March 2023

Pacific Point Stable Earnings™ Portfolios White Paper

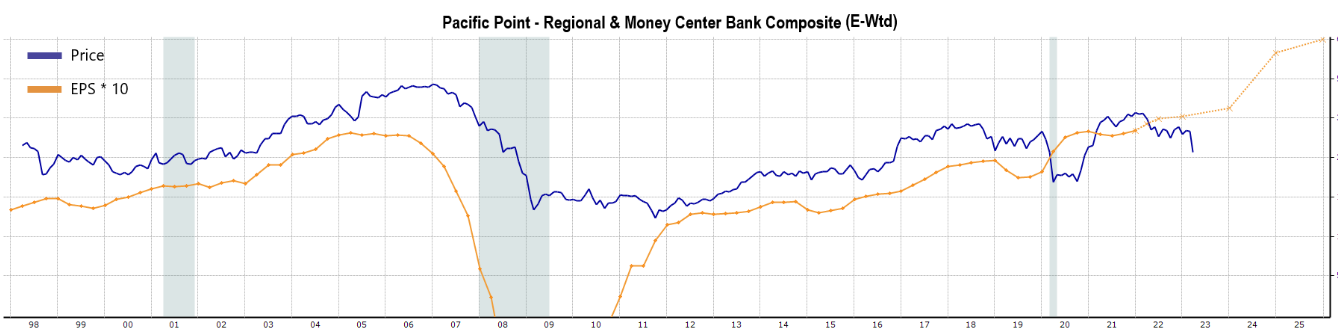
The Rationale For Excluding Bank and Financial Stocks From Our Stable Earnings™ Portfolios

Pacific Point Stable Earnings™ portfolio member companies are characterized by long-term earnings stability and a growth profile that is both *sustainable* and *supportable* in all economic environments. As a strict rule, Stable Earnings™ portfolio membership excludes interest rate and economic cycle-sensitive sectors, including banks and the entire financial sector. This white paper explains why we specifically exclude financials and how you can effectively use Stable Earnings™ portfolios as a core equity allocation.

As shown below, banks and financial service companies tend to have a lower implied asset and earnings quality rating compared to the average industrial company. While many factors contribute to this reality, one of the most significant drivers is the fact that banks are typically leveraged 10:1 to deposits. This leverage makes evaluating banks and financial companies highly subjective and more dependent on macroeconomic factors such as interest rates, credit quality, overall financial market liquidity, and regulatory changes. Historically, leverage has been the primary cause of most bank failures leading up to and during recessionary periods.

Investors in the Pacific Point Stable Earnings™ family of core equity portfolios take comfort knowing that the strategies maintain no exposure to bank stocks or the broader financial sector.

The following 25-year Price and Earnings chart for the equal-weighted Pacific Point - Regional and Money Center Bank Composite illustrates the price and earnings volatility associated with various phases of the economic cycle. Bank earnings collapsed during the Global Financial Crisis, and as a result, price and earnings are still struggling to recover to pre-Financial Crisis levels. As you can see, between 2008-2010, the aggregate index lost money. What is not shown is that many bank stocks went to zero.



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Source: Zacks Research System

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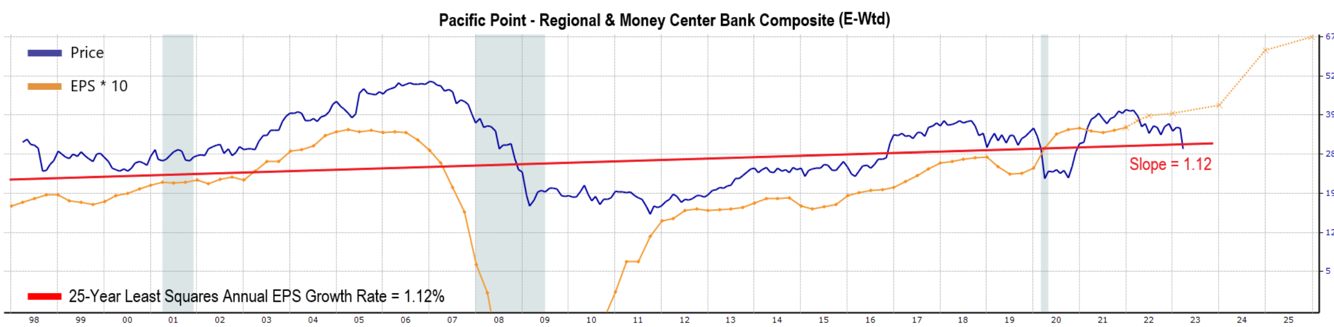
Bank earnings are volatile because they are largely dependent on the term structure of interest rates and the direction of the yield curve, making the banking industry one of the most economic cycle-sensitive industries in the S&P 500. The valuation of bank assets that appear to be of high quality during the early or mid-phase of an economic cycle can significantly differ from the same assets in a late-phase economic cycle with increasing interest rates.

The following chart adds the least squares regression trend line to EPS in red to illustrate the ***negative*** impact of earnings volatility on annual earnings growth. The 25-year annual EPS growth rate of 1.12% is represented by the slope of the least squares trend line. The net effect of bank earnings volatility over the past 25-years is a composite annual EPS growth rate that has not kept pace with U.S. inflation and a price that is essentially flat on a point-to-point basis.



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Source: Zacks Research System

The Pacific Point Stable Earnings™ family of core equity portfolios are intentionally constructed to reduce economic cycle dynamics and are specifically managed for earnings stability and growth. Consolidated long-term earnings stability at the portfolio level is designed to reduce volatility and increase downside protection against loss of capital during economic recessions and unforeseen events.

The cornerstone of the Pacific Point family of funds is the Stable Earnings™ Core Portfolio. The following chart illustrates the Stable Earnings™ Core model portfolio has a 25-year model track record of ***high*** earnings growth and ***low*** earnings volatility. The 25-year annual EPS growth rate of 12.91% is represented by the slope of the least squares trend line. This earnings growth is approximately five times higher than the average rate of U.S. inflation and encompasses three prior recessions, including the U.S. economic shutdown caused by COVID-19 and the monetary normalization period of 2022/2023.

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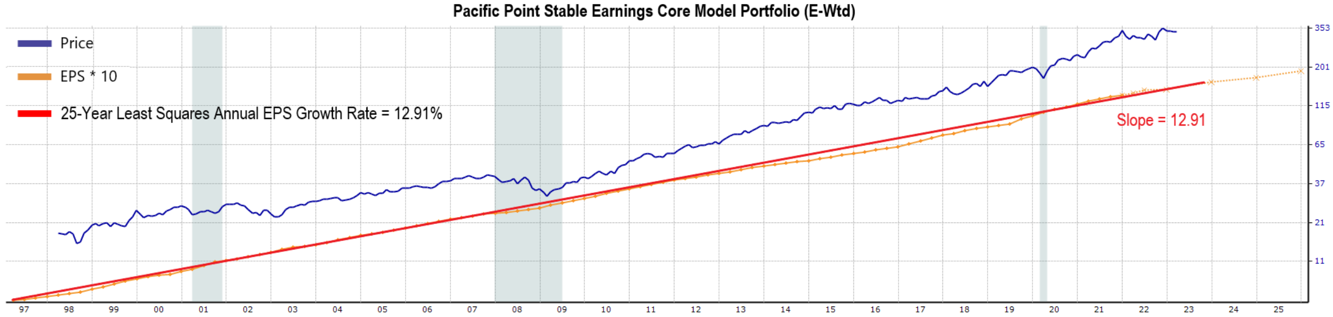
Pacific Point Stable Earnings Core Model Portfolio (E-Wtd)



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Source: Zacks Research System

Conclusion

The Stable Earnings™ family of core equity portfolios are designed to be "sleep at night" portfolios for long-term investors looking to efficiently compound wealth. Because cyclical stocks are specifically excluded from the Stable Earnings™ portfolios, these portfolios give investors and their advisors the freedom to tactically "tilt" around their core equity allocation to add economic cycle exposure when appropriate.

The recent decline in bank and financial stocks illustrates the value of this approach. For example, suppose an investor believed the current banking crisis was behind us and wanted to add financial exposure to a portfolio. In that case, the investor could buy a bank ETF or individual bank stocks. If an investor felt the banking crisis was going to get worse, that investor could either do nothing or proactively short a bank stock ETF or individual bank stocks. Structured correctly, all these outcomes could be achieved without the need to sell the investor's core Stable Earnings™ portfolio, thereby avoiding both taxes and trading costs.

If you want to learn more about using our Stable Earnings™ portfolios and how to construct customized portfolios, please contact Tim Nyland or Jay Winship for additional details.

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Our Discipline, Your Strength

The Stable Earnings™ family of core equity portfolios is a well-defined discipline that's been consistently applied over 25 years. In addition to long-term earnings stability and growth, we carefully select portfolio companies based on superior capital efficiency, profitability, and overall fundamental quality. The Stable Earnings™ family of "core" equity portfolios are available in three different strategies: Core, Dividend and ESG.

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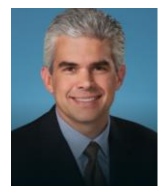

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To learn more about Pacific Point's Stable Earnings™ portfolios, please contact one of our team members, Tim Nyland, Jay Winship or Mike Licosati.

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Zacks Research System was used to create the Pacific Point - Regional and Money Center Bank Composite and the Pacific Point Stable Earnings Core Model Portfolio composite which represent hypothetical portfolios that assume 3/21/2023 membership applied to historical time series data for the periods presented. Hypothetical scenarios calculated by Zacks via Zacks Research System on 3/22/2023.

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