ALLEY COMPANY

Q3 | 2024 ALLEY COMPANY DIVIDEND PORTFOLIO

QUARTERLY LETTER

Beginning in March of 2022, the Federal Reserve embarked on the fastest “tightening” cycle in decades as it lifted the Fed Funds target rate by 525 basis points, or 5.25 percentage points, in a matter of just 16 months. Supply and demand imbalances during the Covid-19 pandemic combined with an abundance of fiscal and monetary stimulus ignited rising inflation, prompting the Fed’s aggressive policy stance. Despite a constant refrain from pundits that a Fed-induced recession was inevitable in the near term, the U.S. economy has remained resilient, and the inflation “genie” has largely been put back into the bottle with the most recent CPI reading at a reasonable 2.4 percent.

With inflation retreating, the Fed now has latitude to recalibrate interest rates to lower levels. The bond market, in its infinite wisdom, has been ahead of the curve and has been signaling for the past several months that policymakers ought to shift course and lower interest rates. With a 50 basis point cut to the Fed Funds target rate several weeks back, an interest rate “easing” cycle has begun in an effort to protect the job market and allow this current economic expansion to persist. While the extent of the Fed’s interest rate cuts is unknowable, the directional shift is a positive on many fronts.

Consumers and businesses alike should benefit from the lower cost of borrowing. In theory, this should spur greater economic activity and provide positive implications for corporate earnings. As it relates to the stock and bond markets, interest rate cutting cycles since 1972 (see exhibit below) have often produced positive returns in the 12 months following the initial interest rate cut. To be sure, the below returns are “on average” and there have been a few periods of negative returns a year after an initial rate cut that were coincident with a recession.

PORTFOLIO MANAGEMENT TEAM

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Exhibit 1: Average Stock and Bond Market Returns after Initial Interest Rate Cut

	Since 1972		Since 1972 (Recessionary)		Since 1972 (Non-Recessionary)	
	US Treasuries	S&P 500	US Treasuries	S&P 500	US Treasuries	S&P 500
+3M	2.49%	3.77%	1.82%	-1.44%	3.43%	11.07%
+6M	5.92%	8.15%	6.87%	2.25%	4.58%	16.42%
+9M	7.60%	10.79%	9.13%	4.14%	5.46%	20.10%
+12M	9.28%	14.04%	10.43%	9.98%	7.67%	19.74%

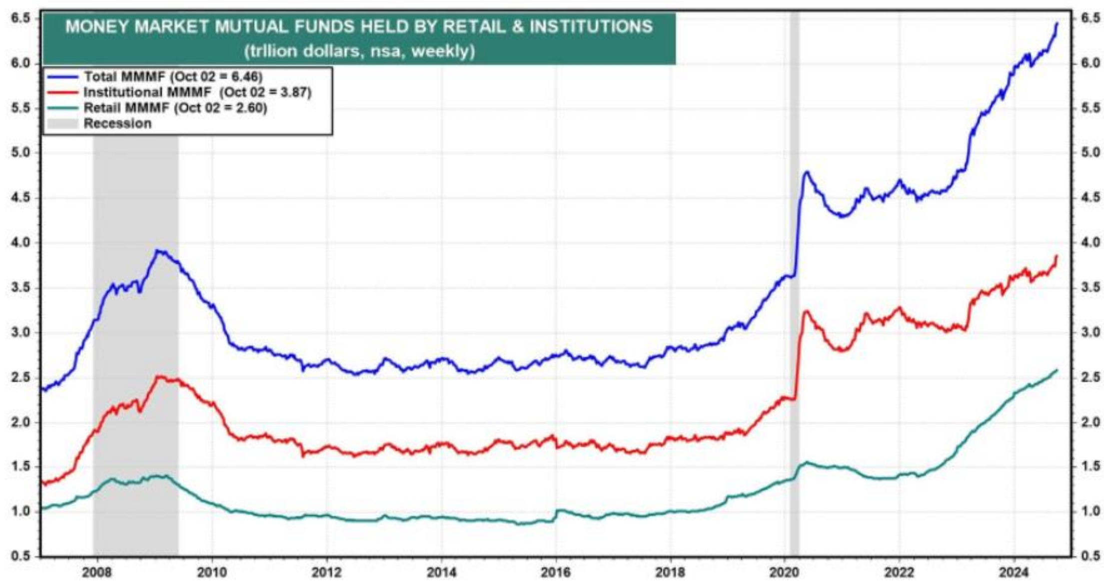
Source: Bloomberg, Macrobond, S&P Global. Recessionary indicates the economy entered into a recession during the interest rate cutting cycle, while Non-Recessionary indicates the economy avoided a recession and the expansion continued during the rate cutting cycle.

As the exhibit shows, the magnitude of stock market returns can vary substantially depending on whether the Fed is cutting rates into a recessionary period or if rate cuts are part of a softer landing where a recession is avoided. Today, a soft landing is increasingly becoming the consensus view due to stable employment trends and corporate profits grinding higher.

Interest Rates and Money Market Funds

A byproduct of interest rates spiking higher in recent years has been investors increasingly becoming comfortable in cash equivalents as part of their overall asset allocation structure. Mid-single digit interest rates on money market funds and Treasury Bills have been enticing after a long period of earning next to nothing on one's cash. We have noted in recent letters that these improved rates of interest could be *"here today, gone tomorrow"* when the Federal Reserve shifts course and recalibrates rates lower. This day has come and rates of return on cash equivalents are likely to continue to move lower in conjunction with rates coming down. Exhibit 2 depicts the recent flood of assets into money market funds. The total of $6.5 trillion is an all-time record. The dividend-paying stocks of high-quality businesses will be an attractive alternative, in our opinion, for these assets "coming off the sidelines."

Exhibit 2: Aggregate Money Market Fund Assets



Source: LSEG Datastream, Yardeni Research, and Investment Institute.

Quarterly Performance Update

During the third quarter of 2024, the Alley Company Dividend Portfolio modestly outperformed the Russell 1000 Value Index.

From an individual holdings perspective, top contributors to and detractors from performance in the portfolio during the third quarter were:

Top Contributors	Top Detractors
Starbucks (SBUX)	Microchip Technology (MCHP)
Lockheed Martin (LMT)	Merck (MRK)
WEC Energy Group (WEC)	Phillips 66 (PSX)

Top and bottom performing sectors in the marketplace during the quarter are displayed in the table below. (+) and (-) symbols indicate the Dividend Portfolio being overweight or underweight the sector relative to the benchmark weighting.

Top Performing Sectors	Bottom Performing Sectors
Utilities (+)	Energy (-)
Real Estate (-)	Technology (+)
Industrials (+)	Communication Services (-)

Portfolio Changes

There were no changes to the portfolio during the third quarter.

Dividend Announcements

Dividend announcements among Alley Company Dividend Portfolio holdings during the first three quarters of the calendar year are below:

Q3 2024

Company	Dividend Change
Accenture (ACN)	+15%
Duke Energy (DUK)	+2%
Illinois Tool Works (ITW)	+7%
JPMorgan Chase (JPM)*	+9%
Microchip Technology (MCHP)**	+0.4%
Microsoft (MSFT)	+11%
Philip Morris International (PM)	+4%
Union Pacific (UNP)	+3%

Q1 2024

Company	Dividend Change
Arthur J. Gallagher (AJG)	+9%
BlackRock (BLK)	+2%
Chevron (CVX)	+8%
Cisco Systems (CSCO)	+3%
Home Depot (HD)	+8%
Microchip Technology (MCHP)**	+3%
NextEra Energy (NEE)	+10%
Prologis (PLD)	+10%
WEC Energy Group (WEC)	+7%

Q2 2024

Company	Dividend Change
Ameriprise Financial (AMP)	+10%
Apple (AAPL)	+4%
JPMorgan Chase (JPM)*	+10%
Microchip Technology (MCHP)**	+0.4%
Paychex (PAYX)	+10%
Pepsico (PEP)	+7%
Phillips 66 (PSX)	+10%
Procter & Gamble (PG)	+7%

*JPMorgan Chase has increased their dividend twice this year for a total increase of 19% compared to the prior year.

**Microchip Technology (MCHP) of late has been increasing their dividend each quarter. Based upon the most recent announcement, the year-over-year increase is approximately 11%.

ALLEY COMPANY DIVIDEND PORTFOLIO

The investment philosophy of the Alley Company Dividend Portfolio focuses on striking the balance between attractive absolute dividend yield and strong dividend growth underpinned by solid company fundamentals of our portfolio holdings. We employ a bottom-up, research-driven process focused on fundamental analysis of our portfolio holdings.

Alley Company

Alley Company is a boutique investment management firm that is dedicated to operating a discernible and disciplined investment philosophy and generating superior risk-adjusted investment returns. Alley Company was originally founded in 1998 and in 2006 established the Alley Company Dividend Portfolio to capitalize on investment opportunities in quality companies with strong dividend-paying cultures