Quarterly Client Bulletin

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WALKER FINANCIAL ADVISORS, INC.
Registered Investment Advisor

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The Bottom Line / Portfolio Update

I hope you're enjoying the beautiful springtime weather along with all of nature's miracles that appear this time of year. Our accounts have blossomed and ended the quarter near all-time high levels. Longer-term interest rates have ticked up while short rates have stabilized as the Fed remains on hold. Our strategy is to hold a balanced all-weather portfolio with stocks for capital appreciation and dividends, while guarding against downside risks with plenty of T-bills and other fixed-income securities for lower volatility, safety, and interest income. For the most recent 3-month period, the total net average return across all managed accounts was 4.14%, and 12.50% for the past twelve months. On March 31, our overall stock exposure was 51% of total managed assets. Our goal is to maximize your total return (interest & dividends, plus capital appreciation), given your risk tolerance level. We hope you are pleased with your results.

Our top performing stocks last quarter were **Diamondback Energy**, **Amazon**, **Berkshire Hathaway**, **Lowe's**, and **Costco**. Only two holdings declined in value, **Apple** and Tesla. Growth has decelerated at each of these American icons and investors hit the sell button last quarter. The U.S. Department of Justice recently filed an antitrust suit against Apple which has created a black cloud over the stock. The bull case is Apple recently announced that they are nearing production of a new M4 computer processor with AI processing capabilities and plans to update every Mac model with it. They also have a cool new VR (virtual reality) headset for $3,499 which has some unique features and business applications that could catch on, so we're holding existing shares.

Tesla's growth has also slowed as evidenced by a decline of 8.5% in 1st quarter vehicle sales as compared to a year ago. This is attributable to fewer cars qualifying for a tax credit and weaker sales in China due to increased competition. On 4/15, the company announced they would be laying off 10% of their global workforce and two key executives are leaving. Given this weak fundamental data along with a battered chart, we chose to sell all shares and move to the sidelines. We still believe they make an excellent product, but demand is waning as more people gravitate to hybrid vehicles to avoid range anxiety on a road trip. Perhaps autonomous driving will provide a new growth catalyst for us to revisit these shares down the road, but the trend in the meantime is lower for this richly valued stock.

We banked a short-term gain on the sale of Delta and made a timely exit from Hershey due to the stagnating price in a roaring bull market.

Dividend-Paying Blue-Chip Value Stocks

Given the acrimonious geopolitical situation and stretched valuations in many tech stocks due to the "AI" frenzy, we like owning energy and utility stocks which trade at more attractive valuation multiples and provide industry diversification benefits. The cash dividends are frosting on the cake.

These value sectors lagged last year but have been moving up lately. Midland, Texas based **Diamondback Energy** has been a superstar stock. The special extra dividends paid last year were evidence of their cash flow discipline and are very shareholder friendly.

Last quarter they announced the acquisition of privately held Endeavor Energy Resources, a Permian basin neighbor for $26 billion. Endeavor's headquarters are across the street in Midland and the merger has been favorably received by the market. **Chevron** is our pick for a mega integrated major, with a 4% current yield. Many of their CA stations have gotten a facelift and the company is working on more carbon friendly technologies to benefit the planet. We got nicked up by this one last year, but we bought more on the dip and the shares have recovered.

Now that the Fed is done raising interest rates, utilities have perked up. We re-established a position in Florida-based **NextEra Energy**, the #1 solar and wind producer in the U.S. Florida Power & Light is their regulated division which has seen growth with the influx of people to the sunshine state. But the real story is how much they are growing their unregulated division with renewable power. The stock has moved from the mid-50's to the mid-60's in the last 30 days and pays a 3.2% current yield. **Sempra** is our local SoCal provider for electricity and natural gas. They also have operations in Texas and Mexico with a focus on LNG, energy networks and low-carbon solutions. Roof top solar installations initially hurt the company, but demand has increased with the proliferation of electric vehicles and charging stations, along with E-bikes and all the tech gadgets that need electricity to charge up. The stock carries a bargain price / earnings (P/E) ratio of 15 and pays a 3.5% dividend yield.

Berkshire Hathaway

We first purchased this Omaha-based holding company in 1999 and it has grown into the largest equity position held at our firm. It's less than a month away from the company's annual meeting dubbed "Woodstock for Capitalists" in Nebraska. Having attended the meeting twice, I would recommend it for anyone wishing to learn more about the inner workings of this massive, very profitable, conglomerate. Shareholder shopping day at the big pavilion on Friday afternoon features displays and product sales from many of the Berkshire-owned brands. There is a giant model BNSF train, and discounts for purchases of See's Candies, Pampered Chef knives, Duracell batteries, Fruit of the Loom underwear, and GEICO auto and homeowner's insurance.

Missing from the panel on Saturday at the annual meeting this year will be Vice-Chairman Charlie Munger who died last year at age 99. In Warren's annual letter to shareholders this year he commented that the best advice Charlie ever gave him was to "add wonderful businesses purchased at fair prices and give up buying fair businesses at wonderful prices." Another interesting fact from the report is that Berkshire's wholly owned operating companies employ 396,000 people, while the corporate office in Omaha employs 26, truly a lean operation. Since its 1965 inception, the per share market value of Berkshire has a compounded annual gain of 19.8% versus 10.2% for the S&P 500 with all dividends reinvested. The shares were up 17.9% in the first quarter.

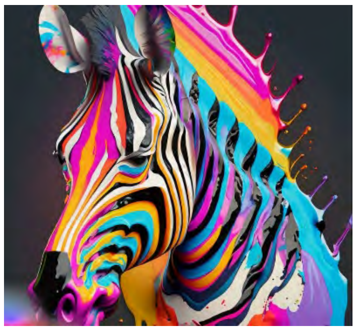
Scott Walker in Omaha - 2018

New Holdings

Last year *Barron's* hosted a health care portfolio manager panel and multiple panelists recommended **Vertex Pharmaceuticals**, which warranted further research. Turns out the company is very profitable with market-leading therapies for cystic fibrosis. Lengthy patent protections extending as far as 2037 provide long-duration cash flows. The innovative culture of the Boston-based company has led to a robust pipeline with trials underway for a non-opioid pain treatment, liver disease, Duchenne muscular dystrophy, and Type 1 diabetes. Excellent fundamentals including a strong balance sheet with little debt only add to the allure.

Adobe, Inc. has been punished this year with shares down 15% due to lighter than expected guidance. We believe they will be just fine and continue to grow with their top-notch suite of design products. The company has made a successful transition away from large upfront licensing fees to a software as a service model with monthly recurring revenue. Adobe has a generative AI tool called Firefly which is natively integrated into Creative Cloud apps like Photoshop and Illustrator. The company is rolling out Firefly in limited geographies and enterprise customers won't see a price increase until their contracts are up for renewal. Their balance sheet is strong with low debt and a net profit margin of 24% which produces a 32% return on equity, all excellent metrics. They do not pay a dividend, but the company is buying shares and recently authorized a new $25 billion stock buyback plan (10% of market cap).

Adobe



Examples from Adobe Firefly

Company News Bytes:

Costco – Special one-time dividend of $15/share declared in December and paid on January 12.

Amazon – Invested an additional $2.75 billion in Anthropic, completing a $4 billion deal with the artificial intelligence startup from last year. Anthropic developed the chatbot Claude, who competes against Open AI's ChatGPT. Alphabet's Google is also an investor in Anthropic. In March, Amazon announced an initiative called Bedrock through their cloud computing division AWS (Amazon Web Services) to help enterprises adopt generative AI tools. The company also has several new joint initiatives with chipmaker Nvidia.

Microsoft – Finalized the $69 billion acquisition of video game maker Activision Blizzard. Copilot for Microsoft 365 allows users to achieve more using AI and is integrated with Teams, Word, Outlook, PowerPoint, and Excel for an extra $30/month per user. Shares notched a new all-time high of $430.82 in March and the company now carries the #1 market cap in the U.S. at $3.1 trillion.

Visa – In one of the most significant antitrust settlements ever, the company agreed to reduce swipe or interchange fees charged to merchants. Although Visa sets the fees, it is the banks that issue the cards that collect most of the revenue which is used to fund popular rewards programs. The deal is subject to court approval and was largely priced into the stock. Shares returned 13.4% last quarter as there was only a mild decline following the announcement.

Bonds & Fixed Income Investments

Treasury yields were flat last quarter with the Fed on hold and inflation readings moderating in the 3.5% range. With the inverted yield curve, we continue to overweight Treasury Bills. These direct obligations of the U.S. government mature in one-year or less. We have laddered several different 6-month T-bill maturities that were purchased at 5%+ yields, and we also hold a two-year Treasury note with a 5% coupon. In addition, we have smaller positions in a 2043 and 2044 U.S. Treasury bond for income and capital appreciation when long-term rates turn lower.

All U.S. Treasuries are liquid marketable securities and may be sold at any time at the prevailing market price. There is no stated penalty for early withdrawal like a bank C.D., and interest paid on Treasuries is exempt from CA State income tax.

Interest rate spreads, or the difference between Treasury yields and yields of other bonds, narrowed last quarter. This provided a price boost to all other types of fixed-income securities. We own the **SPDR High Yield Bond ETF**, along with the **Blackstone Secured Lending Fund**, a business development company involved in private credit that pays quarterly and has done well. These high yield alternatives have payouts ranging from 7.5% - 10.0%.

Note: After the end of the quarter, Treasury yields spiked higher and bond prices declined. We took defensive action and sold all shares of the iShares Preferred & Income Securities ETF to preserve capital and lock in a profit for all but the most recent buys.

For our higher tax bracket clients, we continue to like municipal bonds issued by jurisdictions within the State of California. The interest paid on these bonds is exempt from federal and State of CA income tax. We favor Orange County related issues and often find odd lots trading on the secondary market. We did participate in an initial offering last quarter and bought **general obligation bonds** issued by the State of California. To minimize interest rate risk, we bought the shortest bonds offered which mature in September 2025 that came with a 5% coupon and a tax-exempt yield to maturity of 3.12%. Assuming a combined tax rate of 48% (35% federal + 3.8% net investment income tax + 9.3% State of CA), the lower Muni yield equates to a taxable equivalent yield of 6.00%.

Income Tax Saving Strategies

The April 15 tax filing is in the books, so we are focused on doing everything possible to assist you in minimizing your 2024 tax burden. For taxable brokerage accounts, our strategy is to buy and hold tax-exempt municipal bonds and minimize turnover to keep realized gains at a reasonable level. We prefer to own individual securities and ETF’s for greater tax efficiency versus open-end mutual funds, which often pay large capital gain distributions in December. We opt for common stocks of large U.S. based companies that pay “qualified” dividends which are taxed at more favorable long-term capital gains rates.

For IRA owners who are taking distributions, we have attempted to target the appropriate amount of tax withholdings, so please let us know if you had any surprises for the 2023 tax year. Qualified charitable distributions (QCD) from IRA's remain an excellent strategy for charitable giving versus writing a check from your bank account. Although RMDs aren't required until 73, a QCD is a tax-favored way for those who are 70 ½ years of age or older to donate up to $100,000 to a 501(c)(3) charity each year. Given the cap on state and local tax (SALT) deductions as well as a higher standard deduction threshold, many clients no longer itemize, so the tax deductibility of charitable gifts is wasted. The QCD solves that problem, and we are happy to facilitate the gifts for you.

We are a Fee-Only Independent Registered Investment Advisory firm. In addition, both Warren and I are licensed as CFP® professionals and held to the highest standards of conduct. We have a fiduciary duty to always act in your best interest. It is a privilege to serve as your advisory firm and we appreciate the opportunity to be of assistance in building and protecting your hard-earned dollars. Please let me know if you have any comments or questions.

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