Miller/Howard INVESTMENTS

Depend on Dividends and Earnings Growth, Not Multiple Expansion

MARCH 31, 2021

WATCHING THE SHORT-TERM GYRATIONS OF THE stock market can leave long-term investors wondering, "Is this really investing?" This quarter brought us the latest crazy example, GameStop, which started out below $20, shot above $300, came down sharply and continued to fly up and down, all based on essentially no news that would be of note to a serious long-term investor. However, the vicissitudes of the short term can mask the fundamental basis of long-term stock market returns. Despite the volatility in both single stocks and the overall market, long-term results do point to a fundamental basis for investment returns. Only by understanding what drove results in the past and how that might be different going forward, can we confidently invest for the long term.

The graph below shows the annual investment returns of the S&P 500 Index going back to 1993. We have decomposed returns into dividends, growth in expected earnings, and the change in the forward price-to-earnings (P/E) multiple.

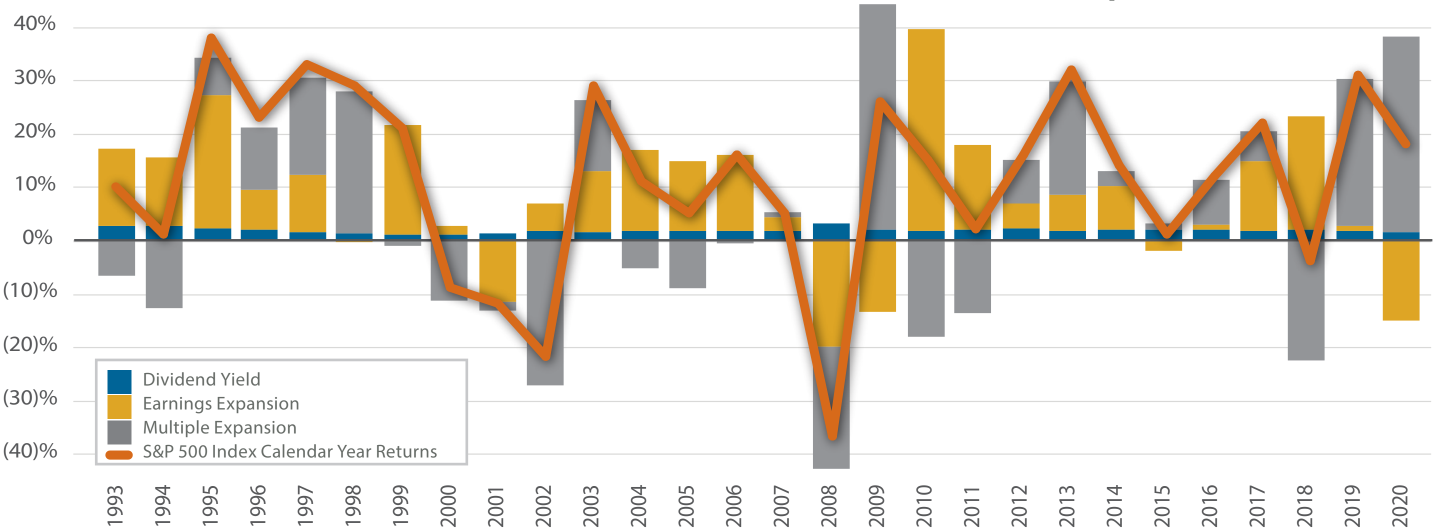
Observations:

- Dividends are always positive, and the yield on the broad market is steady.
- Earnings increase in most years, consistent with a growing economy. Earnings growth does, however, vary much more than dividend returns.
- P/E multiples soar and plunge, causing much of the variation in stock market returns.

Stock market investors are so used to fluctuations in P/E multiples driving variations in returns that they rarely pause to consider how remarkable the concept is. Suppose you are considering buying a small business – how would you calculate your potential return? The first consideration would be the annual income the business would provide you. Second, you would want to forecast how fast earnings will grow – clearly a critical element of investment returns. Lastly, you may think about any change in how much other investors might be willing to pay for a dollar of earnings. The last point sounds like an afterthought until you realize that this is the P/E ratio, the primary fuel for stock market debates.

Contribution to Returns: Dividends and Earnings Growth Have Been More Reliable

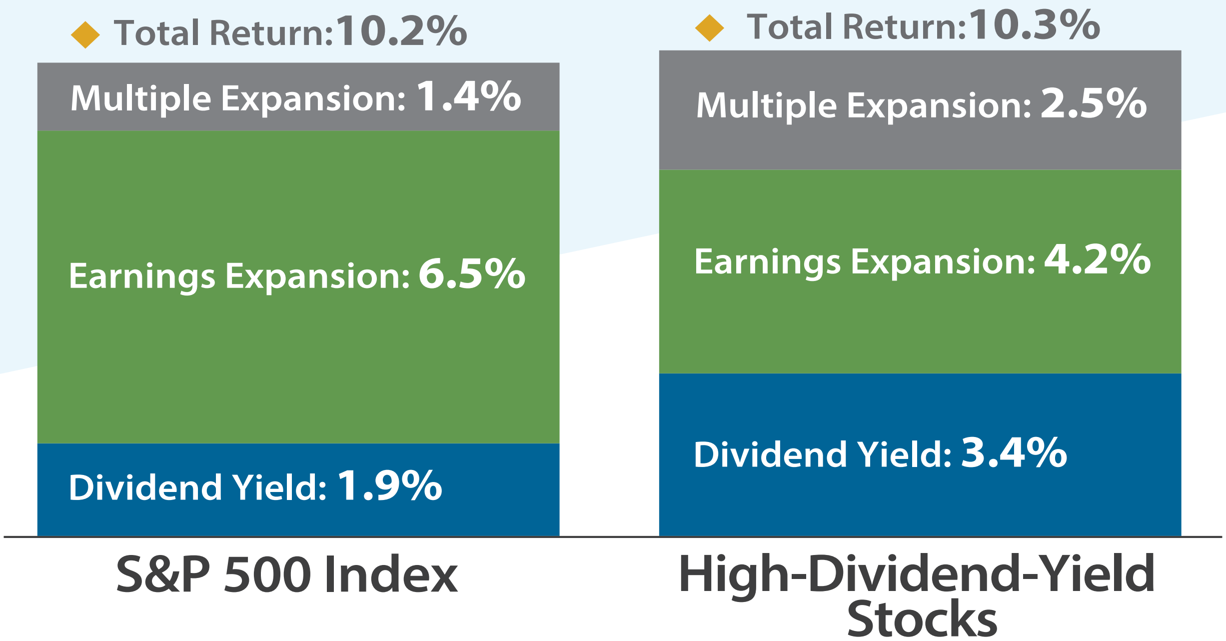
S&P 500 Index Calendar Year Total Returns and Composition



As of December 31, 2020. Source: Bloomberg.

Historic Mix of Stock Market Returns

S&P 500 Index Total Returns and Composition



Data: 12/31/1992-12/31/2020, annualized. Source: Miller/Howard Research & Analysis.
High-dividend-yield stocks are defined as members of the S&P 500 Index that fall within deciles 7 thru 9 by dividend yield (with 1 being lowest; 10 highest). Members without an available historical estimated forward P/E have been excluded from the group.

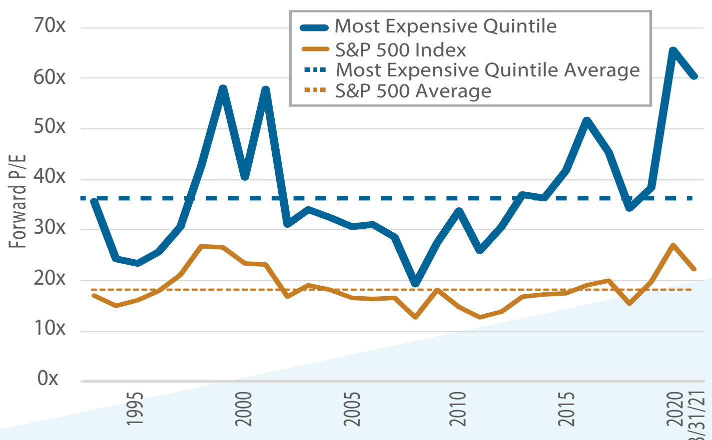
The good news for long-term investors is that while changes in P/E multiples are important in the short term, they have not dominated long-term returns. The chart above shows the annualized decomposition of the S&P 500 returns over 1993-2020, the same years shown in the calendar year graph on the first page. Despite the drama that P/E changes cause year-to-year, the impact on S&P 500 returns during the entire period has been less than the dividend yield and less than a quarter of earnings growth.

In summary, the broad market has offered good but volatile returns with roughly a fifth of return coming from dividends, a seventh from multiple expansion, and fully two-thirds from earnings growth. We will argue that ***the future will look quite different***, but let's first look at the historic decomposition of returns for high-dividend-yield stocks. As you can see, the overall return for high-dividend-yield S&P 500 stocks is a tad higher than the S&P 500 for this period. This should not be a surprise–in Miller/Howard's Q3 2020 Quarterly Report (on page 5), we showed that high-dividend-yield stocks have had better long-term returns over many decades compared to the S&P 500. The important point here is that the mix of return factors for high-dividend-yield stocks has been substantially different. As expected, dividend yield is a larger component of return, but what may be surprising is that multiple expansion has been a larger component for high-dividend-yield stocks than for the market as a whole.

This is only surprising because it runs counter to recent history. The chart below shows how the average P/E for the broad market has soared in the past two years, driven by significantly greater multiple expansion for

Similar to the Tech Bubble, Today's High Valuation Is Driven by the Most Expensive Stocks

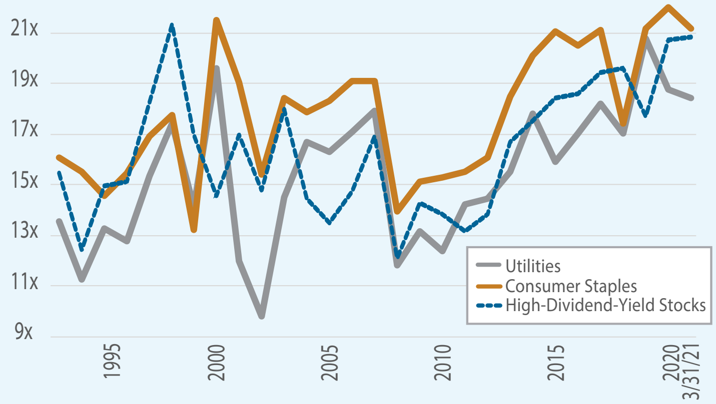
S&P 500 Index: Forward P/E



As of March 31, 2021. Source: Bloomberg; Miller/Howard Research & Analysis

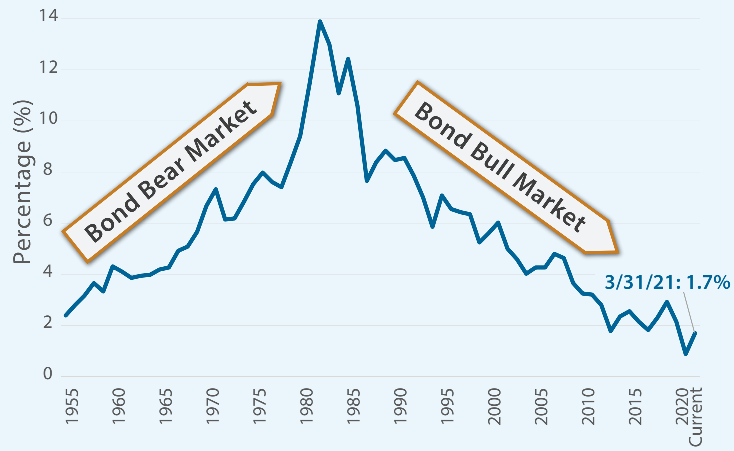
Bond Proxies Have Propelled High Yield P/Es Up

Forward P/E



A 40-Year Bond Bull Market

US 10-Year Treasury Bond Interest Rates



As of March 31, 2021. Sources: Bloomberg; Federal Reserve Bank of St. Louis (FRED); Miller/Howard Research & Analysis.
Bond proxies are represented by utilities and consumer staples. High-dividend-yield stocks are defined as members of the S&P 500 Index that fall within deciles 7 thru 9 by dividend yield (with 1 being lowest; 10 highest).

the most expensive quintile of stocks. Time will tell how this plays out, but the graph looks suspiciously like the P/E expansion that occurred during the Internet/New Economy Bubble in the late 1990s. The P/E graph for high-yield stocks is less dramatic but has grown over time simply because interest rates have trended down. At Miller/Howard, we favor high-yielding stocks with the potential for significant earnings growth, but a material number of high-dividend payers can be considered bond proxies–companies with little earnings growth but steady dividends. As bond prices have inflated over the long term, it follows that the prices of bond proxies would keep pace. As evidence, the graph on the left shows that the P/E of the two sectors with the most bond proxies, utilities and consumer staples, have indeed inflated over time.

The Tide May Be Turning for P/E Expansion

Historic returns are interesting, but what we really care about is future returns. Looking out over the coming decades, we expect dividends and earnings growth to remain important for investment returns, but we expect the returns from P/E multiple expansion to be ***zero at best.***

Naturally, P/E expansion and contraction will continue to cause year-to-year fluctuations, but we expect zero or even negative returns from P/E multiple changes over the longer term. Why? First, higher P/Es come from ascribing more value to earnings in distant years. When considering a single stock, clearly investors can become more optimistic about earnings in the outer years, but is that plausible for the market as a whole?

A much simpler explanation for higher average P/Es is the long-term downward trend in interest rates, causing distant earnings to be less discounted. This implies that ever-higher market multiples would require even lower long-term interest rates–an unlikely prospect given their low starting point today.

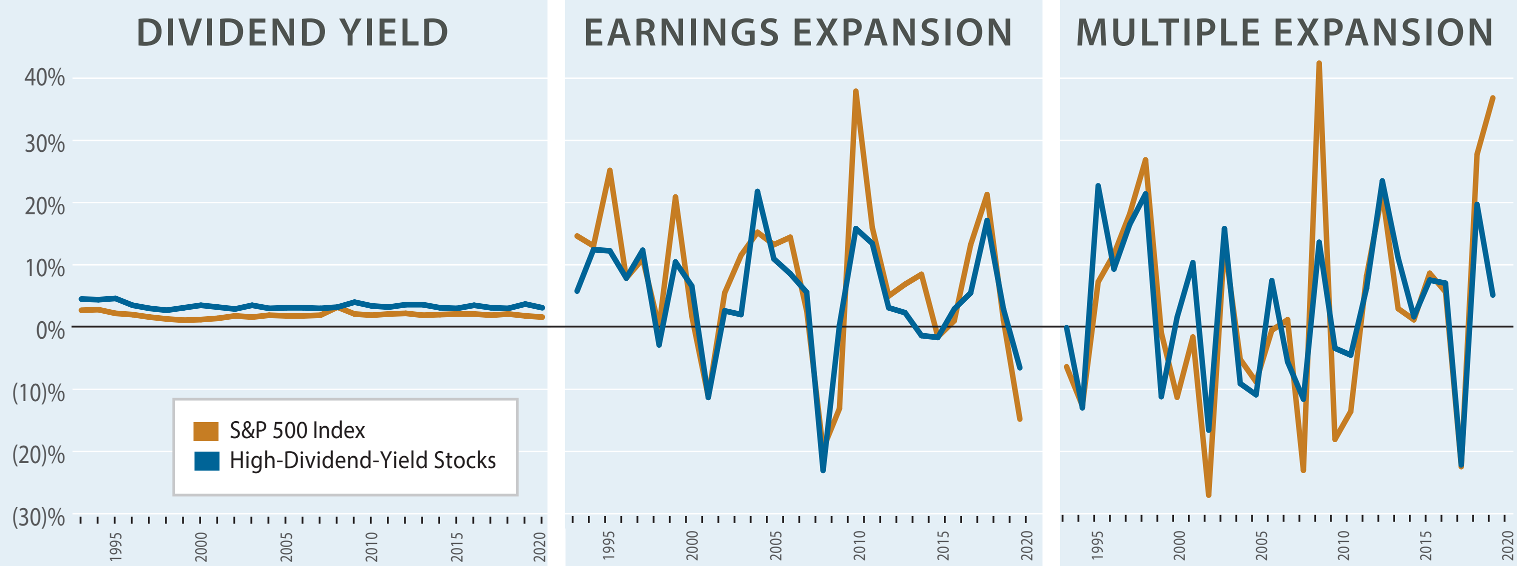
No doubt you can find an experienced equity investor who says something like, *"I don't link stock prices and interest rates. Things get better over time. I've been doing this for forty years and have developed intuition."* But forty years is not enough! We've been in a bond bull market for forty years. The entire career of most equity investors has taken place while long-term interest rates have trended down. How can you trust your intuition on multiple expansion when it has been trained in a largely one-way market?

Despite the recent run-up in interest rates, bond prices are volatile enough that no one can say for sure that the 40-year bond bull market is over. There are strong indications, however, that we may be at a turning point. Last August Federal Reserve Chairman Jerome Powell announced that the Fed would target an average of 2% inflation, allowing inflation to run over 2% for periods of time without policy adjustments. This could prove to be a big change from treating the 2% inflation target as effectively a third rail – tightening before touching it. Another reason to be bearish on long-term bonds is the significant increase in spending in response to the pandemic. This will require a large increase in bond supply, much of it at the long end. The market will likely require higher rates to absorb the new issuance.

The second reason investors should not depend on returns from multiple expansion is that we are beginning from an already high P/E. As a point of reference, the forward P/E for the S&P 500 at the end of 2020 was higher than at the end of either 1998 or 1999. Gray-haired investors remember the late 1990s well, and will recall many similarities. Many large-cap companies, such as Microsoft and Cisco, were going to change the world, and arguably did, but proved to be poor investments for years following their peaks. Today we have many equally exciting companies, but investors have always reached a limit on the P/E multiples they are willing to pay. Combining this argument with the nascent trend towards higher long-term interest rates, it seems much more likely that the S&P 500's P/E will average below recent highs, not above.

But market P/E multiple compression does not necessarily portend poor investment results–it just means that investors need a plan with regards to all three return factors. The chart below shows the sources of investment return for the S&P 500 and high-dividend-yield S&P 500 stocks over time. At first blush, you might be pessimistic, thinking that dividend yields are low relative to your total return expectations, earnings growth is volatile, and P/E changes are even more volatile and likely to be negative going forward. We view it differently.

Miller/Howard's View on the Sources of Investment Returns



Even though dividends are not guaranteed, dividends coming from diversified portfolios have proven to be remarkably reliable. Dialing up this return factor increases what should be a low volatility return, but this must be done with an eye towards not sacrificing earnings growth.

As of December 31, 2020.

Source: Bloomberg; Miller/Howard Research & Analysis. High-dividend-yield stocks are defined as members of the S&P 500 Index that fall within deciles 7 thru 9 by dividend yield (with 1 being lowest; 10 highest). Members without an available historical estimated forward P/E have been excluded from the group.

Stock investors must endure higher volatility versus bonds, but as compensation, they are rewarded when earnings grow. The payoff can be directly through price appreciation, indirectly through dividend growth or, more likely, a combination of the two. Earnings growth has been the biggest driver of returns for the broad market and most diversified portfolios. But as income investors, we are acutely aware that many high-yield stocks have below-par earnings growth. Instead, we focus on companies with strong earnings growth prospects.

The broad market remains near historic highs, and long-term interest rates seem to be rising–both of which suggest that the P/E multiple is likely to contract over the next decade, offsetting some of the return from dividends and earnings growth. In our opinion, this should not, however, mean that all equity portfolios will suffer from multiple contraction.

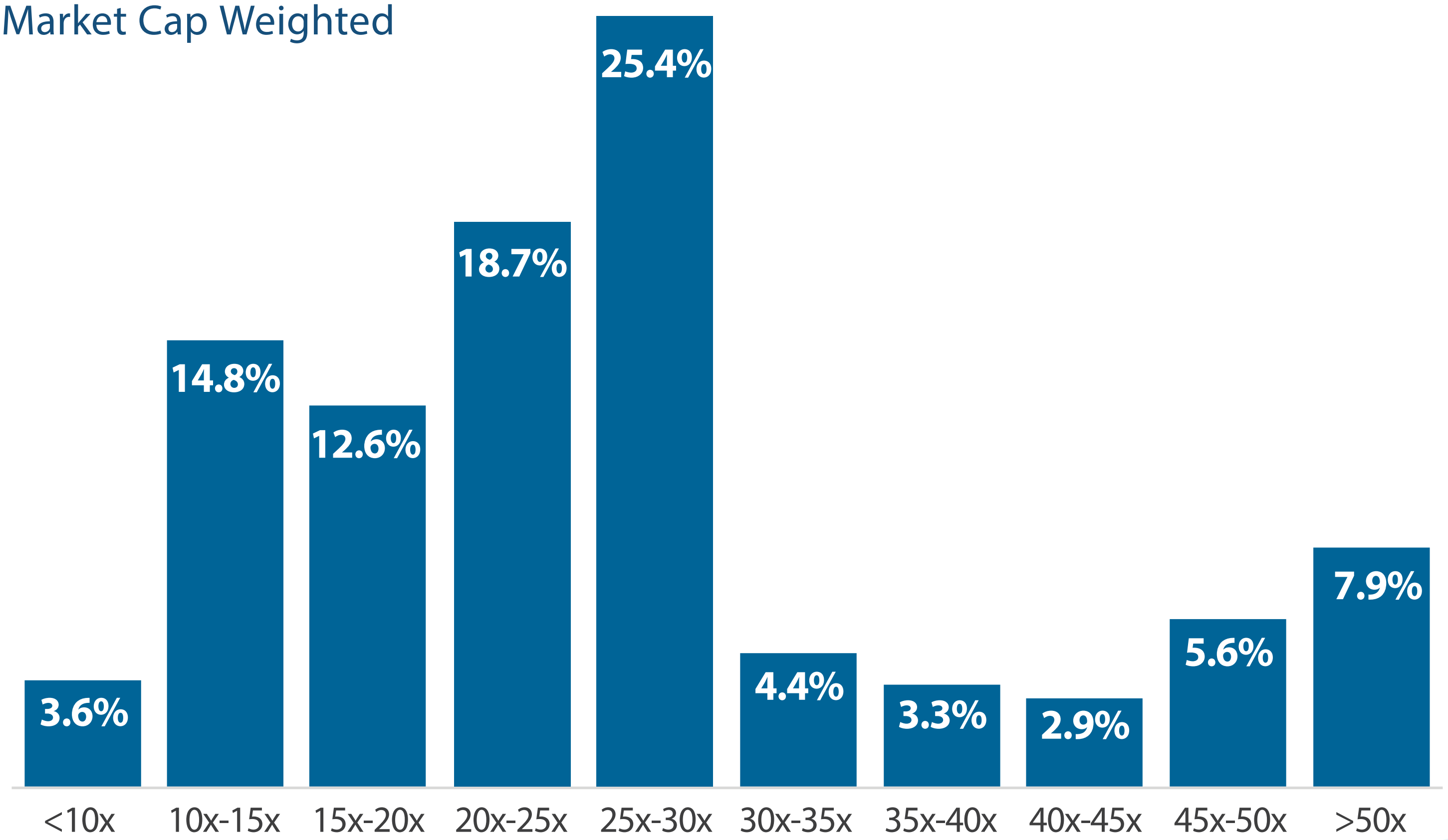
The graph below shows the distribution of forward P/Es across the stocks in the S&P 500 weighted by market cap. Remarkably, 8% are trading at a multiple above 50x. Cumulatively, 24% of the value of the S&P 500 is currently in stocks that trade at more than 30x this year's expected earnings—a historically high number. These are the stocks that we think are most at risk of multiple compression, as rising interest rates reduce the value of their decade-out earnings projections, even if those often-rosy assumptions are realized. But also note the other end of the graph. There are plenty of stocks with P/Es well below the market average of 27x. We believe that the best defense against multiple contraction is constructing portfolios of stocks with high dividend yields and earnings growth potential that are trading at reasonable valuations.

Overall, we continue to be optimistic that the stock market will remain a good source of both income and total returns. Returns in the last couple of years have been dominated by P/E multiple expansion. It's easy to get caught up in the stampede towards expensive stocks. But bear in mind that multiple expansion has not been the principal driver of long-term investment returns over the last few decades, and it is quite likely to be negative for the overall market going forward.

Timing the drop in the market multiple is tricky, but we are confident that portfolios focusing on dividends and earnings growth can navigate these difficult waters, generating both dependable high-and-growing income and total returns.

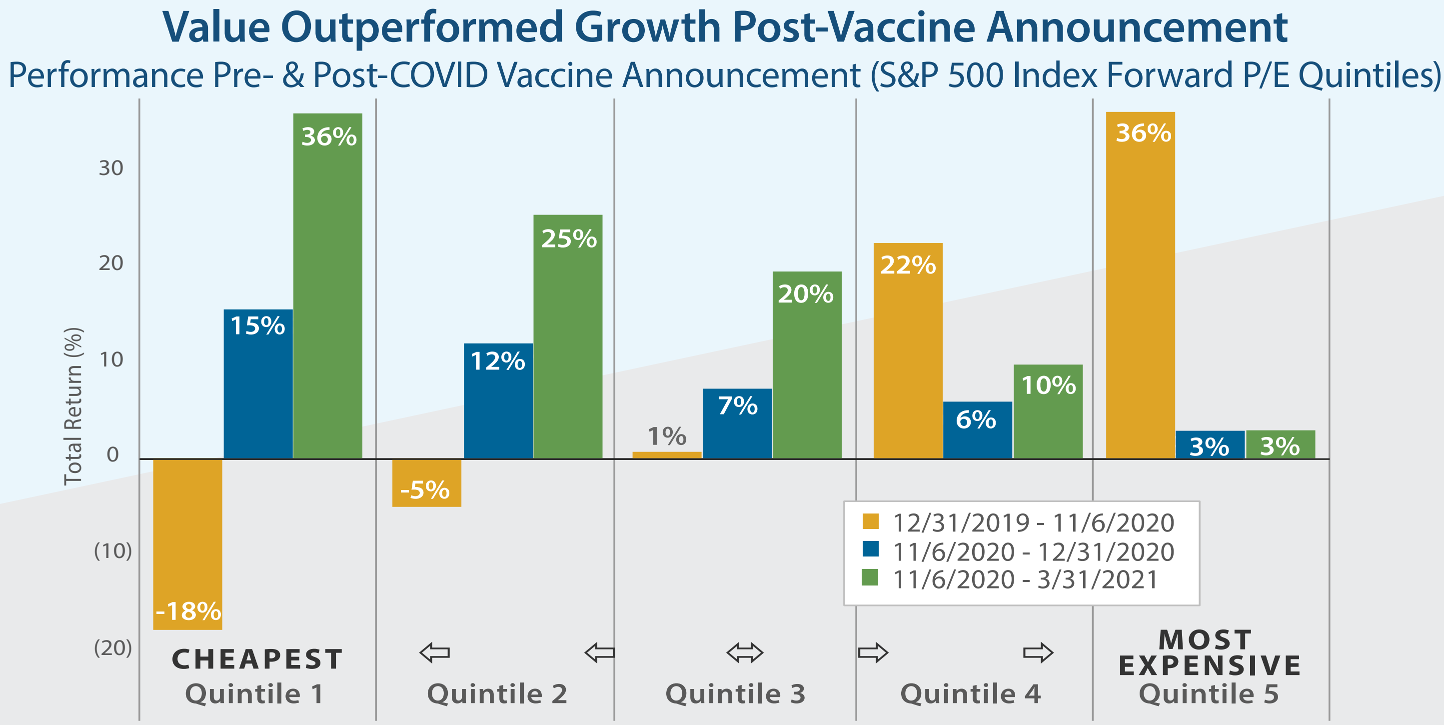
Percent of S&P 500 Index Stocks with Expensive Valuations at a Historic High

Market Cap Weighted



As of March 31, 2021. Based on forward P/E. Source: Bloomberg; Miller/Howard Research & Analysis.

Shift Towards Value Continues



As of March 31, 2021. Source: Bloomberg; Miller/Howard Research & Analysis.

"The news coming out of Pfizer's vaccine trials on November 9th was truly spectacular and triggered a meaningful shift in the stock market."

–Miller/Howard Q4 2020 Quarterly Report

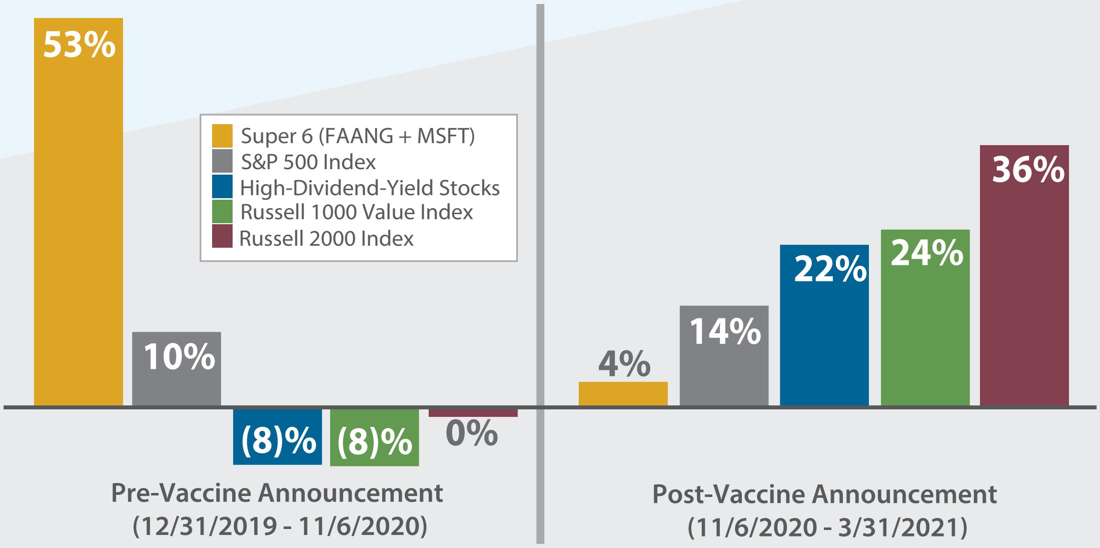
AS WE NOTED LAST QUARTER, ANNOUNCEMENT OF Pfizer's successful development of a COVID-19 vaccine caused investors to lose some of their infatuation with expensive stocks and move towards the value side of the market. When we made that observation, we were admittedly commenting on a short period of time, roughly seven weeks. Now that 20 weeks have passed, we can say with more confidence that the market has indeed changed course.

The chart above shows the performance of stocks split into price/earnings (P/E) quintiles at the beginning of 2020. Prior to the vaccine announcement in November 2020, the more expensive the quintile, the better the performance. Our interpretation is that investors, prior to any proof that a vaccine would work, were more willing to pay for the growth stories of expensive stocks rather than the cheaper earnings and dividends of value stocks. Essentially, investors thought there was no "bird in the hand" option given the uncertainties of the pandemic, so they might as well pay up for mega-cap growth stocks.

Following Pfizer's vaccine news, the market did a full reversal—the cheaper the quintile, the higher the investment returns. The vaccine news gave investors confidence that they could rely on the near-term earnings forecasts and dividends that make value stocks attractive. Of course, we have seen continuing good news since November 9th that helped keep the value rally alive, including additional vaccines authorized in the US and globally. After a sluggish start, US vaccination numbers began to surge in February, and it was announced that all American adults would be eligible for vaccines by April 19th. We also have seen COVID-19 cases drop from 2020 highs and the unemployment rate continue to fall. These are still not the best of times, but enough is going right for confidence to rebound.

Vaccine news did more than shift the market towards value. The graph on the next page shows other indications of investors shifting away from mega-cap growth stocks towards equity categories that have struggled in recent years. Stocks dubbed the Super Six, Facebook, Apple, Amazon, Netflix, Alphabet, and Microsoft, outperformed the market massively during 2020 prior to the vaccine news. The Super Six somehow morphed from stocks with exciting long-term growth stories to places to hide your money when it seemed like the pandemic would never end. Since the vaccine news, the Super Six have trailed the broader market.

Performance Pre- & Post-Vaccine Announcement



As of March 31, 2021. Source: Bloomberg; Miller/Howard Research & Analysis. High-Dividend-Yield Stocks consists of Decile 7, 8, & 9 of a universe of US dividend paying common stocks with a market capitalization or greater than $4 billion. FAANG + MSFT= Facebook, Apple, Amazon, Netflix, Alphabet (Google), & Microsoft.

Value, Dividend Yield, and Small Cap Rotation Continues

Since the vaccine news, the S&P 500 Index has continued to perform well, but the drivers of market performance are now value stocks and high-yield stocks. The recovery of small-cap stocks has been the most dramatic with the Russell 2000 Index up over 35% since the vaccine news.

The story on small-caps is a bit complicated:

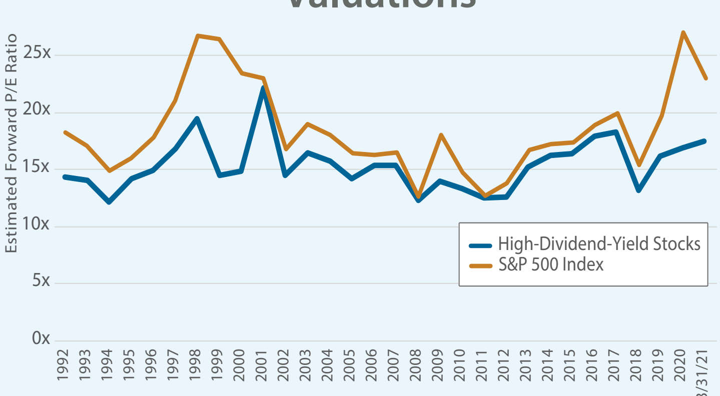
- The small-cap universe is tilted towards cyclicals, so the value shift we saw in large-caps benefitted small-caps even more.
- We also saw growth investors move away from the mega-cap growth stocks towards small-cap growth stocks.

The rebound in small-caps is a good sign for both value and active management. Portfolio managers can, once again, be rewarded for sifting through long lists of potential investments from a wide range of market capitalizations, including stocks with good earnings and dividends that have been underappreciated by the market.

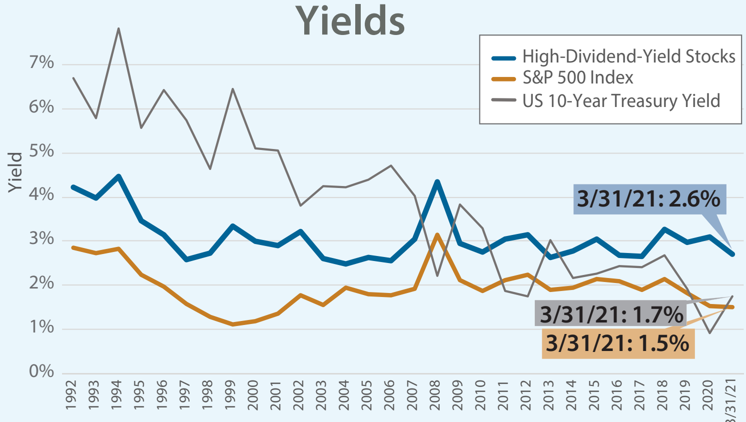
Despite the recent rally, the universe of high-dividend-yield stocks remains attractive relative to both long-term bonds and the broad stock market, in our view. The graph below shows how P/E multiples and yields have varied over time, using a wide-range of market capitalizations for the high-dividend-yield universe. The spread in both yields and valuations of high-dividend-yield equities versus both the S&P 500 and long-term bonds remains high, suggesting a good entry point for investors considering high-dividend-paying stocks.

High-Dividend-Yield Stocks Are Trading at a Valuation Discount While Offering a Significant Yield Advantage Relative to History

Valuations



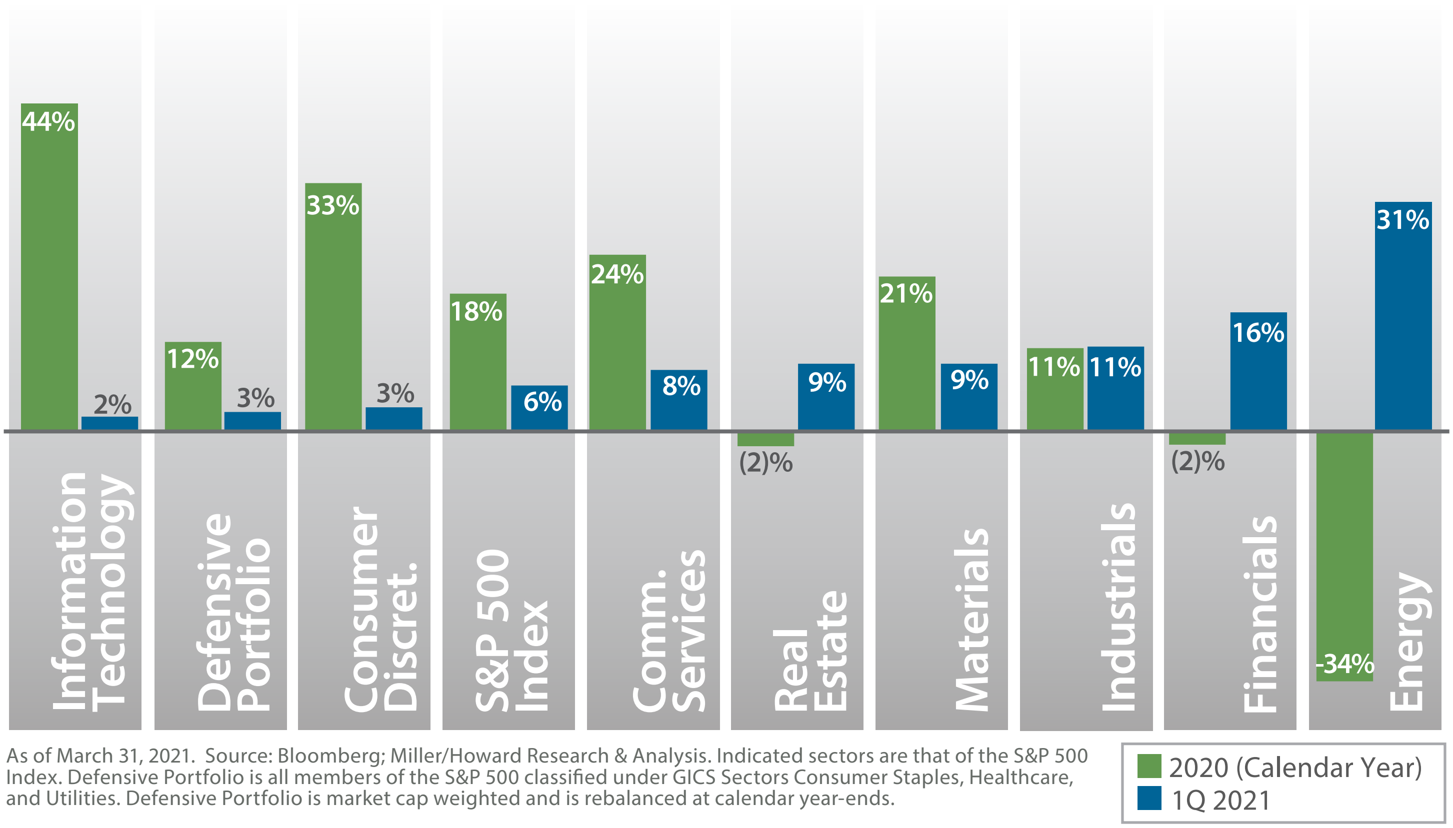
Yields



As of March 31, 2021. Source: Bloomberg; Miller/Howard Research & Analysis. High-Dividend-Yield Stocks consists of Decile 7, 8, & 9 of a universe of US dividend paying common stocks with a market capitalization equal to or greater than $4 billion.

Recovery Optimism Shifts Market Towards Cyclicals

2020 versus 1Q 2021 Total Returns



As of March 31, 2021. Source: Bloomberg; Miller/Howard Research & Analysis. Indicated sectors are that of the S&P 500 Index. Defensive Portfolio is all members of the S&P 500 classified under GICS Sectors Consumer Staples, Healthcare, and Utilities. Defensive Portfolio is market cap weighted and is rebalanced at calendar year-ends.

THE INCOME-EQUITY STRATEGIES PERFORMED well this quarter against the broad market, benefitting from the increase in investor optimism regarding the reopening. Sector performance in the first quarter was dramatically different than results for 2020, with energy, financials, and real estate swinging from negative returns last year to above-market returns this year. The defensive sectors (consumer staples, utilities, and healthcare) trailed the market in Q1, as investors shifted towards more cyclical exposures.

For the most part, performance of the stocks within the Income-Equity Strategies was skewed towards the high-performing market sectors with two exceptions – our consumer discretionary and technology stocks both did better than their broad market peers. In consumer discretionary stocks, both **Magna (MGA)** and **Interpublic Group (IPG)** benefitted from optimism regarding consumer spending. Consumer discretionary stocks in the S&P 500 Index were weighed down by mega-caps Amazon and Tesla, both of which generated negative returns for the quarter.

Technology stocks in the broad market struggled in the quarter, but our tech holdings outpaced the overall market. Our tech holdings have reasonable valuations on average and pay dividends—both uncommon features in a sector dominated by growth stocks.

Financials were strong for the market, but our holdings did even better, with our five banks all doing well. Our biggest contributor to the entire portfolio was insurance company **Hartford Financial (HIG)** after it received a takeover bid from rival Chubb.

Defensives were weak for the broad market and that also proved to be true for our portfolios. Our three lowest returning stocks in the quarter were **Merck (MRK), Coca-Cola (KO),** and **Pfizer (PFE).**

Continued on page 9

Portfolio Highlights

- **Dividend Increases.** The no-MLP version of Income-Equity Strategy had 13 dividend increases in the quarter, including **Life Storage (LSI), STAG Industrial (STAG), Gilead (GILD), Hartford Financial (HIG), Cisco (CSCO), Interpublic Group (IPG), Western Union (WU), Genuine Parts (GPC), Nutrien (NTR), Coca-Cola (KO), Magna (MGA), Old Republic (ORI), and Cousins Properties (CUZ).** The with-MLP version had 14 increases, including the above plus **Enterprise Products Partners (EPD). ORI** also paid a $1/share special dividend—the second $1 special since we first bought the stock in 2018.

- **Sales.** We sold **Verizon (VZ)** based on concerns over how much they might spend in ongoing spectrum auctions. Management may legitimately view spending billions of dollars to expand their spectrum holdings as necessary, but we believe the payoff will be slow and will make it challenging to grow the dividend at a good pace. We also sold **Crown Castle International (CCI), Enbridge (ENB)** and **LSI** as all three stocks had become expensive versus new opportunities. In the with-MLP version, we also sold **Enterprise Products Partners (EPD)** on valuation.

- **Buys.** We bought two new financials this quarter, **Everest Re (RE)** and **Jefferies (JEF)**. Both were selling at a discount to book value and should benefit from the improving economy, in our opinion. We bought **MDC Holdings (MDC),** a homebuilder with a good dividend track record. We also bought **Highwoods Properties (HIW),** a REIT that owns office buildings in the Sun Belt that are expected to do well post pandemic. We bought **Nutrien (NTR),** a producer of fertilizer, which we believe should benefit from increasing crop prices. Lastly, we added **MPLX LP (MPLX)** in the with-MLP version and **TOTAL SE (TOT)** in the without. **MLPX** pays a high dividend and is cheap relative to similar pipeline companies. **TOT** also offers a high yield and we believe should benefit from the rising price of oil.

Looking Ahead

We continue to monitor data on COVID-19 and how it is affecting our holdings. There are still plenty of bumps in the road, such as chip shortages impacting technology companies, and closing auto plants. We remain optimistic regarding the reopening, primarily based on the large number of vaccinations taking place. While we expect the economy to rebound significantly, what's most important is that we remain confident that the stocks in our portfolio will continue to pay high and growing dividends.

This was an excellent quarter for dividend increases (*see Portfolio Highlights*), but we anticipate that we should have more hikes in the coming quarters. One issue last year was that the Fed did not allow large banks to increase dividends even if they had the capital and earnings power to do so. The Fed announced in late March that the moratorium on dividend increases by large banks will be lifted at the end of June 2021. As long as our banks perform well in this June's stress test, we should see dividend increases this year.

Our goal is to provide our investors with dependable income that is both high and rising. We are optimistic that the economy will continue to improve, a conviction that we express by owning many cyclical and financial stocks. But our discipline remains bottoms-up, and we continue to scrutinize each holding for weaknesses that could threaten either dividend growth or the dividend itself.

We remain confident that our holdings have strong enough business models and balance sheets to continue growing their dividends, even if we have an unforeseen delay in the reopening.

See more about Income-Equity on page 14.

Read more about the Fed's Views on Banks on page 15.

MLP Strategy

Quarterly Report 1Q 2021

THE MIDSTREAM SECTOR CONTINUED ITS WINNING WAYS, having another quarter of good performance during 1Q21, on the heels of robust performance in 4Q20. Undoubtedly, some of the positive sentiment surrounding the sector had to do with higher crude oil prices. On December 31, 2020, crude prices were $48.52/barrel and sat at $59.16/barrel on March 31.

In addition, we believe that the midstream sector has undergone an evolution. The focus is changing from companies whose primary goal was high dividend growth and serial issuance of debt and equity, to companies being rewarded for focusing on free cash flow (FCF), returning capital to shareholders through dividend increases and share buybacks, and lower leverage. We believe these developments have resulted in more financially-sound midstream companies and that investors—including sector specialists and market generalists—are taking notice of these changes.

Looking Ahead

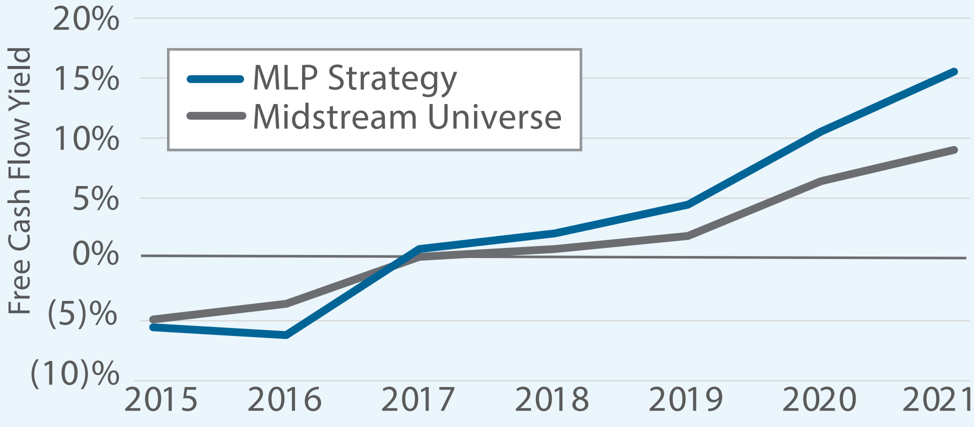
Exploration and production companies have vowed to focus on cash flow, which has impacted the spending requirements of midstream companies. At least in the near term, there will be less spending needed for asset build-outs, thus allowing midstreamers to prioritize returning capital to shareholders. Although the growth of the industry may be slowing, the current yield is quite attractive, and we believe it is more secure given the healthy FCF yields.

As seen in the chart below, the MLP Strategy's FCF yield was negligible until 2019, but it is projected to increase three-fold. We believe that the sector has recovered off the lows seen last year due to the COVID-19 pandemic, and as investors focus on the high-quality midstream names that offer healthy FCF yields, the sector could receive some long overdue interest.

Portfolio Highlights

- **Distributions increases.** This quarter 4 of our 15 holdings announced dividend increases. The average increase was 3.7% year-over-year.
- **Portfolio holdings:** We increased our weight in **MPLX LP (MPLX)** which provides exposure to Permian volumes and northeast natural gas volumes. In addition, the company's FCF yield was above the portfolio's FCF yield. Another upweight was **Energy Transfer (ET),** which was selling at a discount on EV/EBITDA compared with the portfolio and had an attractive +20% FCF yield. Further, **ET's** ample FCF should exceed the current distribution even if the Dakota Access Pipeline were to be shut down. We increased our weight in **Western Midstream Partners (WES)** again this quarter, as it should benefit from higher oil prices that might lead to more drilling activity in the Permian and DJ basins. We sold two holdings, **Enbridge (ENB)** and **TC Energy (TRP)** in order to add to the previously mentioned purchases. While we continue to hold a positive view of those two companies, they were trading at premium valuations to the midstream sector.

Rising Free Cash Flow Yield



As of December 31, 2020. Source: Bloomberg; Miller/Howard Research & Analysis. Midstream Universe is defined as US and Canadian domiciled companies that participate in the midstream industry as classified by BICS (Bloomberg Industry Classification Standard). The midstream universe is weighted by market capitilization. Free Cash Flow (FCF) is cash flow from operations less total capital spending.

Infrastructure

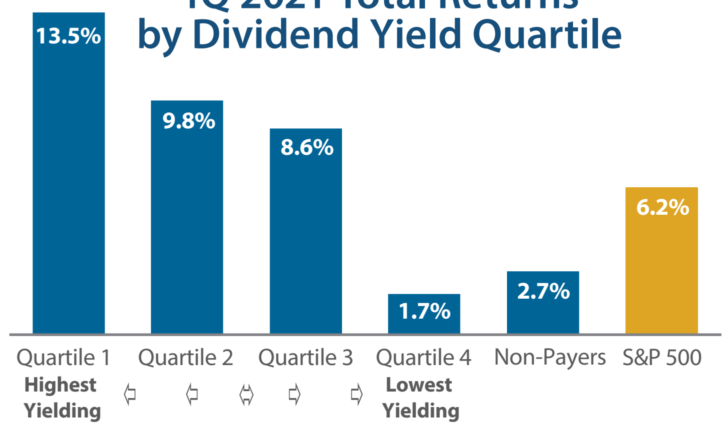
Quarterly Report 1Q 2021

AS THE GLOBAL ECONOMY ACCELERATED AMID continued reopening, long-term interest rates pushed higher, ushering in a dramatic repositioning in the markets. Higher interest rates put renewed emphasis on near-term earnings and cash flow spurring investors to shift into value and income equities.

Within this backdrop, stocks with higher dividend yields performed better. This chart shows that higher dividend-yielding stocks in the S&P 500 Index significantly outperformed the market.

Higher Yielding Stocks Performed Better in Q1

1Q 2021 Total Returns by Dividend Yield Quartile



Source: Bloomberg. Quartiles are based on S&P 500 Index member yields as of 12/31/2020. An ETF that tracks the S&P 500 Index was used to generate total return support.

The market's new penchant for income plays to infrastructure's strengths. We have long maintained that essential service providers with high entry barriers generate durable cash flow profiles that support high and growing dividends. To this point, nearly 50% of the holdings within the Infrastructure Strategy had a first-quartile dividend and over 70% of the portfolio had a first- or second-quartile dividend. This positioning helped the portfolio outpace the broad market and infrastructure benchmarks.

Looking Ahead

We feel that Miller/Howard's Infrastructure Strategy remains well-positioned to capitalize on momentum toward value and income stocks. The strategy has a yield over twice that of the S&P 500 and is trading well-below the broader market's EV/EBITDA.

Despite trading at a discount, we expect the portfolio to benefit from a number of thematic tailwinds. In the short term, an expanding economy should drive demand for energy, power, logistics, and transportation. On top of a cyclical recovery, we continue to see long-term development opportunities associated electrification, renewable energy, 5G deployment, LNG (Liquefied Natural Gas) exports, and higher data demand. The recently proposed infrastructure bill could, if passed, act as an accelerant to a number of these themes.

All told, we believe our Infrastructure Strategy remains well-positioned to deliver a high and growing dividend supported by durable cash flows, creating lasting value for investors.

Portfolio Highlights

- **Rail consolidation:** Canadian Pacific Railway (CP) agreed to acquire **Kansas City Southern (KSU)** in the largest rail deal in over a decade. The merger will create the first rail network connecting Canada, the US, and Mexico, and it should benefit from the passage of the USMCA Trade Agreement. We initiated a position in **KSU** in Q4 as we expected it to benefit from growing North American trade and viewed it as a consolidation candidate.
- **Increased conviction:** We increased our positions in **CSX Corp. (CSX), Schneider National (SNDR),** and **CenterPoint Energy (CNP).** We expect **CSX** to benefit from the transaction multiple in the **KSU** acquisition that implies upside to rail valuations, **SNDR** to benefit from a tight trucking market, and **CNP** to benefit from progress made in its efforts to divest its midstream assets.
- **New additions:** We added **CMS Energy Corp. (CMS),** a name poised to benefit from above-average earnings growth. We initiated a position in this high-quality utility after a period of relative weakness in which its premium to the group narrowed. Later in the quarter, we added **NRG Energy Inc. (NRG),** a retail/generation business with a strong free cash flow profile.

Utilities Plus

Quarterly Report 1Q 2021

MARKETS CONTINUED THEIR MARCH HIGHER AS vaccines were administered, cases dropped from year-end highs, and the economy accelerated. The yield on the 10-year treasury nearly doubled during the quarter, rising ~85 basis points. Utilities followed treasuries lower before diverging in March and ending the quarter squarely in positive territory.

Value and smaller market cap continued to drive utility leadership, an inflection that began with the vaccine announcements last November. For most of 2020, investors bid up already expensive water utilities as well as electric utilities with the most existing renewable energy assets. However, higher interest rates have pressured utilities with the highest P/E multiples, reversing performance in favor of value stocks within the S&P 500 Utilities Index. A similar dynamic can be observed among cap size as small- and mid-cap utilities shifted from laggard to leader, in part due to an increased appetite for risk.

Looking Ahead

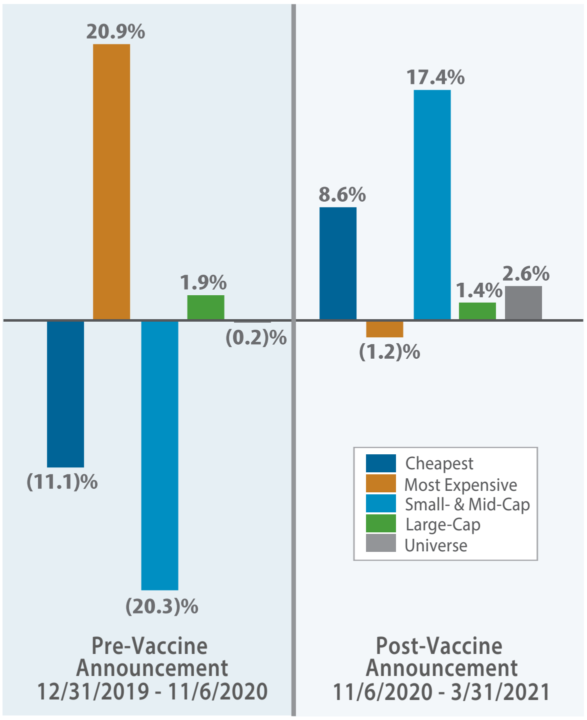
Miller/Howard's longstanding tilt toward smaller-cap and value puts the Utilities Plus Strategy in a position to benefit from continued repositioning within the market. While discounted valuation multiples de-risk the portfolio in the current environment, we still expect the portfolio to deliver a similar growth profile.

We expect much of the future growth in the utilities sector to be driven by a multi-year tailwind from renewables projects. The coal to natural gas and renewables transition is supported by public opinion, regulatory support, and more recently federal policy proposals.

Utilities continue to provide an underappreciated avenue in which to gain exposure to the nation's energy transition, and in our view, utilities stand to benefit from the best growth prospects in decades. Collectively, high and growing dividends supported by a defensive business model create a compelling risk-reward tradeoff for investors.

Vaccine News Shifted Market Towards Value, Small Cap within Utility Universe

Total Returns



As of March 31, 2021. Source: Bloomberg; MHI Research & Analysis. Market cap weighted. The cheapest and most expensive groups were created by quintiling the holdings of the S&P 500 Utilities Index as of 12/31/2019 by forward P/E estimates. Small- & mid-cap are defined as GICS sector Utilities in the S&P 600 and S&P 400 Indices. Large-cap is defined as GICS sector utilities in the S&P 500 Index. Universe is all members of small-, mid-, and large-cap.

Portfolio Highlights

- **New additions:** We added **CMS Energy Corp. (CMS)**, a name that we feel is poised to benefit from above-average earnings growth. We initiated a position in this high-quality utility after a period of relative weakness in which its premium to the group narrowed. Later in the quarter, we added **NRG Energy Inc. (NRG),** a retail/generation business with a strong free cash flow profile.
- **Simplifying the story:** **CenterPoint Energy (CNP)** and **OGE Energy Corp. (OGE)** took a major step in streamlining their asset base to pure-play regulated utilities. The companies agreed to the acquisition of Enable Midstream Partners (ENBL) by Energy Transfer (ET) which will provide the liquidity needed to exit their positions in ENBL. We expect both **CNP** and **OGE** to benefit from the divestiture, and we added to our positions.
- **UK consolidation:** **PPL Corp. (PPL)** announced the sale of its UK utility business to National Grid (NGG). In a separate transaction, **PPL** acquired NGG's Rhode Island utility business. Once the dust settles, we expect **PPL** to rerate toward US peers.
- **Winter Storm Uri:** In addition to the humanitarian toll, Uri wreaked financial havoc as the cost to procure natural gas spiked and power plants battled outages. Utilities may ultimately be able to recover the related costs, but it will likely take time to reach a resolution.

Drill Bit to Burner Tip®

Quarterly Report 1Q 2021

THE MARKET CONTINUED RIDING THE DUAL WAVE of higher commodity prices and a rotation into relatively inexpensive value stocks to deliver the strongest start for energy investors in at least the last 30 years when looking at the S&P 500 Energy Sector. Our portfolio captured 86% of the S&P 1500 Energy Index upside this quarter, roughly consistent with our long-term average (whereas since inception we participated in just 69% of the downside in weaker markets).

Notably in this bull market, the return of drilling activity has been slow despite strong commodity prices. This weighed on investor enthusiasm for our volume- and activity-oriented holdings in oilfield services and midstream, though we see this as a growing mispricing as the recovery unfolds. But for long-term investors in cyclical commodity businesses, a quality bias towards better balance sheets and lower cost structures is generally the appropriate formula, and it's been a winning one for this strategy for many years.

Portfolio Highlights

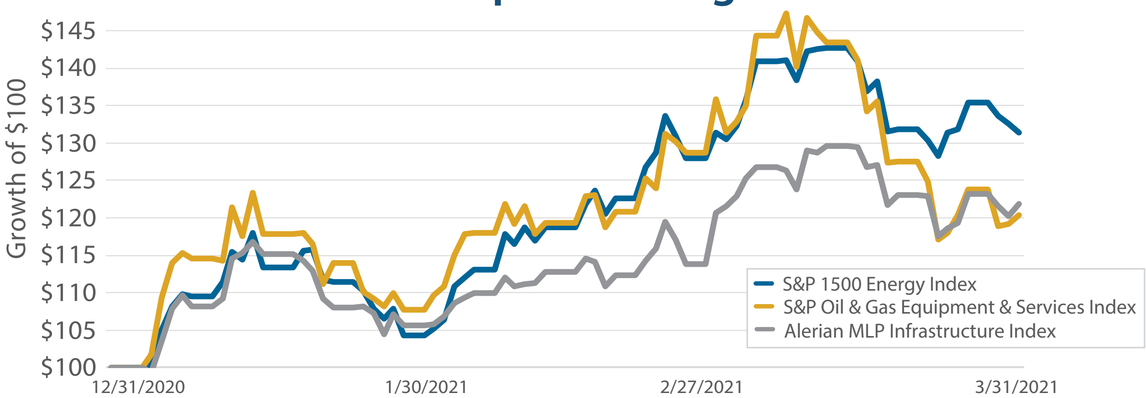
- **Energy and income.** This portfolio continues to be an underappreciated source of dividends. As shale companies continue to mature, E&Ps are poised in our view to join refiners and pipelines as among the highest dividend-payers in the market. While not the absolute highest-yielding energy vehicle, this portfolio offers a 4.2% yield that we estimate is supported at $40 oil, and that carries projected 12-month growth of 10%.
- **Along the energy value chain.** The portfolio continues to lean into the energy recovery. We were less active in our trading than quarters past, though we did reorient our midstream positioning with the addition of **MPLX, LP (MPLX)** and **Energy Transfer (ET)** in our w/ K-1s version, and further increased our upstream exposure with the re-addition of **Occidental Petroleum (OXY)** in both versions of the strategy. **OXY's** balance sheet is much improved at prevailing oil prices, and there's significant financial leverage to higher oil prices.

Looking Ahead

We don't think the energy wave has crested just yet. Energy stocks trade at just 15.5x 2022's earnings, far below the S&P 500's 20x forward multiple for its 2022 earnings. Moreover, the S&P multiple is currently 30% above its 20-year average. Said another way, energy stocks remain inexpensive relative to the broader market, even after large year to date outperformance, and without considering further support from potentially higher commodity prices later this year.

What about oil prices? With world inventories tightening due to rebounding post-pandemic demand, and restrained supply from both OPEC+ and US shale, the most likely path for prices appears higher, in our view. In the portfolio, we also anticipate a catch-up trade from energy pipelines, which comprised 34% of our portfolio at quarter end, and which derive profits principally from volumes not price. Due to improved E&P discipline, less drilling has meant delayed full gratification, though we expect rising profits as oil well completions increase.

Activity Sensitive Energy Stocks Should Catchup as Drilling Accelerates



As of March 31, 2021. Source: Morningstar Direct.

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 to weather a downturn and poised to return to dividend growth as economic conditions improve.

Income-Equity Strategy (with MLPs)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	1Q 2021
Income-Equity Yield	5.1	4.8	4.4	4.2	4.7	4.0	3.7	4.3	3.7	3.6	3.4
S&P 500 Yield	2.1	2.2	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5
Ratio	2.4x	2.1x	2.3x	2.1x	2.2x	1.9x	2.0x	2.0x	2.0x	2.3x	2.3x
Income-Equity Projected Dividend Growth*	6.8	7.5	7.5	7.5	5.8	5.0	6.3	7.8	7.3	5.1	5.7
S&P 500 Projected Dividend Growth**	5.9	5.1	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.5
Ratio	1.1x	1.5x	1.3x	1.6x	1.4x	1.2x	1.5x	1.5x	1.7x	1.5x	1.0x
Income-Equity Dividend Coverage Ratio	1.4x	1.5x	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	1.9x
Income-Equity Net Debt/EBITDA***	2.4x	2.5x	2.6x	4.2x	2.8x	2.0x	1.9x	1.4x	1.9x	1.9x	1.7x
Income-Equity P/E Ratio Trailing	13.3	14.1	13.4	16.4	14.2	17.2	17.7	12.6	12.8	16.7	17.9
S&P 500 P/E Trailing	13.4	14.4	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	28.1
Premium/Discount	-1%	-2%	-23%	-10%	-24%	-16%	-18%	-23%	-41%	-40%	-36%

Income-Equity Strategy (No MLPs)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	1Q 2021
Income-Equity (No MLPs) Yield	5.0	4.7	4.1	4.0	4.6	3.9	3.7	4.2	3.6	3.5	3.2
S&P 500 Yield	2.1	2.2	1.9	2.0	2.2	2.1	1.9	2.2	1.9	1.5	1.5
Ratio	2.4x	2.1x	2.2x	2.1x	2.1x	1.9x	2.0x	2.0x	2.0x	2.3x	2.2x
Income-Equity (No MLPs) Projected Dividend Growth*	7.0	7.6	8.2	7.7	5.9	5.0	6.4	7.9	7.5	5.2	5.7
S&P 500 Projected Dividend Growth**	5.9	5.1	5.9	4.7	4.2	4.0	4.2	5.2	4.2	3.3	5.5
Ratio	1.2x	1.5x	1.4x	1.6x	1.4x	1.2x	1.5x	1.5x	1.8x	1.5x	1.0x
Income-Equity (No MLPs) Dividend Coverage Ratio	1.4x	1.4x	1.3x	1.3x	1.3x	1.3x	1.5x	1.9x	2.3x	2.1x	1.9x
Income-Equity (No MLPs) Net Debt/EBITDA***	2.4x	2.5x	2.7x	2.6x	2.6x	2.2x	2.1x	1.4x	1.9x	1.9x	1.6x
Income-Equity (No MLPs) P/E Ratio Trailing	13.5	14.5	14.6	17.2	16.5	18.2	18.0	12.9	13.5	16.8	18.1
S&P 500 P/E Trailing	13.4	14.4	17.4	18.4	18.8	20.5	21.7	16.5	21.6	27.6	28.1
Premium/Discount	0%	1%	-16%	-6%	-12%	-12%	-17%	-22%	-38%	-39%	-36%

Source: Bloomberg; S&P 500; 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 15.

Banks May Offer Dividend Growth Again in 2021

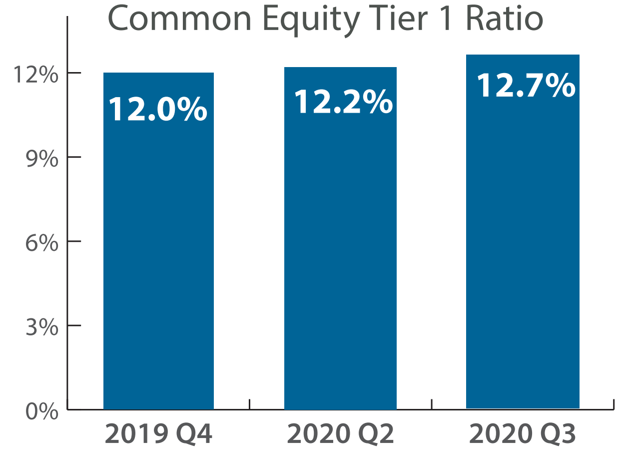
Out of the 22 large US banks, only Wells Fargo and Capital One (neither is owned by Miller/Howard) cut dividends during 2020. Banks proved to be a reliable source of dividends, even during a difficult period.

What's more, bank balance sheets continue to be strong, even in the additional December 2020 stress test using COVID-19 recession scenarios. As a group, despite doubling the reserves set aside for potential (but not realized) loan losses, banks actually improved their capital metrics during 2020, as earnings were substantially more than dividends paid. The money is literally "in the bank," meaning that excess capital has accumulated.

Importantly for us, the Fed recently announced that it will once again allow banks to increase their dividends, provided they pass the June 2021 stress test.

Until then, buybacks in the first half of 2021 reduce shares outstanding, making dividend increases more affordable.

Large US Banks: Aggregate Common Equity Tier 1 Ratio



Source: Executive Summary of the Fed's December 2020 Dodd-Frank Act Stress Test, page 2. The common equity tier 1 capital ratio is the primary metric the Fed uses to judge bank capital adequacy.

Follow Our Blog for Updates from Our Portfolio Management Team

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.

Note: GameStop, Facebook, Apple, Amazon, Netflix, Alphabet (Google), & Microsoft were not held in any Miller/Howard strategies.

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