Reaves Asset Management

Review and Outlook

Third Quarter 2017

OVERVIEW

The ERISA Composite[1] returned approximately 3.2%, net of fees, in the third quarter, underperforming the S&P 500 Index[2] return of 4.5%. The composite generated positive returns in each sector despite significant volatility in commodity prices and interest rates.

ENERGY

The composite's energy sector returned 6.6% versus 6.8% for the S&P 500 Energy Index[3] during the quarter. West Texas Intermediate[4] crude oil rallied throughout the quarter, rising from $46 per barrel on June 30th to nearly $52 on September 30th. The commodity rally helped most energy stocks, especially our second largest holding Royal Dutch Shell.

Despite the rally over the past three months, we believe oil does not have much more upside, and have positioned our portfolio accordingly. Our 12 to18-month outlook is for oil to remain range-bound between $45 and $55 per barrel. Drilling costs in North America have fallen so dramatically that many companies can profitably grow production at $50 oil, and that prospect effectively puts a ceiling on prices for now. Globally, the effect of the slowdown in capital spending over the past three years will result in large production declines which may not be felt in a meaningful way until late 2018.

The other holdings in energy produced mix results. TransCanada Corporation's performance was helped by a strong Canadian dollar as well as by an improving regulatory environment for natural gas pipelines in the United States. The U.S. Federal Energy Regulatory Commission (FERC) finally reached a quorum and immediately approved several new construction projects. TransCanada acquired Columbia Pipeline in 2015 with the goal of building out a huge backlog of projects positioned around the Marcellus Shale, and it appears that these projects will have a much easier time getting approvals under the new FERC.

Pioneer Natural Resources Company was down during the quarter despite the run-up in oil prices. The company reported disappointing production results during its latest quarterly conference call. We believe the disappointment was misunderstood; the problem is fixable with a different completion technique that is commonly used within the industry but the stock sold off as if the viability of Pioneer's entire resource base was in question. We maintained a large position in the stock and were rewarded as it recovered off the lows reached in August.

COMMUNICATIONS

Composite investments in communications[5] contributed 0.3% to performance, underperforming the S&P 500 Telecommunication Services Index[6] by 647 basis points[7]. Our investment in Charter Communications served us well as its shares benefited from the reported takeover interest during the quarter. We took advantage of the run-up in price around the acquisition news in early August and sold a meaningful portion of the position. This positive result was offset by a down quarter at

Comcast which declined due to renewed concerns about video competition. This concern arises every so often and always causes a brief swoon in the stock. What the market ignores is that the broadband division is much more profitable than video, and growth in broadband remains strong.

We have increased the overall weighting in communications primarily with the purchase of a position in the Canadian cable company Cogeco Communications. The stock rallied during the quarter after the company announced a deal to expand its footprint in the United States. Cogeco should benefit from many of the same competitive dynamics that have helped Charter and Comcast and is trading at a significant valuation discount. The company should also benefit as it gains scale and closes the valuation gap over time.

An investment in Uniti Group hurt composite returns. Uniti's largest customer, Windstream Holdings, makes up a majority of its revenue. Unfortunately for Uniti, Windstream eliminated its dividend which caused investors to worry about its future viability. Uniti was hit hard on the news and generated a negative return in the portfolio during the quarter. We have since sold a portion of the position.

UTILITIES

Third quarter performance of the composite's utilities was 3.2% versus the 2.9% return for the S&P 500 Utilities Index[8]. The 10-year U.S. Treasury[9] yield ended the quarter essentially flat but the path to get there was volatile. Government bonds rallied consistently from the beginning of the quarter through the middle of September before yields started to rise, reflecting better economic results and inflation concerns. Performance in the utilities portfolio largely mirrored the volatility seen in the treasury market.

Performance in the quarter was driven by two leaders in renewable energy, NextEra Energy Partners and NextEra Energy. Prospects for renewable energy improved meaningfully when American Electric Power announced a $4.5 billion plan to build 2000 megawatts of wind power in the Oklahoma panhandle, dubbed the Wind Catcher Energy Connection Project. Abundant wind resources and increasingly efficient technology enable American Electric Power to invest $4.5 billion, shut down existing coal plants, and deliver savings to customers. The announcement confirmed that new wind generation is finally cheaper than existing power plants. This has significant implications for future utility growth. Utility growth is typically constrained by the impact initiatives have on customer bills, not project availability. Most companies try to limit bill increases to less than inflation and set capital budgets correspondingly. If renewable resources can deliver savings to customers, utilities will likely deploy more capital to such projects and, consequently, earnings growth should be higher. We anticipate that cost reductions in battery storage will accelerate this trend.

NextEra Partners and NextEra Energy are not involved with this particular project but are the clear leaders in renewable energy development in the United States. The Wind Catcher announcement means that renewable energy is on the verge of rapid development. Several other utilities have announced similar projects. More will come, and the NextEra group of companies will be major beneficiaries of the trend.

OUTLOOK

We believe the companies we invest in can generate steady, sustainable growth in varying economic environments. We are confident that over time our companies will grow shareholder value through increasing earnings, cash flows, and dividends.

Advances in renewable and battery technology as well as an abundance of cheap natural gas are causing electric grids to change. Wind power is the cheapest source of power in parts of the country even before the impact of tax credits. Wind and solar power plus battery storage is on its way to being a competitive source of baseload power within the next decade. Natural gas is cheap and plentiful and is in the process of replacing coal as the country's largest source of electricity. These changing infrastructure dynamics, involving billions of dollars of capital projects, present significant investment opportunities.

Consumer demand for data services continues to grow and drive investment. Tower, fiber, and broadband companies should be the primary beneficiaries. Video delivery and newer, faster networks are just the beginning: as society automates and digitally links more functions, a phenomenon generally referred to as the "Internet of Things", data usage is expected to grow exponentially. As an example, a self-driving vehicle might use 1,000 times as much data as the average internet user consumes today. Massive investment is required to accommodate the move to more automated processes, and the infrastructure companies should have the ability to capitalize on this trend.

Energy companies are adjusting to a world in which oil and natural gas prices remain low by cutting costs and becoming much more efficient. Production techniques are improving so dramatically that it is possible for some companies to grow production without outspending cash flow and be profitable at current oil and natural gas prices. Removing this dependency on the commodity could mean that the stocks become less volatile and earnings more consistent in the future.

We believe a portfolio made up of infrastructure companies that take advantage of these trends can grow earnings, cash flows and dividends consistently over time. The steady compounding of value will be a key that can lead to strong long-term portfolio returns.

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[1] *The Reaves ERISA Composite reflects the dollar-weighted return of all corporate ERISA pension accounts with assets of at least $1,000,000 under management. All references to performance and holdings reflect the Reaves ERISA Composite. This quarterly commentary covers the period 06/30/17 through 09/30/17.*

[2] *The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The typical Reaves portfolio includes a significant percentage of assets that are also found in the S&P 500. However, Reaves' portfolios are far less diversified, resulting in higher sector concentrations than found in the broad-based S&P 500 Index.*

[3] *The S&P 500 Energy Index comprises those companies included in the S&P 500 Index that are classified as members of the GICS energy sector.*

[4] *West Texas Intermediate (WTI), also known as Texas light sweet, is a grade of crude oil used as a benchmark in oil pricing.*

[5] *Reaves' communications investments are comprised of telecommunications, consumer discretionary companies and Real Estate Investment Trusts (REITS): wireless communications and tower companies.*

[6] *The S&P 500 Telecommunications Services Index comprises those companies included in the S&P 500 that are classified as members of the telecommunication services sector.*

[7] *Basis point (BPS) refer to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01% (0.0001), and is used to denote the percentage change in a financial instrument.*

[8] *The S&P 500 Utilities Index is a capitalization-weighted index containing 28 electric and gas utility stocks (including multi-utilities and independent power producers). Prior to July 1996, this index included telecommunications equities.*

[9] *The 10-year U.S. Treasury note is a debt obligation issued by the United States government that matures in 10 years. A 10-year Treasury note pays interest at a fixed rate once every six months and pays the face value to the holder at maturity.*