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First Quarter 2017 Commentary **Carol M. Lippman, CFA**

Low Volatility of Almost Unprecedented Duration

According to an article in the March 21, 2017 *Wall Street Journal:* The Standard & Poor's 500 ("S&P 500") dropped 1.2% to close at 2,344.02, the benchmark's biggest slide of 2017[1]. It was the first time the index fell more than 1% in a day since October 11, 2016, the longest such stretch since 1995. Measures of actual and expected stock-market volatility have been anchored at multiyear lows, as the S&P 500 soared 11% from Election Day through Monday, March 20.

Excerpts from a March 26, 2017 Wall Street Journal article titled, "Why the 'Trump Slump' Still Stings for Mom and Pop Investors," explain the perils of impatience on investment success.

> "When the S&P 500 fell 1.2% last Tuesday (March 21, 2017), individual investors probably fared even worse. The drop made headlines for several reasons. Not only was it the biggest of the year, but it also snapped a streak of 109 trading days without a 1% decline, the longest span since the first Clinton administration. In a market that has churned higher since the election without much getting in the way, investors shouldn't be fazed by the first sign of volatility. The problem is, they usually are. . . .
>
> This is a big reason why investors almost always underperform the actual market's returns. Consider a long-running study of investor returns by Dalbar, a financial-research firm in Boston. It found the average investor in U.S. stock mutual funds lost 2.3% in 2015, whereas the S&P 500 was slightly positive that year, including dividends. And 2015 wasn't an anomaly. The gap between investors' returns and the market's performance is even wider over a longer time horizon. Equity-fund investors earned just 3.7% annually over the past 30 years through 2015 compared with a 10.4% annual return for the S&P 500."[2]

Full-time market participation and patience are still critical.

Our generally conservative, defensive rising dividend portfolios have tended to perform, or hold up, best in challenging markets. Since inception (September 30, 2011), on what we call "big down days," when the market as measured by the S&P 500 dropped 1% or more, our

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[1] Dieterich, Chris, and Eisen, Ben. "Banks, Biotechs suffer on Down Day." *The Wall Street Journal*, March 21, 2017.

[2] Russolillo, Steven. "Why the 'Trump Slump' Still Stings for Mom-and Pop Investors." *The Wall Street Journal,* March 26, 2017.

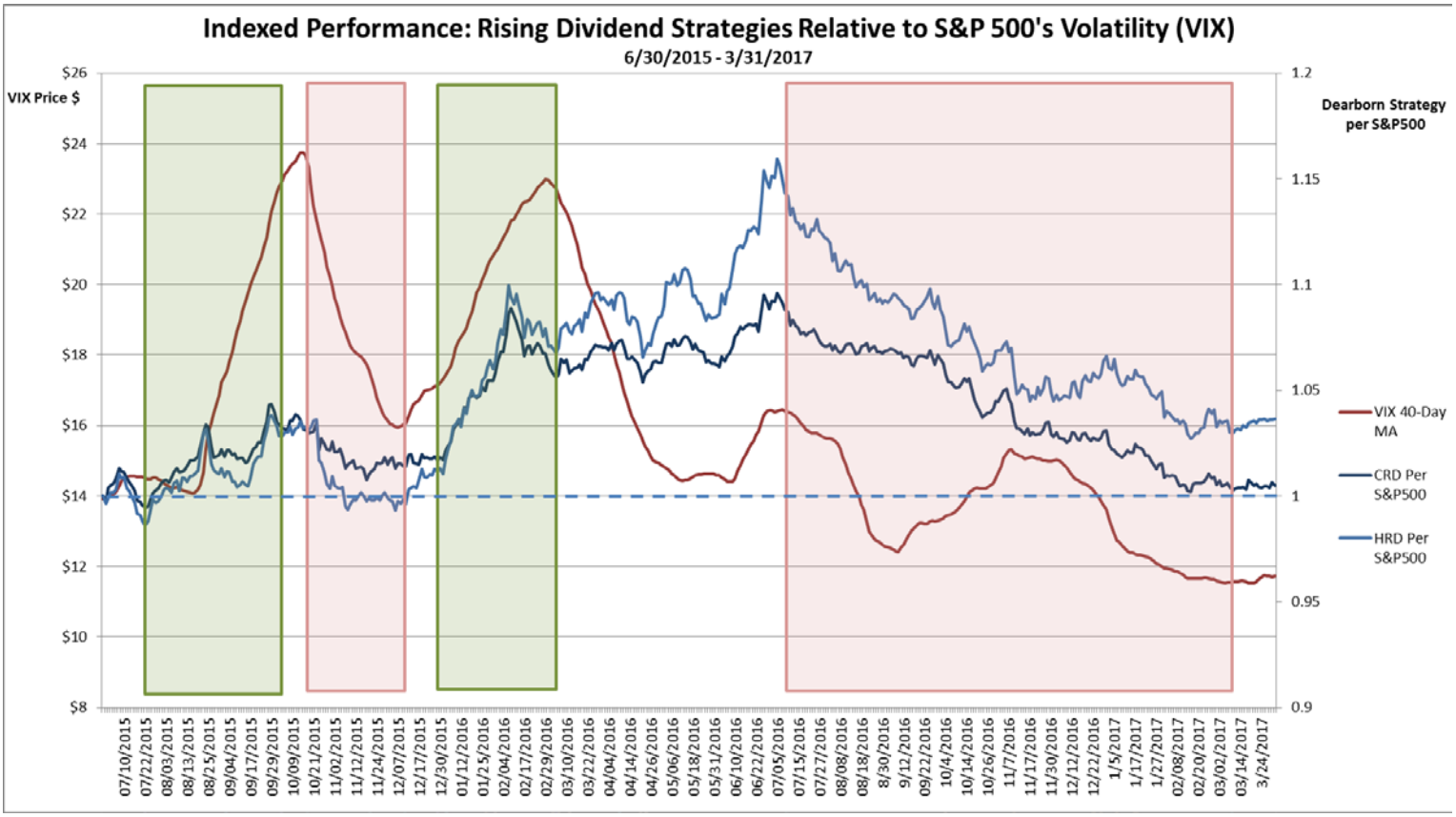
two separately managed account ("SMA") portfolios outperformed the broad market about 87% and 91%of the time, respectively.

Big down days from inception through March 31, 2017:

Total Days	1,385	
Total "Big Down Days" (down over 1%)	127	
Total days that the Core Rising Dividend SMA ("CRD") outperformed the S&P 500 on "Big Down Days"	116	91.3%
Total days that the High & Rising Dividend SMA ("HRD") outperformed the S&P 500 on "Big Down Days"	111	87.4%

In the largely one-way-up stock market since Election Day, our portfolios have participated but not outperformed. Since the election, there have been very few down days in the stock market, much less big down days.

The light blue (HRD) and dark blue (CRD) lines in the graph below show our two SMAs relative to the broad market's volatility as measured by the red line—a smoothed, 40-day moving average of the VIX (Chicago Board Options Exchange Volatility Index). The green shaded areas show that our portfolios performed best when volatility was greatest or increasing, i.e., the red line spiked. Since the end of the second quarter of 2016, market volatility has been very low (the red shaded area farthest to the right). Low volatility typically has not benefitted our portfolios.



Recent Market Leaders

From July 1, 2016 through March 31, 2017, the 10 stocks that were the largest contributors to the S&P 500 accounted for more than one-third of the benchmark's total return: Apple Inc, Microsoft Corp., Bank Of America Corp., JPMorgan Chase & Co., Amazon.Com Inc., Facebook Inc-A, Citigroup Inc., Wells Fargo & Co., Alphabet Inc-Cl A, Alphabet Inc-Cl C.

Only Apple is included in our Core Rising Dividend portfolio. The other nine are not included in either of our Dearborn Rising Dividend portfolios. The four banks slashed their dividends in the financial crisis. One of our disciplines is to disqualify for inclusion in our portfolios any company that cut or omitted its dividend in that crisis. Amazon, Facebook, and Alphabet pay no dividends. Microsoft, another mega-cap stock, is not in our portfolios. Our SMA portfolios had positive returns over the past year, but the results lagged the benchmark largely as a result of the absence of most of these stocks.

How Did We Do?

Here are the performance results of our two Dearborn Partners SMAs and the S&P 500 Composite Index ("S&P 500," the benchmark against which we compare our portfolios) for the year ended March 31, 2017.

First Quarter 2017 Total Returns (%) as of March 31, 2017[3]

	Gross	Net
Core Rising Dividend SMA	3.0	2.6
High and Rising Dividend SMA	2.7	2.3
S&P 500[4]	6.1	

Total Returns Annualized (%) as of March 31, 2017

	1- year		3- year		5- year		Since Inception (9/30/11)	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
Core Rising Dividend SMA	9.5	7.8	9.5	7.8	11.8	10.0	14.0	12.1
High & Rising Dividend SMA	10.3	8.7	10.6	8.9	12.2	10.6	14.3	12.7
S&P 500	17.2		10.4		13.3		16.8	

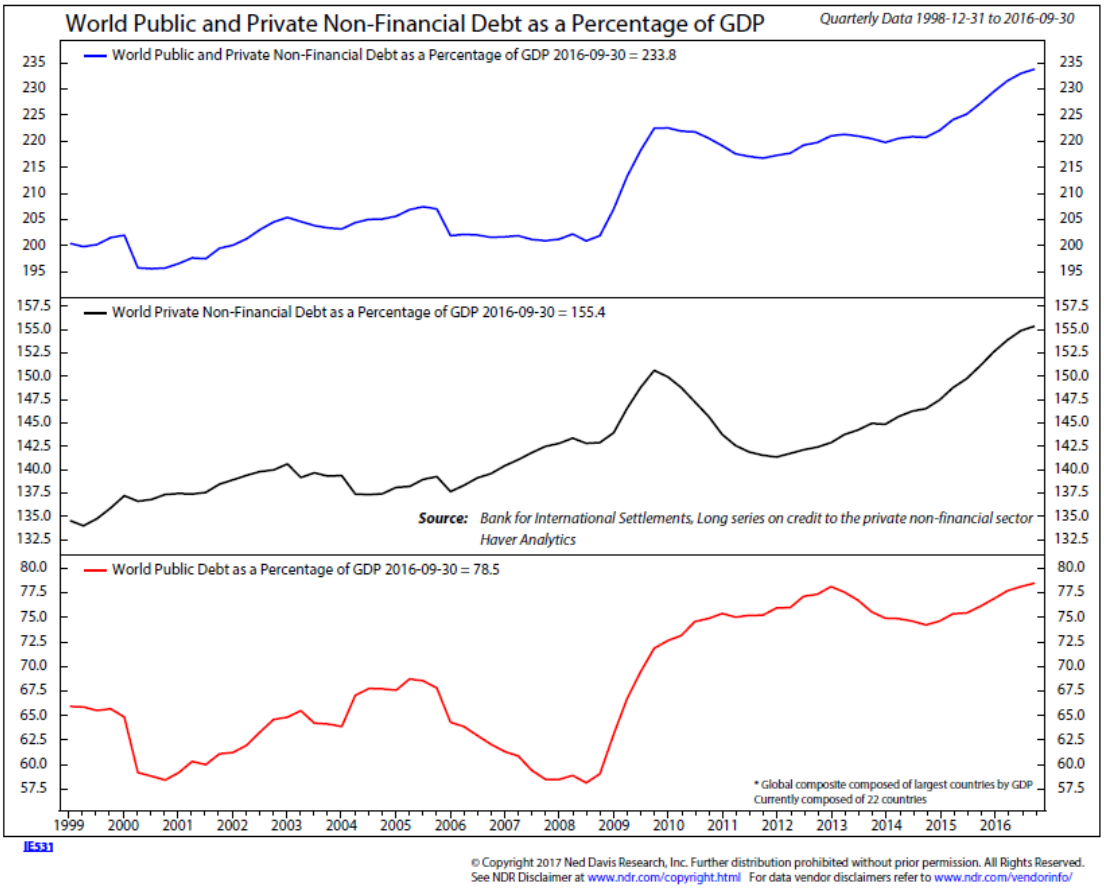
A Premise for our Strategy

Ned Davis Research's March 17, 2017 *Global Debt Update* provided the following:

> "Debt represents consumption today; it is generally at the expense of future consumption. Thus, excessive debt is a burden on growth, and I believe it is the actual cause of slow growth. It is apparent that most policy makers believe the solution to too much debt is to increase debt.

[3] Returns are presented on a pure gross and net basis and include the reinvestment of all income. Pure gross returns do not reflect the deduction of any expenses, including trading costs, and are supplemental to net returns. Net of fee performance was calculated using actual fees, which include wrap fees, management fees and trading commissions. The Dearborn management fee schedule is 1.00% on the first $1 million and 0.75% on amounts over $1 million, but actual fees may vary.

[4] The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered to be representative of the U.S. stock market. Inclusion of this index is for illustrative purposes only. Historical performance results for investment indexes generally do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment management fee, the incurrence of which would have the effect of decreasing historical performance results. Economic factors, market conditions, and investment strategies will affect the performance of any portfolio and there are no assurances that it will match or outperform any particular benchmark.



> In conclusion, it is a myth to argue that the 2008 debt bubble has been truly corrected. In many ways, on a global basis, it is much worse now. We believe global growth is on an upswing, thanks to record low interest rates, which has made the debt load manageable. However, should interest rates 'normalize,' I believe high levels of global debt would weigh on global growth prospects later on, as they nearly always do."[5]

Debt throughout the world is at record levels both in absolute terms and relative to GDP. Too much debt can create vulnerability when conditions turn difficult. An objective of our strategy is to reduce vulnerability. Among the ways that we attempt to achieve that objective are to include in our portfolios companies that are in strong financial condition with little or no debt, that we believe are capable of growing at rates above the historic average annual 3% rate of inflation regardless of the economic environment, and to diversify properly across and within the sectors. We further believe that rising dividends offer the potential to reduce vulnerability in challenging markets.

The broad market has not presented many challenges for nearly a year. It is our experience, however, that markets have not remained complacent and on an uptrend forever. When

[5] Davis, Ned. "Global Debt Update." *Ned David Research.* March 17, 2017. www.ndr.com

that trend ends, we believe that the solid companies in our portfolios are likely to not only survive but continue to pay dividends with the potential to increase with regularity. Successful investing typically requires patience. Every company in our portfolios pays us while we patiently hold.

Cumulative Income Summary

Here is the cumulative dividend income from an initial $200,000 investment on September 30, 2011 (the inception date of our SMA portfolios) through March 31, 2017 in each of:

	Current Yield	Cumulative Income*
Core Rising Dividend SMA	2.4%	$41,625
High & Rising Dividend SMA	3.1%	$54,194
S&P 500	2.0%	$37,787

**The S&P 500 dividend income in the table above is calculated by creating hypothetical investable "share units" by dividing the assumed initial $200,000 investment by the price of the index (1131.42) on September 30, 2011 (the inception date of our Rising Dividend SMA portfolios), resulting in 176.77 share units. The dividends per share unit of the index, provided by S&P Dow Jones Indices, are applied to the calculated units on a quarterly basis. The total represented in the table is the sum of those quarterly dividends per share unit, from December 31, 2011, through March 31, 2017.*

Dividend Increases

In the first quarter of 2017, 15 of the 49 companies in our Core Rising Dividend SMA portfolio announced 16 dividend increases averaging about 7.2% more than those particular companies paid a year before their latest dividend increase announcement date. One company in this portfolio has already announced two dividend increases so far this year.

In our High & Rising Dividend SMA portfolio, 10 of the 25 companies in the portfolio have announced 11 dividend increases averaging about 4.8% more than those particular companies paid a year before their latest dividend increase announcement date. One company in this portfolio has already announced two dividend increases so far this year.

Thank you for your interest in our Dearborn Partners Rising Dividend Strategy.

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Dearborn Partners Rising Dividend Separately Managed Account Portfolios
Average Calendar Year Dividend Increases

	Core Rising	High & Rising	CPI*
2012	13.0%	9.6%	1.9%
2013	12.2%	8.7%	1.7%
2014	12.2%	7.4%	1.6%
2015	9.7%	7.5%	2.1%
2016	8.0%	6.5%	2.1%
Q1 2017	7.2%	4.8%	2.2%
** Core Consumer Price Index for All Urban Consumers Unadjusted 12-month Percent Change. First quarter (Q1) 2017 CPI through February.*			

On the date that a company in our SMA portfolios announces a dividend increase, we calculate the percentage difference from the dividend the company paid a year earlier. We are excluding any special or accelerated dividends paid. We then calculate the average of all those year-over-year increases. However, if a company announces a dividend increase more than once a year, we use the average of that company's multiple increases to be considered in the year-over-year comparison.

Past performance is no guarantee of future results. Dividends are not guaranteed and must be authorized by the company's board of directors.

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