1919 INVESTMENT COUNSEL
Complexity to Clarity

FOURTH QUARTER

4Q 2021 INVESTMENT ROUNDTABLE

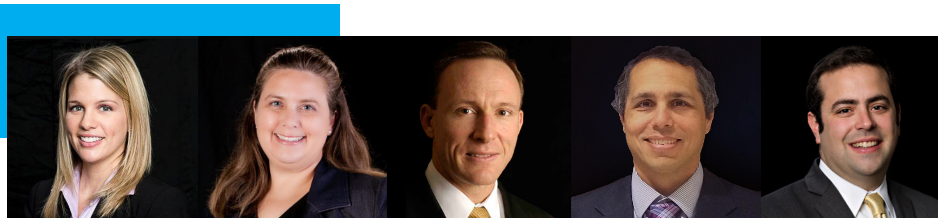
Recently our team of investment analysts met to discuss a number of compelling long-term secular themes that are having a profound impact across a variety of industries and that provide investment opportunities for our clients.

From game-changing breakthroughs in healthcare and the soaring interest in responsible investing utilizing ESG (environmental, social, and corporate governance) criteria, to the transition to a lower-carbon economy, and the passage of a historic infrastructure plan, there is much to consider.

In the short term, however, inflation continues to be a concern. Companies and consumers across many industries are also feeling the impact of supply constraints and labor shortages. Truly, the challenges and opportunities as we move forward are complex and ever-changing.

At 1919 Investment Counsel, we believe that keeping a long-term perspective is key while understanding the dynamics and opportunities provided by the markets and economy today. In this issue of our Investment Roundtable, we provide insight into some of the developments we are following. We hope you enjoy our perspectives.

CHARLES KING, CFA
Managing Director, Chief Investment Officer



As we close out 2021 and move forward into 2022, what is your perspective on the US economy and equity markets?

CHARLES KING, CFA
Managing Director, Chief Investment Officer

CK **The period of transition in the markets and economy continues.** Although the stock market exceeded optimistic forecasts this year, several cross-currents add to the sense of uncertainty as we move forward. COVID-19, and now the Omicron variant, is still the main issue both domestically and globally, with vaccinations a topic of debate between the vaccinated and unvaccinated. The healthcare and economic challenge is compounded by different vaccine availability and adoption among developed and emerging economies.

Domestically, inflationary pressures are top of mind. The inflation we are experiencing and the debate over whether it is transient versus persistent continues. We expect many of these inflationary pressures to be short-lived except in the housing and semiconductor arenas, where supply constraints may continue to fuel rising prices. While retail supply chain issues are expected to be resolved by mid-2022, semiconductor supply recovery is forecasted for 2023 and beyond. The downstream effect of semiconductor supply constraints is felt across many industries, including the automobile industry. The emergence of the new Omicron variant is something that we are monitoring closely as it could create renewed global supply chain disruption which would interrupt the normalization.

The labor shortage adds to the sense of uncertainty. Almost four and a half million people resigned as of September 2021, which has been a significant issue for small and medium-sized businesses. We have seen an uptick in the number of people retiring as they are more comfortable retiring when their 401(k) and investment account balances have grown, their home is worth more, and they have stockpiled savings during the pandemic. Also, hospitality and restaurant workers who may have been laid off during the pandemic have transitioned to other jobs, creating labor shortages in those areas. Other employees, seeking greater flexibility, have taken the entrepreneurship route and started new businesses. The pandemic has provided the opportunity for many people to rethink their overall employment and lifestyle approach.

These various cross-currents continue to force innovation and accelerate changes in how companies operate. As a result, digital transformation, using digital technologies to transform how companies operate in the world and interact with consumers, is well underway across many industries.

To what degree may interest rates be impacted in 2022 as concerns about inflationary pressures persist? What impact may this have on both the equity and fixed income markets?

LAUREN WEBB, CFA
Principal, Portfolio Manager

LW **As Charlie mentioned, inflation, currently at a 30-year high, is a hot topic** and the most significant factor in determining where interest rates will go in the coming year or two. Supply constraints due to pandemic-fueled supply chain issues, pent-up demand, and labor force shortages are also exacerbating inflationary pressures. The Fed remains focused on controlling inflation but is also concerned with the unemployment aspect of their dual mandate.

Currently, the Fed is just beginning to taper their bond purchases, which is a remnant of emergency measures put in place in response to the COVID-19 pandemic. That bond purchasing program will likely come to an end by June 2022 based on the Fed's current pace. However, there is concern that this tapering is not quick enough and the Fed will need to address inflation sooner. Regardless of the exact timing of tapering and increasing the overnight rate, it is clear that the Fed will use their tools to combat inflation as needed. We continue to monitor inflation, unemployment, and the impact of COVID-19 variants on the economic recovery as we consider the path of interest rates.

From our perspective, we continue to believe that this level of inflation will not persist and should ultimately revert to the 2% target the Fed is working towards. Disinflationary trends pre-COVID-19 such as demographics, globalization, and technology are still factors but wage growth and housing prices are more permanent. Monetary policy related to these inflation expectations would provide welcomed higher interest rates. In light of a persistently low-rate environment, a fixed income allocation has become more about portfolio diversification and providing a ballast to an equity allocation rather than a compelling income-generating solution. We would like to see more opportunities for income as we move forward.

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How may the recently passed infrastructure bill provide opportunities for the municipal bond market?

LW **On the margin, we expect the $1.2 trillion infrastructure bill to be positive for the municipal bond market over the long term.** Infrastructure projects will most likely require additional funds than those provided by the infrastructure package, bringing new supply to the market. The bill also expands the limits for private activity bonds, allowing communities and municipalities to partner with private corporations on specific projects. We look forward to the prospect of greater municipal bond issuance and more municipal bond investment opportunities for our clients.

ESG-oriented investing continues its historic growth trajectory. Are there any particular areas of focus that merit investor attention as we move forward into 2022?

ALISON BEVILACQUA
Principal, Head of Social Research

AB **The concept of the S (the social considerations) in ESG continues to garner attention** regarding employees in the workforce. COVID-19 has raised many questions about employers and their responsibility to employees regarding safety, workplace practices, flexibility, and other issues. This has become even more of a focal point as continued labor constraints and the Great Resignation of 2021 (with record numbers of employee resignations and job changes) have only added to the reevaluation of what is expected from companies. Many employees are now reconsidering the type of work they want to do, how they want to structure that work, and where they want to do it, which has been a catalyst for change in how employers respond to these new realities to attract and retain talent.

Diversity and inclusion also continue to be at the forefront of the social conversation as companies evaluate the representation of women and minorities on boards, within management, and across their employee base. This has been a continued focus in company sustainability reports, and we have seen evidence of greater board and management diversification as a result. In addition, new resource groups and support programs have been made available for underrepresented workforce communities. We look forward to seeing the positive impact these measures may make over the long term.

With the conclusion of COP26 (the 2021 United Nations Climate Change Conference), the heightened focus on climate change continues. Many companies have publicly stated commitments to decarbonization, yet uncertainty remains around how to measure the progress. Climate-aware investors and activists will continue to exert pressure for change, and the debate will continue, particularly regarding oil and gas companies—how they fit into the transition, and what kind of changes they are willing to make on the path to a low-carbon economy.

Green, social, and sustainable bonds continue to be an area of focus for us, and the number of investment opportunities is growing. We are looking forward to seeing more ESG-oriented municipal bond opportunities as cities and states follow through on their commitments to climate change and move forward with projects sparked by the passage of the infrastructure bill.

The pandemic accelerated healthcare innovations. Would you please provide an update on any game-changing developments that may provide compelling opportunities for long-term investment? Are there any innovations that may ultimately drive down costs?

CHRISTOPHER DELPI, CFA
Principal, Equity Research Analyst

CD **Tremendous innovations continue in the healthcare arena from the pharmaceutical and technology perspective.** On the pharmaceutical front, both Merck and Pfizer have created COVID-19 antiviral treatments that should be available for use shortly. Typically, development takes five to seven years, yet this antiviral development has been accomplished in under two years, with meaningful efficacy shown for patients with mild to moderate symptoms. As we continue to battle COVID-19 and its variants across the globe, healthcare developments such as these antivirals will be key.

We are excited about technological innovations, including advancements that help benefit patient outcomes and mitigate the impact of nursing labor shortages. These innovations include increased use of outpatient surgical centers and robotic surgery—enhancing surgical precision, and ameliorating staffing requirements. For example, a patient may have needed a multi-day stay at a hospital for knee surgery in the past. Now they may receive treatment at an outpatient surgical center in one day. In addition, "smart knee" technology is now available to track steps taken and ensure appropriate post-operation rehabilitation occurs. As a result, the best healing outcome is achieved, preventing infection and other potential post-operation concerns—increasing patient satisfaction and controlling time and money spent. Over time, we believe improvements like these should help reduce costs for patients and the medical system.

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Telehealth also continues to play a significant role for patients who prefer not to go into an office due to COVID-19 concerns or logistical or time constraints. We expect telehealth acceptance to grow. For example, we have started to see innovative use of telehealth technology in psychiatry and therapy, particularly for the treatment of depression, wherein depression medication and therapy work best when used together. Such telehealth solutions and conveniences can provide easier access for many patients.

Another recently introduced minimally invasive technology is a tiny pill camera that, when swallowed, can diagnose ulcerative colitis, Crohn's, or polyps. This innovative technology eliminates the need for a costlier, more time-intensive procedure under anesthetics. These are the types of exciting game-changing healthcare innovations we are exploring for long-term investment potential.

How may inflation, decarbonization, and the recently passed infrastructure plan impact industrials and utilities?

ERIC THOMPSON, CFA
Principal, Equity Research Analyst

ET **Many companies face increased raw materials costs, rising labor costs in a labor-constrained environment, and growing logistics and transportation costs.** While we initially saw prices for raw materials rise, now labor and logistics costs have become more of a pinch point. From a labor shortage perspective, companies have increased pay, benefits, and signing bonuses to attract talent while paying more for supplies and transportation. Bottlenecks at west coast ports and further inland have stifled freight movement, and in many cases, companies are unable to procure materials, components, and other needed inputs. Demand has remained strong and due to lack of availability, companies are unable to produce enough to meet demand. Many companies are able to pass through price increases to offset costs, and although supply chain constraints will likely remain through the first half of 2022, order rates are strong, which bodes well for economic growth for the first half of 2022.

Decarbonization continues to be a driving theme throughout the economy, both in terms of renewable energy and transportation electrification. When it comes to renewable energy, we have seen constructive progress from the Biden Administration. Declining costs for wind and solar generation, State RPS (renewable portfolio standards), and corporate GHG (greenhouse gas) commitments are supporting the race to decarbonization. Plus, the Biden Administration is clearly doubling down on energy transition through executive orders, the infrastructure bill, and the pending Build Back Better bill. Tax credits have broadened for renewables to include offshore wind, and a plan to develop the US offshore wind market is underway with a stated goal of 30,000 megawatts of capacity by 2030—enough to power 10 million homes. Streamlining the permit process to build wind farms has also helped drive progress, and we believe offshore wind will be a significant area of renewable growth throughout the decade.

From the electric vehicle perspective, major auto original equipment manufacturers continue to state their commitment to EVs and are transitioning model lineups away from internal combustion vehicles. In the US, only about 2% of light vehicles sold in 2020 were battery electric. Moreover, most forecasters expect this to increase to one-third by 2030, or 6 million EVs assuming an 18 million seasonally adjusted annual rate. In addition to at-home residential charging, accommodating that level of adoption will require a nationwide network of public charge points. According to a report from the National Renewable Energy Lab (NREL), there are nearly 13,500 public Level 3 chargers installed in the US and nearly 66,000 Level 2 chargers. This is a fraction of what will be needed by 2030 if EVs account for approximately a third of new vehicle sales. To eliminate range anxiety and accommodate EV owners whose residences may not be suitable for charger installation, NREL estimates that one Level 2 charge point per 25 EVs while one Level 3 charge point for every 545 EVs will be necessary. By 2030, the cumulative number of EVs on the road could approach 20 million, implying that 800,000 Level 2 and 36,000 Level 3 charge points are needed.

The recently passed Infrastructure Investment and Jobs Act has earmarked $7.5 billion to jumpstart a push to achieve a national network of 500,000 charge points by the end of the decade. Utilities stand to play a critical role in this build out since EV adoption will place upward pressure on load growth and additional strain on infrastructure that in many cases is decades old. Investment in transformers, switchgear, and other behind-the-meter equipment will be needed. Plus, the intent is to charge EVs with renewable power rather than fossil fuels, which requires further investment in wind and solar generation as well as battery storage.

In terms of the recently passed $1.2 trillion infrastructure bill, it sounds significant, but approximately half of that amount, $550 billion, is incremental spending on top of what would normally be deployed over the next five years. For example, the

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package reauthorizes existing surface transportation programs for five years at $237 billion and will invest an additional $110 million over that period. Nevertheless, it is one of the most significant investments in public infrastructure in a decade or more and so clearly will be helpful to shore up aging infrastructure across the country. The bill includes spending on roads and bridges, public transit, high-speed rail, broadband, water, and the nation's electrical grid.

Funding has also been earmarked for infrastructure resilience, which is an interesting area because it recognizes the impact of climate change and severe weather events—drought, wildfires, rain, storms, and flooding—on infrastructure. The spending impact on an already heated inflationary environment is yet to be known; however, it is possible that some of the near-term economic impact is mitigated since input costs for many of these projects have increased.

Would you please provide us with your perspective on the traditional and renewable energy infrastructure space?

SHAYA BERZON
Principal, Equity Research Analyst

SB The energy arena continues to evolve. Importantly there has been rising acceptance of renewable energy and a drive for companies and governments to be more proactive in terms of carbon reduction initiatives. There is a rising tide of companies announcing long-term net-zero goals. Much of that activism focuses on the supply side, with increasing pressure on oil companies to transition their business lines. Meanwhile, price spikes in natural gas and transportation fuels, sparked by supply constraints and lower production, are driving inflation, uncertainty, and the risk of political backlash. This might trigger a resurgence in fossil fuel production but may also provide a greater impetus to supplement or supplant fossil fuels with renewable energy, which may offer more price stability.

In terms of compelling investments in the renewable energy arena, we focus on technology that facilitates pricing power because it is not easy to replicate or commoditize. For example, a solar energy technology company that provides home energy systems centered on a unique electric inverter design, a growing battery business, and other technologies to enhance solar energy production efficiency has a more defensive moat around its business than other renewable energy components that may be more easily commoditized.

We are also interested in energy-efficiency technology and the growing renewable energy storage market. Energy efficiency, in particular, tends to be an overlooked theme on the march to decarbonization but, if governments across the globe are going to reach their stated climate goals, significant investment is needed. Battery storage is also an important enabler in the race to expand renewable energy. It is an essential part of reducing electrification costs and the inherent volatility of energy production dependent on sunshine or wind direction and force.

Biofuels, including renewable diesel, are another interesting investment story. Some of these fuels are created by recycling animal fats and used cooking oil from restaurants. Unlike with ethanol or older biofuels, there is no need for special infrastructure or motors to use this type of biofuel, nor are there limits to blending it with fossil fuels. Biofuels have grown as a result of federal support boosted by incentives from individual states, including California. Some of these fuels are 80% to 90% lower in carbon intensity than the fossil fuel alternative they are displacing. More companies, including traditional fossil fuel producers, are now venturing into this space.

The next generation of biofuels includes sustainable aviation fuel. Aviation is one of the most challenging areas to decarbonize and developments in this area can be game-changing. This is an area we expect to grow, and companies producing this biofuel will benefit.

When we look for new energy businesses, it is important to us that their business models are profitable and not wholly dependent on speculation about future legislation, technology, or other factors to become viable. While legislation, regulation, technology, or other developments are important to us and may influence their future growth rate, we seek companies that have a model that can be profitable, attractive, and growing under current and visible realities.

Amongst the integrated oil producers, we have seen several different approaches to renewable energy. At one extreme, we have seen a traditional fossil fuel producer slowly reducing their oil production footprint, especially the highest carbon part, by divesting assets and focusing on renewables. Others focus on reducing their carbon intensity by becoming more efficient rather than selling their fossil fuel production assets to companies that have a less efficient approach. Other traditional energy companies are making significant investments in renewable energy production but are not abandoning their traditional fossil fuel businesses. However, they may let their oil production stay flat. We will continue to monitor a host of energy developments and evaluate investment opportunities as they arise.

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Looking Forward To Opportunity

CHARLES KING, CFA
Managing Director,
Chief Investment Officer

As we close out 2021 and move forward into 2022, our team will continue to monitor developments in the many themes we have discussed throughout this Investment Roundtable. The early identification of compelling themes and long-term investment opportunities is the cornerstone of our investment approach at 1919 Investment Counsel. We hope you have found this issue informative. We look forward to sharing our market and economic insights in our upcoming Investment Review and Outlook, available in early January. ■

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ABOUT 1919

1919 Investment Counsel, LLC, an investment management firm, provides discretionary separate account management services for affluent individuals, families, trusts, foundations, endowments, and institutions. As of September 30, 2021 the firm managed approximately $19.5 billion of assets.

The cornerstone of 1919's investment process is proprietary, fundamental research with an emphasis on quality, risk management, and diversification.

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