FALL 2021 | VOL. 29 | NO. 4
QUARTERLY PERSPECTIVE

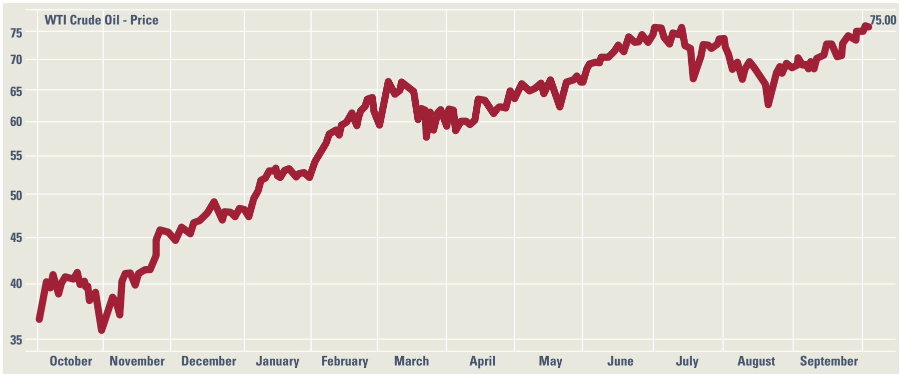
DVI
DAVID VAUGHAN INVESTMENTS

Will Williams *Chairman, President & CEO*

THE ENERGY SECTOR - UNDER THE RADAR SCREEN

In recent days, I have made a point of polling participants in the various meetings that I attend, "So what do you think has been the best performing economic sector of the S&P 500 Index year-to-date? And for that matter, over the past twelve months?" Typically, the responses range from Information Technology (Apple & Microsoft), Communication Services (Google & Facebook) or Consumer Discretionary (Amazon & Tesla). To their collective surprise, I suggest they are wrong on all counts. With the backdrop of the Covid-19 pandemic, Healthcare stocks tend to be the "Of course, how could we have made such an obvious oversight!" Here again, I share the perspective that Healthcare would be a logical choice as well, but not the correct answer. When I provide them the news that the Energy sector has been hands down the performance leader for the past twelve months, most react in disbelief. Yes, an economic sector that has been written off as all but dead in May of 2020 has quietly nearly doubled over the course of the past year.

WTI CRUDE OIL - [LAST 12 MONTHS]



Source: FactSet

If the Energy sector had performed in a similar fashion back in 2008 when crude oil was trading at nearly $150 per barrel, I can assure you this development would have gained far greater notoriety and press. Beginning with the decline of crude oil prices back in 2014, oil prices for the most part have traded in a range between $40 - $75 dollars. As the overall equity market has rebounded significantly over the past decade, energy stocks on a relative basis have lost much of their market capitalization significance, down to less than 2.5% by year end 2020.

S&P 500 ECONOMIC SECTOR WEIGHTS

SECTOR	2020	2010	2000	1990
Communication Services (*)	10.77	3.11	5.46	8.74
Consumer Discretionary	12.72	10.63	10.28	12.77
Consumer Staples	6.51	10.63	8.10	13.96
Energy	2.28	12.03	6.57	13.38
Financials	10.44	16.06	17.34	7.46
Healthcare	13.46	10.91	14.36	10.40
Industrials	8.4	10.95	10.57	13.60
Information Technology	27.61	18.65	21.23	6.30
Materials	2.63	3.74	2.30	7.21
Real Estate (**)	2.42	n/a	n/a	n/a
Utilties	2.76	3.30	3.79	6.18

Source: Janney Montgomery Scott LLC

* In 2018 Telecom Sector eleminated & added select IT
** Added in 2016

What is behind the recent resurgence in energy stocks?

- The price increase of the underlying commodity has certainly been a tail wind, as both crude oil and natural gas prices have increased substantially over the past year.
- Large multinational integrated oil companies have shifted their focus from further investment and reserve development to cashflow generation. With their recent commitment towards financial discipline, as commodity prices have recovered, so too have operating cashflows.
- There appears to be a growing awareness that there will be a premium assigned to fossil fuels as we transition to renewable energy sources. The pace of change required to shift the nearly 80 percent of global energy currently provided by fossil fuels is staggering and certainly laden with the potential for unintended outcomes.
- Global economic growth adds additional challenges to the renewable transformation. This has resulted in an increased recognition that emerging economies might be much more reliant on fossil fuel solutions for far longer than had originally been anticipated.

Continued on page 3

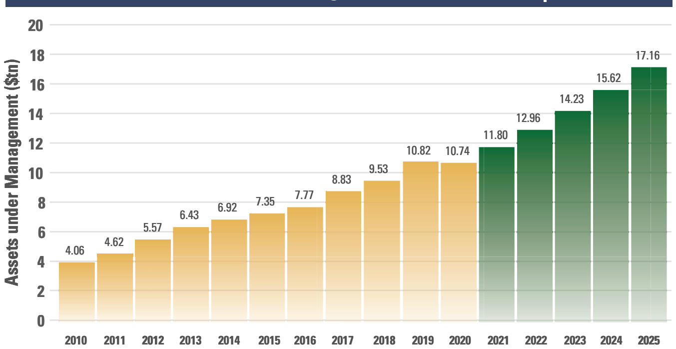
Brian Christensen, CFA
Senior Vice President & CIO

ALTERNATIVE THINKING

Hedge funds, private equity, private debt, venture capital, real estate, commodities, and even collectibles all fall into a broad investment category called Alternative Assets. Broadly speaking, any investment that does not freely trade in today's public markets or falls outside of the traditional asset classes of stocks, bonds, and cash, could be considered an alternative asset. I suspect the history of alternative investing might be identified as having started with the trading of Dutch tulip bulbs in the 1600's. "Non-traditional" would certainly apply.

Investing in alternative assets has evolved over the last decade to where it has become mainstream in many institutional investment portfolios. The Yale Investment Office, investment manager to the Yale University Endowment Fund, is commonly recognized as one of the first major institutions to incorporate alternatives in its portfolio. Thirty years ago, the Yale portfolio was invested nearly three-quarters in U.S. stocks, bonds, and cash. Today, these asset classes represent less than 10% of the Yale portfolio while non-traditional asset classes are the preferred holding. UBS Asset Management estimates alternative strategies represent nearly 16% of total global investment assets. The growing popularity of investing in alternative assets can be seen in the chart below.

Alternative Assets under Management and Forecast | 2010-2025*



*Source: Preqin *2020 figure is annualized based on data to October. 2021-2025 are Preqin's forecasted figures.*

Growth in alternative assets under management has nearly tripled since Preqin, an industry leader in alternative asset data and analytics, began tracking in 2010. So why?

Analysts typically identify four fundamental factors behind the growing popularity of alternative assets. They are portfolio diversification, enhancing investment returns, reducing portfolio volatility, and generating a reliable income stream. Sound familiar?

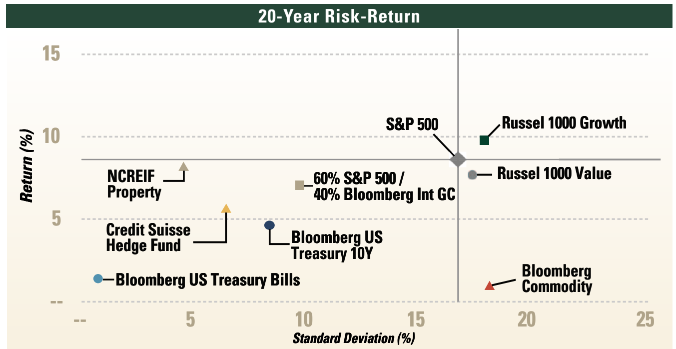
Of course it does, as these characteristics are universally similar to the objectives of any sound investment strategy.

Presuming alternative asset strategies achieve the benefits of greater diversification, enhanced returns, reduced volatility, and reliable income, what rates of return can we expect? Following are risk and return data for traditional asset classes as well as alternative asset classes.

	Total Return			Standard Deviation		
	5-Year	10-Year	20-Year	5-Year	10-Year	20-Year
Alternative Asset Benchmarks						
Credit Suisse Hedge Fund	5.63	4.24	5.67	6.68	5.72	6.54
Bloomberg Commodity	2.40	(4.44)	0.94	15.80	15.79	18.27
NCREIF Property	6.13	8.79	8.21	1.63	1.78	4.62
Public Market Benchmarks						
S&P 500	17.65	14.84	8.61	17.30	15.04	16.83
Russell 1000 Value	11.87	11.61	7.73	18.64	16.17	17.52
Russell 1000 Growth	23.66	17.87	9.78	19.02	16.24	18.10
60% S&P 500 / 40% Bloomberg Int GC	11.72	10.11	7.07	10.45	8.96	9.87
Bloomberg US Treasury 10Y	1.75	3.67	4.69	8.10	7.75	8.45
Bloomberg US Treasury Bills	1.18	0.65	1.41	0.48	0.43	0.78

Source: Morningstar Direct | Note: Returns data updated for the quarter ending 6/30/21; standard deviation based on quarterly returns data

20-Year Risk-Return



Clearly shown above, traditional asset classes have provided competitive rates of return to hedge funds, commodities, and real estate. It is likely private equity has been a superior performer but tracking the risk and return is challenging at best, given the lack of published benchmarks and the illiquidity of the asset class.

As with all investment strategies, there are potential pitfalls and risks to consider. Illiquidity, lack of regulation, limited transparency, higher fees, and complexity lead the list for alternative assets. Alternative investments tend to be private rather than public, unless aggregated in a fund of some type, and are generally illiquid. Typically, alternative assets have long time horizons, which lead to lock-ups where investors aren't able to gain access to their funds for an extended period of time. Perhaps the most significant disadvantage of many alternative strategies is that they are not governed or registered by any securities regulator. This leads to poor transparency in terms of both reporting and pricing the assets in which a fund is invested. Imagine trying to determine "fair value" at any point in time for a start-up business, a private loan, or distressed real estate. The valuation certainly won't be timely and subject to many variables. Monthly or quarterly reports are atypical given the challenge in determining the true value of the asset.

Complexity and limited access further complicate investing in alternative asset strategies. Most commonly, alternative strategies are structured as private placements available only to accredited investors. The accredited investor rules require a person to have annual income exceeding $200,000 ($300,000 for joint income) for the last two years with the expectation of

Continued on page 3

CONTINUED FROM PAGE 2

earning the same or a higher income in the current year or a net worth exceeding $1 million. It is assumed that if one has income or net worth meeting the accredited investor levels, you have the sophistication to understand the risks of the investment. I'll not dive further into the old saying about what happens when you assume, but I am sure you get the picture.

As reflected in the risk and return statistics shared previously, public markets compare favorably to a variety of alternative asset classes. Exposure to alternative assets can be achieved in public markets as represented by DVI's inclusion of Apollo Capital Management in our strategies. Apollo is one of the world's largest alternative investment managers with assets under management exceeding $450 billion. Apollo does the heavy lifting of managing the complexities of investing in alternative assets. As investors in their publicly traded shares, we gain transparency and intend to be rewarded by their success.

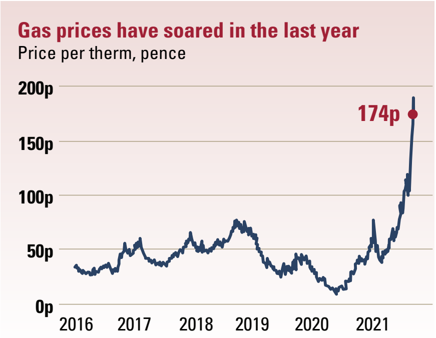
The Yale Investment Office states in their investment strategy that, "Alternative assets, by their very nature, tend to be less efficiently priced than traditional marketable securities, providing an opportunity to exploit market inefficiencies through active management. The Endowment's long time horizon is well suited to exploiting illiquid, less efficient markets…"

If an investor's goals and objectives allow for the uniqueness and complexity of alternative assets, perhaps a direct investment makes sense. However, my instincts from more than 30 years of being in the markets make me think the recent surge in the popularity of alternative assets is being driven by something other than the suitability for one's portfolio. The allure of exclusivity is often a strong draw. It becomes easy to assume (yes, there's that word again) you are going to do well with no questions asked, just because it is a *private* investment opportunity. People often hear of alternative investment opportunities at social functions, from fellow executives, and friends. When mingling with your peers, it becomes tempting to believe investing in alternative assets is a social must. This sentiment runs counter to the actual purpose of investing, which is to achieve *your* personal financial goals.

THE ENERGY SECTOR - UNDER THE RADAR SCREEN | CONTINUED FROM PAGE 1

The Current U.K. Energy Crisis

A recent example of the fragility of the global energy market is taking place in the United Kingdom today. A series of unrelated factors have resulted in an unprecedented surge in power prices.



Source: ICE, Bloomberg.
Last update 23/09/2021 10:30 BST

Weather: A cold winter, followed by above average temperatures in the spring and summer increased the use of natural gas to supply power plants. In addition, wind power from the North Sea which supplies 25% of U.K. power has been on the decline this fall with below average wind speeds in the North Sea.

Power Production: In the U.K., nearly all coal plants have been shut down, negatively impacting overall power generation capacity. Only two are left and are used as peaking power plants. They will both be closed by October 2024.

Storage: Natural Gas storage levels have been on the decline as certain large storage areas have been de-commissioned and consumption has been running higher than normal due to unusual weather patterns and the resurgence of the economy.

Energy Suppliers: With the unprecedented spike in natural gas and liquified natural gas prices, near term power prices have surged. Energy suppliers who have agreed to long-term price contracts with their clients have generally met those obligations by purchasing in the short-term wholesale gas and power markets. Because of the recent disruption, energy suppliers are closing their doors as they can no longer absorb the price differential between short and long-term market prices.

Patience and Discipline

"The stock market is a device to transfer money from the impatient to the patient. We don't have to be smarter than the rest. We have to be more disciplined than the rest."

Warren Buffet

One of the real challenges of subscribing to a value/yield-oriented investment philosophy is the recognition that in many, if not most instances, you will find yourself out of sync with many popular investment themes. In today's world, carbon neutrality and environmental, social and governance (ESG) are top of mind for many investors.

For DVI, sometimes we maintain exposure for risk management and diversification purposes. Under other circumstances, we are attracted to an economic sector for valuation and relative yield characteristics. Energy was viewed as a value trap twelve months ago; its prospects are looking much brighter today. Despite net zero emissions targets by 2050, it is highly likely that fossil fuels will have a key role in global energy production well into the future.

Jeff Huizenga, CFP®, ChFC, MSFS®
Director of Relationship Management

BUILD BACK BETTER ACT PROPOSED LEGISLATIVE IMPACT

On September 13, the House Ways and Means Committee released its plan to pay for the $3.5 trillion Build Back Better Act. This proposed legislation contains sweeping changes across the tax code, including income and estate planning implications. The following chart highlights a number of these proposals and the potential implications. It is important to stress that this is only proposed legislation and will inevitably go through further revisions before it moves out of the House and then to the Senate. With this legislation, we now have a framework to start discussions and prepare for year-end planning strategies.

HOUSE WAYS AND MEANS - *(All proposals are effective after December 31, 2021 unless noted)*

		PROPOSED TAX CHANGES
INDIVIDUAL TAXES	**Marginal Individual Income Tax Rate**	Increase to 39.6% for joint income in excess of $450,000, individual income in excess of $400,000.
	Increased Capital Gains Tax Rate (Effective Date: 9.13.2021)	Top Capital Gains rate is increased from 20% to 25% for those in the top Income Tax Bracket. With the 3.8% NIIT, this will move the top rate to 28.8%. The proposed effective date for the higher rate would be September 13, 2021.
	High-Income Surcharge	3% Surcharge for Joint Modified Adjusted Income in excess of $5 million.
	Net Investment Income Tax for Pass-Through Businesses	3.8% would be expanded to include earnings from pass-through businesses with income in excess of $500,000 for joint filers and $400,000 for single filers.
	Limit the Sec 199A Deduction	Maximum Deduction would be $500,000 for joint filers and $400,000 for single filers.
	SALT Relief	It is anticipated that House Democrats will push for meaningful SALT relief.
ESTATE TAXES & TRUSTS	**Estates and Trusts Marginal Income Tax Rate**	Increase to 39.6% for income in excess of $12,500.
	Estate & Gift Tax Unified Credit Adjustment	Exemption amount will revert back to inflation adjusted $5 million per taxpayer. Top estate tax rate of 40% will remain.
	Limit the Sec 199A Deduction	Trusts and Estates will be limited to $10,000.
	Grantor Trust Rules	Certain grantor trusts such as intentionally defective grantor trusts (IDGT), grantor retained annuity trusts (GRATs) or spousal lifetime access trusts (SLATs) will lose their favorable tax status. Any sales between grantor trusts and their owner will be treated as a sale to a third party. These provisions will apply to future trusts and transfers after the date the Act is enacted.
	Valuation Discounts	Discounts on transfers of nonbusiness assets will be eliminated.
RETIREMENT ACCOUNTS	**Required Minimum Distributions**	For high income taxpayers (> $450,000 for joint filers, > $400,000 for single filers) if their combined retirement plans (IRA, Roth IRA and defined contribution accounts) exceed $10 million at prior year end, 50% of the excess will need to be distributed in the current year. If aggregate retirement plan balances exceed $20 million, the excess would be required to be distributed with the lesser of (1) the amount needed to bring the total balance in all accounts down to $20 million from Roth accounts or (2) the aggregate balance in all Roth accounts. Once this rule is met, then the above rule applies.
	Future Contributions	The prohibition of contributions to Traditional & Roth IRA's for high income taxpayers once the combined retirement plans exceed $10 million at the end of the prior taxable year. This limit applies to high income taxpayers with taxable income over $400,000 for single filers and $450,000 for joint filers.
	Rollovers to Roth IRA's	Roth Conversions eliminated for high income taxpayers (> $450,000 for joint filers, > $400,000 for single filers) after December 31, 2031. Also prohibits all employee after-tax contributions in qualified plans and after-tax IRA contributions from being converted to Roth regardless of income level eliminating "Back-door" Roth IRA strategies after December 31, 2021.