roughly one third of European gas. In a recent summit with European Union leaders, the Biden administration agreed to increase LNG exports to Europe through 2030. Increased exports will require additional infrastructure given a lack of spare capacity.

We feel that the Miller/Howard Infrastructure Strategy is well-positioned to take advantage of these opportunities. With midstream and utility positions covering assets from the wellhead to the export dock, we expect our investors to benefit from increased global demand for US natural gas.

Portfolio Highlights

- **New position:** We expect **Exelon (EXC)** to benefit from a low-risk business model following the spin-off of its nuclear assets.
- **Exiting position:** We exited our position in **Spire (SR)** based on the notion that its recent rate case suggested a deteriorating relationship in its primary regulatory jurisdiction and the risk of its STL Pipeline being vacated.
- **Trimming on strength:** Following a strong move up in liquefied natural gas and crude prices that drove stock prices higher, we trimmed **Cheniere Energy (LNG)** and **Targa Resources (TRGP)**. Both companies remain core positions in the portfolio.
- **Reducing risk:** During the quarter, we took steps to reduce the portfolio's volatility. This included trimming **Marathon Petroleum (MPC), MDU Resources Group (MDU), FedEx (FDX),** and **UGI Corp. (UGI)**, as well as adding to **Waste Management (WM), Dominion Energy (D), CMS Energy (CMS), Entergy (ETR), Crown Castle International (CCI),** and **CenterPoint Energy (CNP).**

US Quarterly Liquefied Natural Gas Export Capacity

Source: US Energy Information Administration, database of US LNG export facilities. Blue and black blocks represent capacity additions.

Utilities Plus

Quarterly Report 1Q 2022

THE UTILITIES SECTOR FINISHED THE QUARTER IN positive territory, outperforming the broader market as the conflict in Ukraine took a devastating humanitarian toll and drove a risk-off environment in financial markets. In the two weeks following the invasion of Ukraine, the performance of utilities and the broader market diverged. As investors sought safety, utilities' outperformance reached roughly 12% in early March before narrowing through quarter end.

Interest rates were also a key driver during the quarter and contributed to the broader risk-off sentiment. Facing a surge in inflation, the Fed raised the federal funds rate and signaled to the market to expect more hikes throughout the next two years. We believe the combination of rising inflation and interest rates should moderate spending, causing economic growth to slow.

Among utilities, diversified names with exposure to energy and gas local distribution companies (LDCs) outperformed, while water and renewable plays underperformed. While LDCs benefitted from the private market values ascribed to two recent industry transactions, relative performance was generally consistent with the outperformance of value over growth.

Looking Ahead

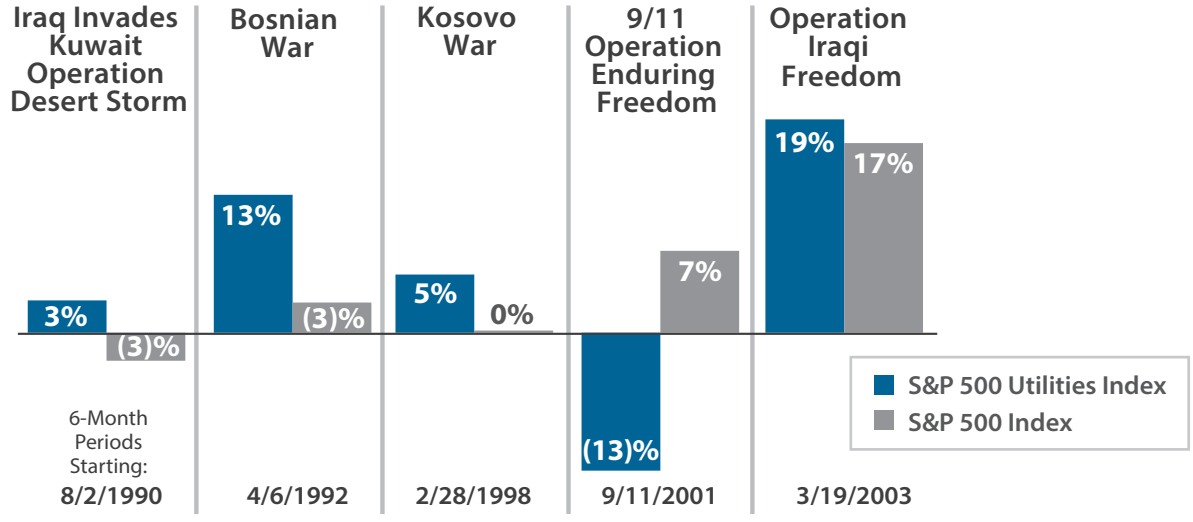
Historically speaking, the market's pivot to defensive and domestic names is not an anomaly. Following major US- and Euro-centric conflicts since 1990, utilities have outperformed the broader US market four out of five times. The main outlier was the six-month period following 9/11 that included the collapse of Enron which pressured utilities. Going forward, we expect utilities to continue to provide investors with a safe haven as investors grapple with the economic implications from the conflict in Ukraine.

While interest rates continue to provide a potential headwind to the group (particularly against the backdrop of a strong economy), utilities have outperformed the broader market for the last three quarters, despite the yield on the 10-year marching higher. Our strategy is relatively well positioned for continued rate increases given the portfolio's emphasis on value names within the space.

Portfolio Highlights

- **New position:** We expect **DTE Energy (DTE)** to benefit from what is widely considered to be one of the best regulatory jurisdictions in the country (Michigan) and a long runway of growth opportunities driven by decarbonization goals.
- **Reducing risk:** We exited our position in **Spire (SR)** based on the notion that its recent rate case suggested a deteriorating relationship in its primary regulatory jurisdiction and the risk of its STL Pipeline being vacated. Additionally, we trimmed **PPL (PPL)** which is currently navigating the increased execution risk associated with transforming its utility portfolio.
- **Adding on valuation:** During the quarter, we increased our positions in **American Electric Power (AEP), Dominion Energy (D),** and **Duke Energy (DUK).** Despite strong fundamentals, these names all trade at discounted forward price/earnings multiples when compared to the S&P 500 Utilities Index.

6-Month Total Return Following Conflict



As of March 31, 2022. Source: Bloomberg.

Drill Bit to Burner Tip®

Quarterly Report 1Q 2022

We are excited to announce that this strategy's name will change to North American Energy, and it will be benchmarked versus the S&P 1500 Energy Index. We believe this change best reflects the investment objective of the strategy, which will continue to invest in all facets of the North American energy value chain.

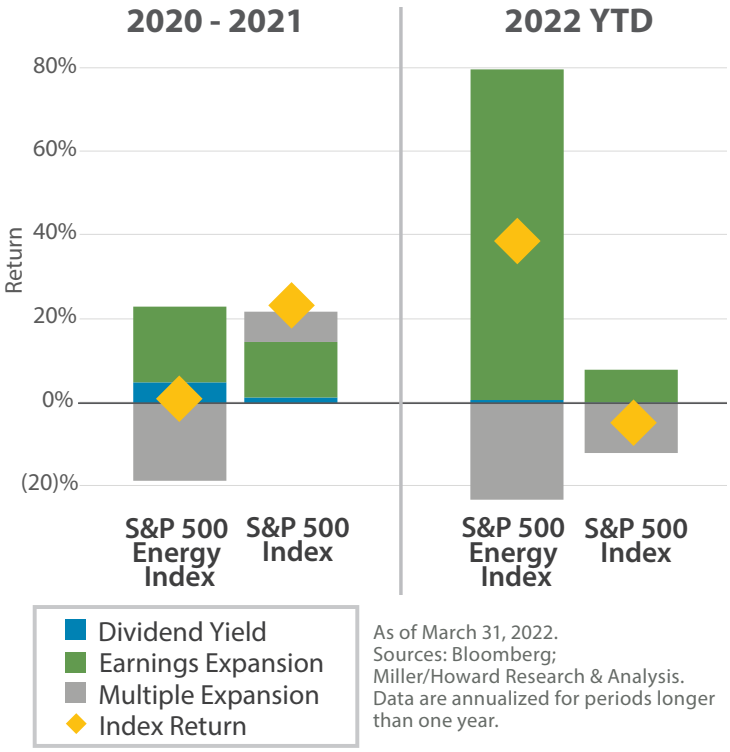
NOT ONLY DID ENERGY STOCKS POST THEIR BEST quarter in over 20 years, the sector's 44% relative outperformance to the S&P 500 Index nearly doubled the margin of the second ever best quarter, which occurred exactly one year ago. This clustered period of sizable energy outperformance is reminiscent of 2000, which proved to be an inflection point that preceded multiple years of strong energy sector relative returns. Critically, nearly two-thirds of this quarter's gains were achieved in the first five weeks of the year, well before Russia's invasion of Ukraine. Indeed, we firmly believe the supply/demand fundamentals supporting energy stocks over the past 18 months are more powerful than any temporary dislocation tied to Russia. While the conflict and sanctions have tightened energy markets, in our view, rising commodity prices mainly reflect years of underinvestment in new production, exacerbated by COVID-driven supply cuts amidst continued growth in oil and gas demand.

Looking Ahead

While rising prices are a familiar dynamic across many sectors today, we believe a favorable energy price environment could persist for some time. It takes enormous investments of time and money to overcome declining production from existing fields, with the latter increasingly deterred by tightening monetary policies, investor demands for capital returns, and alternatives-driven stranded asset concerns. Have investors missed out? Our answer remains, "no." Strong energy returns over the past year have been entirely driven not by exuberance, but by rising earnings and cash flow, with a current portfolio forward free cash flow yield of just under 10%, supporting robust dividends and buybacks.

S&P 500 and S&P 500 Energy Indices

Total Return Compositions



As of March 31, 2022.
Sources: Bloomberg; Miller/Howard Research & Analysis.
Data are annualized for periods longer than one year.

Portfolio Highlights

- **Energy and income.** This quarter, nearly one in four portfolio holdings declared a dividend increase. Exploration and production (E&P) companies are rapidly joining refiners and pipelines as among the highest dividend payers in the market. This portfolio currently indicates a 3.5% yield (not including expected 2022 E&P variable dividends) that we estimate is well supported at $40 per barrel oil.
- **Along the energy value chain.** We added upstream holding **Magnolia Oil & Gas (MGY)**, a small-cap E&P with a clean balance sheet, generous special dividends, and an exciting exploration program in the emerging "Giddings" play in Texas.
- **Other transactions** included our exiting **Equitrans Midstream (ETRN), Suncor Energy (SU), LyondellBasell Industries (LYB),** and **DT Midstream (DTM)**. We bought **Plains GP Holdings (PAGP)** and **MRC Global (MRC).**

Small Cap Dividends

Quarterly Report 1Q 2022

VOLATILITY ISN'T A NOVEL CONCEPT FOR small-cap investors. Since 1995, almost one-third of calendar-year returns for the Russell 2000 Index have been negative. For perspective, the S&P 500 Index was down in fewer than one-fifth of the years over the same period. Market volatility tends to dissuade transient investors, but history has rewarded those who weather the storm: The average annual return for the Russell 2000 following a down year was 16%, topping the S&P 500's figure of 11% over the same period.

The Russell 2000 has had eight down years since 1995. Profitable small-cap companies, defined by positive trailing GAAP net income, outperformed the index in 100% of those years. Dividend-paying small-cap stocks outperformed 75% of those years. In our opinion, the outperformance is justified: Profitable companies have a financial cushion if markets sour, and dividend-paying companies are signaling confidence in future cash flow. We believe these factors present an opportunity for sustained outperformance in an otherwise volatile universe.

Our Small Cap Dividend Strategy finished the first quarter of 2022 marginally ahead of the Russell 2000, but behind the broader market.

Looking Ahead

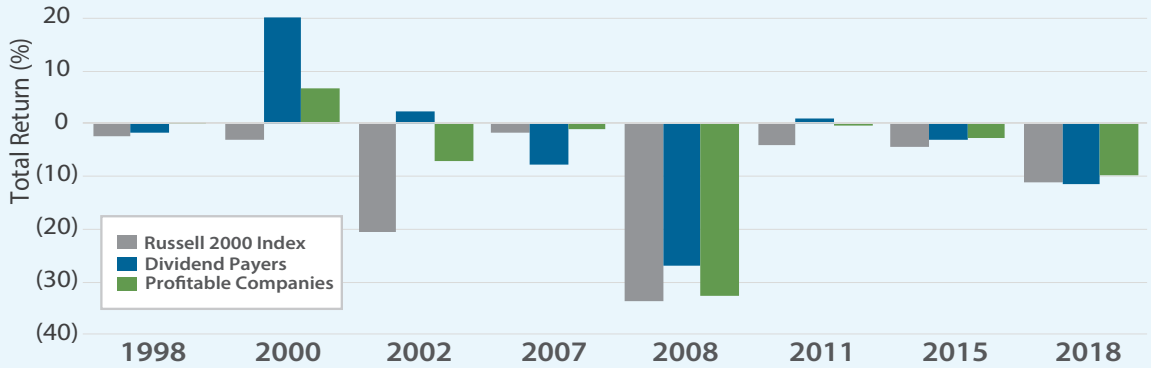
With plenty of uncertainty left for 2022, Miller/Howard's Small Cap Dividend Strategy continues to emphasize investments in dividend-paying companies with positive earnings and strong balance sheets. We believe in our approach—our niche focus on quality small-cap stocks is supported by the group's historical outperformance versus the broader universe during down markets. Roughly one-third of the Russell 2000 Index is unprofitable. Our approach allows investors to participate in the growth opportunities associated with small caps without sacrificing quality.

Portfolio Highlights

- **Dividend increases:** Twenty of our holdings announced dividend increases, including **Bank OZK (OZK), Stag Industrial (STAG), Apogee Enterprises (APOG), Shutterstock (SSTK), Washington Federal (WAFD), HomeStreet (HMST), Standard Motor Products (SMP), Magnolia Oil & Gas (MGY), Kforce (KFRC), Radian Group (RDN), Terex (TEX), Avnet (AVT), Louisiana-Pacific (LPX), Assured Guaranty (AGO), Installed Building Products (IBP), Fulton Financial (FULT), Signet Jewelers (SIG), Medifast (MED), Oxford Industries (OXM),** and **Movado (MOV).**
- **Special dividends:** One of our holdings declared a special dividend: **Oasis Petroleum (OAS).**
- **Sales:** We exited **Owens & Minor (OMI), Spire (SR), Brandywine (BDN), Equitrans Midstream (ETRN), NextGen Healthcare (NXGN), ABM Industries (ABM), La-Z-Boy (LZB), Installed Building Products (IBP), Patrick Industries (PATK),** and **MDC Holdings (MDC).**
- **Buys:** We initiated positions in **Kontoor Brands (KTB), Oasis Petroleum (OAS), PS Business Parks (PSB), Premier (PINC), Catalyst Pharmaceuticals (CPRX),** and **Carter's (CRI).**

Small-Cap Stocks in Down Years

Since 1995, the Russell 2000 Index has had 8 calendar years with negative total returns.



Profitable companies outperformed 100% of the time (by 4% on average)

Dividend payers outperformed 75% of the time (by 10% on average)

Data as of December 31, 2021. Sources: Bloomberg; Miller/Howard Research & Analysis. Based on the stocks in the Russell 2000 Index, market-cap-weighted, rebalanced yearly. Dividend Payers: divided into two groups (dividend paying vs. non-paying). Profitable: divided into two groups (profitable vs. unprofitable). Profitable is defined as positive trailing 12 month net income at each calendar year end. Unprofitable is defined as negative trailing 12 month net income at each calendar year end.

Yield, Growth, Strength, Stability

- Our Income-Equity Strategies each offer a high dividend yield that is over 2x the yield on the S&P 500 Index, and have ample dividend coverage and reasonable leverage levels (net debt/EBITDA).
- Both portfolios trade at a significant discount to the broad market on price-to-earnings as well. Value investing historically has done best coming out of a recession, so the historically low valuations should set the Income-Equity Strategies up for a strong recovery, in our view.
- We believe the portfolios are well-positioned for dividend growth as economic conditions continue to improve.

Income-Equity Strategy (with MLPs)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	1Q 2022
Income-Equity Yield	4.8	4.4	4.2	4.7	4.0	3.7	4.3	3.7	3.6	3.3	3.4
S&P 500 Yield	2.2	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5	1.4
Ratio	2.1x	2.3x	2.1x	2.2x	1.9x	2.0x	2.0x	2.0x	2.3x	2.2x	2.4x
Income-Equity Projected Dividend Growth*	7.5	7.5	7.5	5.8	5.0	6.3	7.8	7.3	5.1	6.0	7.8
S&P 500 Projected Dividend Growth**	5.1	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.9	6.2
Ratio	1.5x	1.3x	1.6x	1.4x	1.2x	1.5x	1.5x	1.7x	1.5x	1.0x	1.3x
Income-Equity Dividend Coverage Ratio	1.5x	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.0x	2.7x
Income-Equity Net Debt/EBITDA***	2.5x	2.6x	4.2x	2.8x	2.0x	1.9x	1.4x	1.9x	1.9x	1.2x	1.4x
Income-Equity P/E Ratio Trailing	14.1	13.4	16.4	14.2	17.2	17.7	12.6	12.8	16.7	14.0	12.1
S&P 500 P/E Trailing	14.4	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	24.1	23.3
Premium/Discount	-2%	-23%	-10%	-24%	-16%	-18%	-23%	-41%	-40%	-42%	-48%

Income-Equity Strategy (No MLPs)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	1Q 2022
Income-Equity (No MLPs) Yield	4.7	4.1	4.0	4.6	3.9	3.7	4.2	3.6	3.5	3.2	3.2
S&P 500 Yield	2.2	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5	1.4
Ratio	2.1x	2.2x	2.1x	2.1x	1.9x	2.0x	2.0x	2.0x	2.3x	2.1x	2.3x
Income-Equity (No MLPs) Projected Dividend Growth*	7.6	8.2	7.7	5.9	5.0	6.4	7.9	7.5	5.2	6.0	8.1
S&P 500 Projected Dividend Growth**	5.1	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.9	6.2
Ratio	1.5x	1.4x	1.6x	1.4x	1.2x	1.5x	1.5x	1.8x	1.5x	1.0x	1.3x
Income-Equity (No MLPs) Dividend Coverage Ratio	1.4x	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	2.0x	2.7x
Income-Equity (No MLPs) Net Debt/EBITDA***	2.5x	2.7x	2.6x	2.6x	2.2x	2.1x	1.4x	1.9x	1.9x	1.2x	1.3x
Income-Equity (No MLPs) P/E Ratio Trailing	14.5	14.6	17.2	16.5	18.2	18.0	12.9	13.5	16.8	14.0	12.1
S&P 500 P/E Trailing	14.4	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	24.1	23.3
Premium/Discount	1%	-16%	-6%	-12%	-12%	-17%	-22%	-38%	-39%	-42%	-48%

As of March 31, 2022. Sources: Bloomberg; S&P; Miller/Howard Research & Analysis. The data above are based on representative accounts in our Income-Equity Strategies both with and without MLPs and are subject to change. Median P/E ratio trailing is published for our Income-Equity Strategies.

* Projected Dividend Growth—Miller/Howard Portfolio Team's 3-year annualized projected dividend growth based on data from various sources, adjusted to reflect our view of future economic and market conditions. There is no assurance projections will be realized.

** Bloomberg Dividend per Share 3-year forward estimates.

*** Excludes financials.

Dividend yields shown for Miller/Howard portfolios exclude cash.

All data are as of year-end, unless otherwise noted.

Common stocks do not assure dividend payments. Dividends are paid only when declared by an issuer's board of directors, and the amount of any dividend may vary over time. Dividend yield is one component of performance and should not be the only consideration for investment. See definitions and full disclosure on page 16.

SPRING IS PROXY SEASON

AN IMPORTANT OPPORTUNITY–Corporate governance issues such as executive compensation, shareholder resolutions requesting reports and transparency, and director elections are put before investors at companies' annual general meetings. Weighing in on these items is the right of every shareholder, and a powerful aspect of active ownership and investment.

VOTING IS VOICE–Active proxy voting works as a feedback mechanism for companies and is central to the functioning of a robust, healthy market. Miller/Howard's guiding values inform the votes we cast, and serve our commitment to provide Sustainable Income Opportunities®, utilizing the power of the vote for the good of the investor.

We look forward to updating you with details of the 2022 Proxy Season and our other work with companies on a variety of environmental, social, and governance (ESG) issues.

Watch for our next ***Shareholder Advocacy & Engagement Report***, due out this summer.

Visit mhinvest.com to learn more about our 30+ year **commitment to ESG**

Miller/Howard Investments Inc. is an independent, research-driven investment boutique with over three decades of experience managing portfolios for major institutions, mutual funds, and individuals in dividend-focused investment strategies. The firm is 100% employee-owned through an Employee Stock Ownership Plan (ESOP).

We continue to evolve and develop strategies that strive to provide investors with various levels of current income and dividend growth. Our objectives are to generate total returns in line with the broad equity market and provide a high and rising stream of income with the lower volatility that an investor might seek from bonds or other income alternatives. With a primary goal of reliable income and long-term returns, coupled with a belief that investors can play an important role in securing a sustainable future, our shareholder advocacy efforts include environmental, social, and governance (ESG) research and/or screening, direct engagement with companies, filing shareholder resolutions, proxy voting, coalition building, and public policy involvement.

This report represents Miller/Howard Investments' views. The statistics and projections cited in this report have been provided by sources generally considered to be reliable, but are not guaranteed. Opinions and estimates offered constitute Miller/Howard Investments' judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. This material is solely informational. The information and analyses contained herein are not intended as tax, legal, or investment advice and may not be appropriate for your specific circumstances; accordingly, you should consult your own tax, legal, investment, or other advisors, at both the outset of any transaction and on an ongoing basis, to determine such appropriateness. The material may also contain forward-looking statements that involve risk and uncertainty, and there is no guarantee they will come to pass. **Any investment returns—past, hypothetical, or otherwise—are not indicative of future performance.** The information provided should not be considered a recommendation to buy or sell any security, and should not be considered investment, legal, or tax advice. Securities mentioned are being shown for informational purposes only. Buy and sell rationales are the express opinions of MHI's investment team. These securities should not be considered a recommendation to buy, sell, or hold any of the securities and are not intended to imply that any one security listed above, or the portfolio as a whole, is suitable for a particular client. There is no assurance that the securities purchased have remained or will remain in the portfolio or that securities sold have not been or will not be repurchased. To receive a list of all recommendations for the previous year, please email compliance@mhinvest.com. Common stocks do not assure dividend payments. Dividends are paid only when declared by an issuer's board of directors, and the amount of any dividend may vary over time. Dividend yield is one component of performance and should not be the only consideration for investment.

DEFINITIONS: Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)—A non-GAAP measure used to provide an approximation of a company's profitability. This measure excludes the potential distortion that accounting and financing rules may have on a company's earnings; therefore, EBITDA is a useful tool when comparing companies that incur large amounts of depreciation expense because it excludes these noncash items, which could understate the company's true performance. **High-Dividend Yield Stocks** consists of Decile 7, 8, and 9 of a universe of US dividend paying common stocks with a market capitalization equal to or greater than $1 billion. **Net Debt to EBITDA—**A measure that computes the company's ability to pay off its debt by utilizing the earnings before interest, taxes, depreciation, and amortization (EBITDA). **Enterprise Value/EBITDA (EV/EBITDA)**—A valuation ratio used to compare the enterprise value (the market value of the company's total operating assets including debt and equity) to the company's EBITDA. The metric allows comparisons across companies with differing capital structures and tax rates. **Price-Earnings Ratio (P/E)—**The ratio of a company's share price to its earnings per share. The ratio is used as a valuation tool and can help determine whether a company is overvalued or undervalued. **S&P 500 Index®** widely regarded as the best single gauge of large-cap US equities and serves as the foundation for a wide range of investment products. The Index includes 500 leading companies and captures approximately 80% coverage of available market capitalization. **The S&P Composite 1500® Energy Index** comprises those companies included in the S&P Composite 1500 that are classified as members of the GICS® energy sector. **The Russell 1000® Growth Index** measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000® companies with higher price-to-book ratios and higher forecasted growth values. **Russell 2000 Index** measures the performance of the small-cap segment of the US equity universe and is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

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Notification to Clients: Contact your Advisor with any material changes to your financial profile that would impact your appropriateness for investment.

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