DEARBORN

PARTNERS

**First Quarter 2019 Commentary** **Carol M. Lippman, CFA**

## How Did We Do?

After declining 13.5% in the fourth quarter of 2018, the S&P 500 roared back 13.7% in the first quarter of 2019, the benchmark's best quarterly results since September 2009. As is typical of less volatile portfolios—our Core Rising Dividend portfolio's beta is 0.83 and our High & Rising Dividend portfolio's beta is 0.71—our portfolios performed well in the first quarter but did not outpace the benchmark, for which the beta is 1.0. (A lower beta means less volatility.) Because our portfolios declined significantly less than the benchmark in 2018, our results for the one-year ended March 31, 2019 outpaced the benchmark's returns by a wide margin.

Here are the performance results of our two Dearborn Partners separately managed account portfolios (SMAs) and the S&P 500 Composite Index ("S&P 500," the benchmark against which we compare our portfolios) for the first quarter followed by longer periods as of March 31, 2019.

**First Quarter 2019 Total Returns (%) as of March 31, 2019**[1]

| | Gross | Net |
|---|---|---|
| Core Rising Dividend SMA | 13.4 | 12.9 |
| High and Rising Dividend SMA | 12.8 | 12.4 |
| S&P 500[2] | 13.7 | |

**Total Returns Annualized (%) as of March 31, 2019**

| | 1- year | | 3- year | | 5- year | | Since Inception (9/30/11) | |
|---|---|---|---|---|---|---|---|---|
| | Gross | Net | Gross | Net | Gross | Net | Gross | Net |
| Core Rising Dividend SMA | 15.6 | 13.8 | 11.8 | 10.1 | 10.9 | 9.2 | 13.7 | 11.9 |
| High & Rising Dividend SMA | 17.9 | 16.1 | 11.6 | 9.9 | 11.2 | 9.6 | 13.7 | 12.1 |
| S&P 500 | 9.5 | | 13.5 | | 10.9 | | 15.4 | |

[1] 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 will vary.

[2] 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.

**Interest Rates**

The March 19, 2019 **Ned Davis Research Group's *U.S. Comment*** titled "**How Powell's Dovish Pivot Impacts Dividend Stocks"** includes information persuasive to owning stocks of companies that pay dividends, especially growing dividends, given the Federal Reserve's stance revealed at the Federal Open Market Committee meeting that week.

> "… the big picture from Chairman Powell's communications so far this year is that he has gotten the message that the markets cannot handle a Fed that is too hawkish. That includes ending quantitative tightening earlier and keeping the balance sheet larger than expected previously. The results are lower bond yields and a flatter yield curve than if the Fed shrank the balance sheet further.
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> The changes could have profound implications for dividend stocks, since they have acted as bond proxies throughout the era of ultralow interest rates. The implications vary, depending on the type of dividend stock and what they are compared to. We broke the analysis into three categories:
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> **Versus bonds**. Lower interest rates mean that **dividend stocks should remain an attractive alternative to bonds.** Income-seeking investors will continue to need dividend stocks to be part of their portfolios. Bond yields should not be high enough to meet most income requirements, unless bond investors reach for riskier fixed income securities, in which case blue-chip stocks may fit their risk profiles better. … Currently 32% of S&P 500 stocks have dividend yields greater than the 10-year Treasury yield (which ended the first quarter of 2019 at 2.4%) versus 22% in September and the long-term average of 15%.
>
> **Versus other stocks.** The implications for dividend stocks versus the broad market is mixed. A friendly Fed is bullish for the broad stock market, so Dividend Payers' lower betas could work against them relative to Non-Payers.
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> The combination of underperformance and earnings growth has left **Dividend Payers cheap relative to Non-Payers.** Payers are trading at **the steepest discount in 15 years** relative to Non-Payers. Neither are cheap on an absolute basis, but the overvaluation of dividend stocks relative to the rest of the market during the Fed's zero interest rate and quantitative easing policies has been worked off.
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> **Within the dividend universe.** Most factors favor **Dividend Growth over Dividend Yield.** A falling 10-year Treasury yield has favored the Fastest Growers over the Highest Yielders. Similarly, a negative Citigroup Economic Surprise Index, which means economic data has been weaker than expected, has favored Growers over Yielders. The rationale is that a sluggish economic environment puts a premium on companies that can grow their dividends."

Both of our Dearborn Partner Rising Dividend SMA portfolios have average current yields competitive with the end-of-quarter 2.4% yield of the U.S. 10-year Treasury bond. The average current yields on March 31, 2019 of our Core Rising Dividend and our High & Rising Dividend SMAs were 2.4% and 3.2%, respectively. Twenty-five, or 51%, of the 49 stocks in our Core Rising Dividend SMA portfolio had current yields greater than 2.4%. Eighteen, or 72%, of the 25 stocks in our High & Rising Dividend portfolio had current yields greater than 2.4%. Furthermore, we believe that the companies in our portfolios offer the potential to increase their dividends with regularity.

## Dividend Increases

Core Rising Dividend SMA portfolio:

In the first quarter of 2019, 16 of the 49 companies in our Core Rising Dividend SMA portfolio announced 17 dividend increases averaging about 12.2% more than those companies paid a year before their latest dividend increase announcement date.

High & Rising Dividend SMA portfolio:

In the first quarter of 2019, 8 of the 25 companies in our High & Rising Dividend SMA portfolio announced 9 dividend increases averaging about 7.2% more than those companies paid a year before their latest dividend increase announcement date.

## Cumulative Income Summary

Here is the cumulative gross (before fees) dividend income from an initial $200,000 investment on September 30, 2011 (the inception date of our SMA portfolios) through March 31, 2019 in each of:

| | Average Current Yield | Cumulative Income* |
|---|---|---|
| Core Rising Dividend SMA | 2.4% | $62,468.47 |
| High & Rising Dividend SMA | 3.2% | $80,370.47 |
| S&P 500 | 2.0% | $56,336.83 |

*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, 2019.

**Losing Less in Bad Markets Can Help**

Losing less money in challenging markets can help lead to portfolio outperformance. In past Commentaries we have reviewed that our generally conservative, defensive strategy tends to hold up better than the benchmark on what we call “big down days” when the S&P 500 declined 1% or more. In the first quarter of 2019, the broad market declined 1% or more three times. Both Dearborn Partners SMA portfolios declined less than 1% on each of those three days. Since inception through March 31, 2019, the S&P 500 declined 1% or more on 165 days, or 8.7% of the 1,888 trading days during this period. Here is an update.

Big down days from inception (September 30, 2011) through March 31, 2019:

| | | |
|---|---|---|
| Total Days | 1,888 | |
| Total “Big Down Days” (down more than -1%) | 165 | |
| Total days that the Core Rising Dividend SMA (“CRD”) outperformed the S&P 500 on “Big Down Days” | 150 | 90.9% |
| Total days that the High & Rising Dividend SMA “(HRD”) outperformed the S&P 500 on “Big Down Days” | 146 | 88.5% |

**A Premise for our Strategy**

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 increasing dividends 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.

A few largely non-dividend-paying stocks that have led the market for an incredibly long time have finally proven not to be invincible after all. Although past performance cannot assure future results, we believe that the solid companies in our portfolios are likely to not only survive long term 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.

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

Research assistance provided by Jackson Finks, CFA and Matthew Guttosch, CFA

**Dearborn Partners Rising Dividend Separately Managed Account**
**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% |
| 2017 | 7.8% | 5.8% | 1.7% |
| 2018 | 13.3% | 9.5% | 2.2% |
| YTD 2019 | 12.2% | 7.2% | 2.1% |
| *Core Consumer Price Index for All Urban Consumers Unadjusted 12-month Percent Change. Year to Date (YTD) 2019 CPI through February. | | | |

Source: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items Less Food and Energy [CPILFENS], https://www.bls.gov/cpi/ March 12, 2019.

## Disclaimer:

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. Dividend yield is one component of performance and should not be the only consideration for investment.