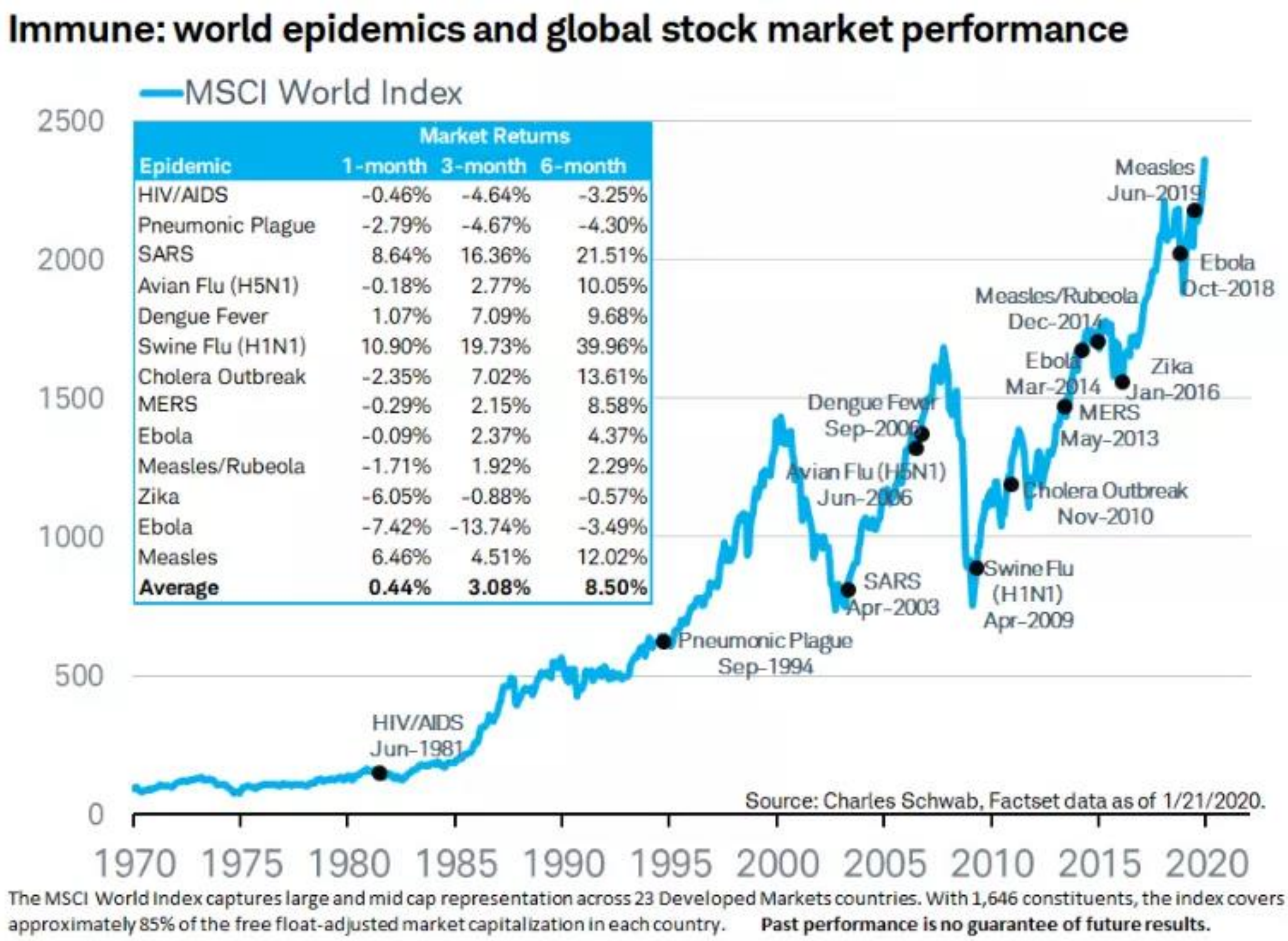
Second Quarter 2020 Commentary **Carol M. Lippman, CFA**

First, we hope that everyone who is reading this Commentary and their loved ones are virus free and continuing to do well. Viruses have created epidemics and crises throughout the world for decades. Yet, the wonders of modern medicine have prevailed over time. Global stock markets, as measured by the MSCI World Index shown in Figure 1 below, have dealt with the epidemics along with other market and economic challenges, and despite temporary setbacks, eventually resumed their historic, long-term upward trend. We are hopeful that medical, scientific, and technological geniuses ultimately will tackle this latest novel coronavirus, Covid-19. In the meantime, let's all remain prudent and safe so that together we can get through this and come out stronger on the other side.

Figure 1: Epidemics and Markets[1]



[1] Lucas Downey, "Epidemics and Stocks – A Look Under the Hood," Investopedia, March 16, 2020, https://www.investopedia.com/epidemics-and-stocks-a-look-under-the-hood-4799823

The Current Environment

The chart in Figure 2 below shows the S&P 500 Index's forward 12-month price-to-earnings multiples for the past 20 years. Valuations have already surpassed levels reached earlier this year just before the novel coronavirus emerged, and current levels have not been seen since the peak of the dot.com stock market bubble at the turn of this century.

Figure 2: 20 Years of S&P 500 Forward P/E Multiples

Source: FactSet

Yet, there is evidence that many investors are missing out, not benefiting from these strong stock market returns. An article in the June 17, 2020 Investment News newsletter reported record inflows to bond funds and sizable outflows from equity funds.

> A record $74 billion worth of net flows into taxable bond funds in May was the driving force behind the second straight month of positive flows into mutual funds and exchange-traded funds. The biggest losers in May were domestic equity funds, which suffered net outflows of $29.6 billion, and international equity, with $27.5 billion in net outflows.[2]

We would point out that these massive inflows to bond funds have occurred when the benchmark long-term U.S. 10-year Treasury bond yield has been at or below 0.7%. With yields this low, such bond fund investors certainly are not getting much income. And because of the inverse relation between yield and value, the only way bonds generate any capital appreciation is if yields decline further. Bond fund investors at these levels may be overlooking the risks to principal values if interest rates rise.

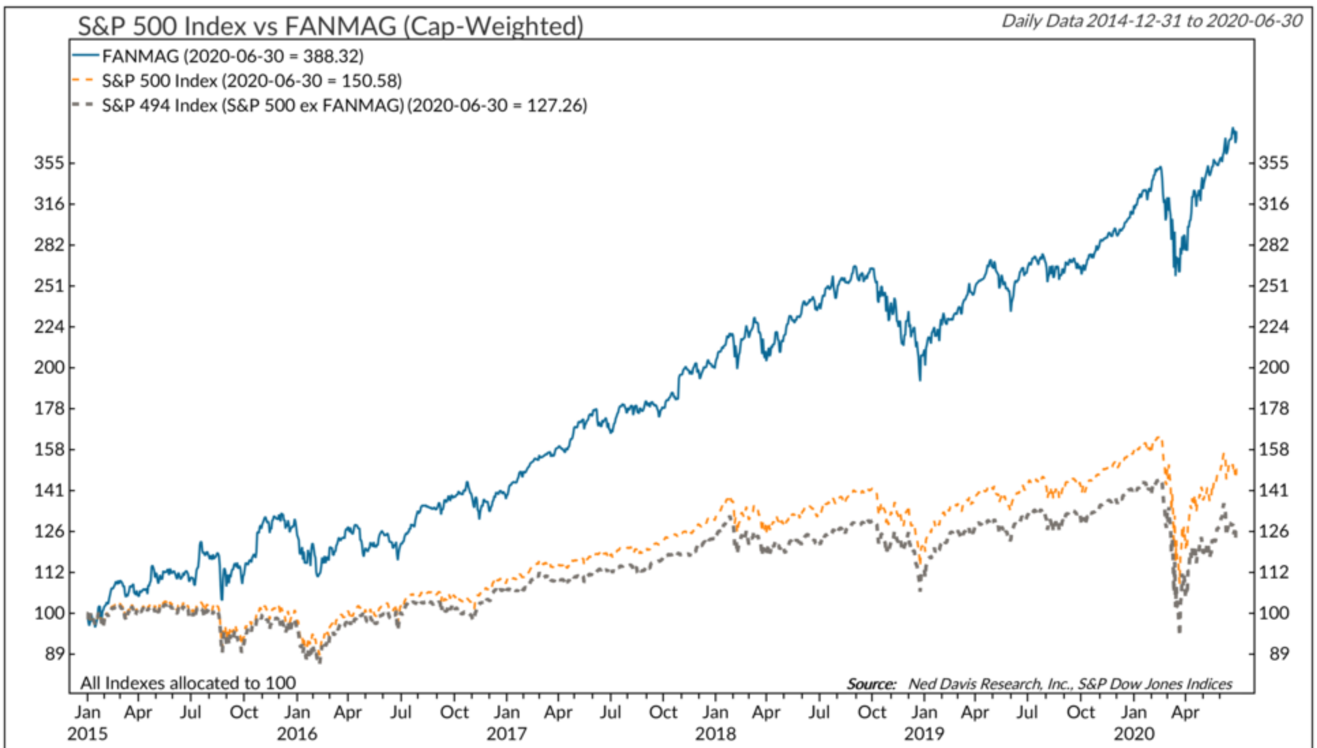
According to FactSet, 71% of companies in the S&P 500 had current yields greater than the 0.66% yield on the 10-Year U.S. Treasury bond as of June 30, 2020. It would certainly seem logical that investors who need or like income would flood

[2] Jeff Benjamin, "Bond Funds See Record $74B in Net Flows in May," InvestmentNews, June 17, 2020, https://www.investmentnews.com/bond-funds-see-record-74b-net-flows-may-194126?NLID=IN-Daily-Pulse.

the equity market rather than the bond market. Why haven't they? My guess is that fear of a return to the extreme volatility equity markets demonstrated in March may be a big factor.

Furthermore, Figure 3 from Ned Davis Research shows that six growth stocks—only one of which is in Dearborn Partners Rising Dividend portfolios, and four of which pay no dividends and therefore do not meet the stringent criteria to qualify for our portfolios—that have surged in value this year have had an outsized influence on the S&P 500. Year to date through the end of the second quarter of year 2020, the S&P 500 Index's total return was -4.04%. The return during the same period of the 494 stocks not including Facebook, Amazon, Netflix, Microsoft, Apple, and Google's parent company Alphabet was -10.08%. The capitalization-weighted total return of those six stocks during the first half of this year was 25.99%. Portfolios that do not own all six of these largest stocks may have difficulty comparing favorably with the S&P 500 benchmark's performance since year 2015. On the other hand, these six stocks are largely responsible for the P/E multiples shown in Figure 2 above, levels for which have not been seen for two decades since the dot.com era before the stock market bubble burst.

Figure 3 S&P 500 Index vs. FANMAG (Cap-Weighted)



Ticker	Name
FB	Facebook
AMZN	Amazon.com
NFLX	Netflix
MSFT	Microsoft
AAPL	Apple
GOOGL	Alphabet

Index (Cap-Weighted)	Gain/Annum % 2014-12-31 to 2020-06-30	YTD % 2019-12-31 to 2020-06-30
FANMAG	27.97	25.99
S&P 500 Index	7.72	-4.04
S&P 494 Index (S&P 500 ex FANMAG)	4.48	-10.08

DAVIS230B

NDR

Dearborn Partners' Rising Dividend Philosophy

This shut-down environment reinforces the wisdom, in our opinion, of having always emphasized owning defensive businesses for this strategy—businesses that provide products and services that people patronize in tough times as well as good times. This time, however, we are going even further and asking: does this company provide products and/or services that are a need or a want? Many 'wants' are or have been shut down with this pandemic.

The lens through which we view every company in our portfolios and those that may be candidates for our portfolios is: do they possess the ability to not only pay a dividend but increase the dividend consistently over time. Our view is: **A dividend is tangible evidence of a company's health; a rising dividend telegraphs a company's strength.**

Cumulative Income Summary

Here is the cumulative gross (before fees) dividend income generated by the companies in both of our Dearborn Partners Rising Dividend Separately Managed Account (SMA) Portfolios from an initial $200,000 investment on September 30, 2011 (the inception date of our SMA portfolios) through June 30, 2020 in each of:

	Average Current Yield	Cumulative Income*
Core Rising Dividend SMA	2.2%	$77,385
High & Rising Dividend SMA	3.4%	$101,543
S&P 500	1.8%	$69,404

**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 June 30, 2020.*

The table above shows that the average yield of both of our Rising Dividend SMA portfolios at the end of the second quarter of year 2020 exceeded the average yield of the S&P 500. As a result of their above average yields, lower volatility, and generally conservative features, our portfolios may appeal to some generally risk-averse investors who are in search of yields greater than those offered by both long-term bonds and the broad market.

<u>Dividend Increases: S&P 500 and Dearborn Partners SMA Portfolio Companies</u>

What follows is a description of the dividend activity summarized in Figure 4 *Dividend Activity* below.

Standard & Poor's 500 Index

Fewer companies in the Standard & Poor's 500 Index have indicated that they are paying dividends this year (through June 30, 2020), 75%, down from 84% in year 2019. So far this year, 62 companies in the S&P 500, or 12%, have cut or suspended dividends versus 7, or 1%, in all of year 2019.

Core Rising Dividend SMA portfolio

All 49 companies in our Dearborn Partners Core Rising Dividend separate account portfolio are indicated to pay dividends. In 2019 all but one company in our Core portfolio increased its dividend. One company kept its dividend flat in 2019, but that company (Qualcomm) announced a dividend increase in early March of this year. The average of the 60 dividend increases announced by 48 companies in our Core portfolio in 2019 was 9.6% more than those companies paid a year earlier. So far this year, 22 of the 49 companies have announced 25 dividend increases averaging about 7.9% more than those companies paid a year earlier. One company announced three dividend increases and another company announced two dividend increases in the first half of this year.

We, on the Dearborn Partners Investment Team, have redoubled our efforts in scrutinizing the dividend security and growth potential of every company in these portfolios. We are active portfolio managers. Markets trade on the future, not the past. So, we attempt to be not only active but proactive. In the second quarter of 2020, we proactively removed from our Core

Rising Dividend portfolio a company whose dividend security appeared questionable in an environment of strictly constrained activity in which only essential businesses remained open. After removing it from our portfolio, the company suspended its dividend. As a result, so far this year, no companies in our Core Rising Dividend portfolio have cut or suspended dividends.

High & Rising Dividend SMA portfolio:

In our High & Rising Dividend SMA portfolio, three of the 25 companies in the portfolio announced three dividend increases in the second quarter. The average of these increases is about 3.3% more than those particular companies paid a year earlier. In the first half of year 2020, 13 of the 25 companies in the portfolio announced 15 dividend increases averaging about 6.4% more than those companies paid a year earlier. One company has announced three dividend increases in the first half of this year.

Having redoubled our efforts in scrutinizing the dividend security and growth potential of every company in these portfolios, this year, we proactively removed from our High & Rising Dividend portfolio a company whose dividend security appeared questionable in an environment of strictly constrained activity in which only essential businesses remained open and travel was largely curtailed. After removing it from our portfolio, the company suspended its dividend. As a result, so far this year, no companies in our High & Rising Dividend portfolio have cut or suspended dividends.

Figure 4: Dividend Activity

	S&P 500		Core Rising Dividend		High & Rising Dividend	
	12/31/2019	YTD through 6/30/2020	12/31/2019	YTD through 6/30/2020	12/31/2019	YTD through 6/30/2020
Issues with Indicated Dividend	423	380	49	49	25	25
Percent of Issues	84%	75%	100%	100%	100%	100%
Average Yield	1.8%	1.8%	2.2%	2.3%	2.8%	3.5%
Increases	355	164	48	22	22	13
Favorable Actions	65%	32%	98%	45%	88%	52%
Suspensions	0	41	0	0	0	0
Decreases	7	21	0	0	0	0
Unfavorable Actions	1%	12%	0%	0%	0%	0%

YTD: Year to Date

Source: S&P Dow Jones Indices A Division of S&P Global https://us.spindices.com/indices/equity/sp-500#overview

We are truly grateful that you are taking this journey with us and hope that you will patiently stay with us for many years to come. That we concentrate so intently on including in our portfolios companies that offer the potential to continuously pay and increase dividends we hope will enable you to get invested and stay invested in our equity portfolios throughout the volatility and in any environment. We promise to continue to work hard to try to bring you lots of rising dividends. We plan to continue to keep the lines of communication open with you. We firmly believe that together we will get through this crisis and uncertainty and come out stronger on the other side.

The Dearborn Partners Investment Team,
Carol, Mike, Pete, Matt, and Jack

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

Dearborn Partners Rising Dividend Separately Managed Account
Average Calendar Dividend Increases

	Core Rising	High & Rising	CPI*
YTD 2020	7.90%	6.40%	1.20%
2019	9.60%	8.20%	2.30%
2018	13.30%	9.50%	2.20%
2017	7.80%	5.80%	1.70%
2016	8.00%	6.50%	2.10%
2015	9.70%	7.50%	2.10%
2014	12.20%	7.40%	1.60%
2013	12.20%	8.70%	1.70%
2012	13.00%	9.60%	1.90%

** Core Consumer Price Index for All Urban Consumers Unadjusted 12-month Percent Change. Year to Date (YTD) 2020 CPI through May. Updated June 10, 2020.*

Source: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items Less Food and Energy [CPILFENS], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/CPILFENS June 10, 2020.

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.

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