DEARBORN PARTNERS

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

First, we hope that you and all those dear to you are virus free and doing well. The 1918 flu pandemic ran its course in somewhat more than two years, without vaccines, albeit with catastrophic numbers of casualties. The Roaring Twenties followed. Now we are reading about progress across several types of vaccines for this century's pandemic, COVID-19. Washington University here in St. Louis, for example, is making strides with a single-dose nasal inhalant delivery that purportedly produces a more widespread immune response than intramuscular injections.[1] There are reasons for optimism. In the meantime, let's all remain prudent, patient and safe until we can resume some sense of normalcy.

There Is No Alternative

On August 27, 2020 in a speech from Jackson Hole, Wyoming, Federal Reserve Chairman Jerome Powell said the central bank will keep interest rates near zero to help prop up the pandemic-ravaged economy even if inflation rises above its target level of 2% for periods of time. The Federal Reserve approved a major shift in how it sets interest rates by dropping its longstanding practice of pre-emptively lifting them to head off higher inflation, a move likely to leave U.S. borrowing costs very low for a long time. Low borrowing costs appeal to debtors, but not to bond investors and certainly not to savers. With the Fed Funds rate at 0-0.25% and the 10-year U.S. Treasury bond yielding 0.68% at the end of year 2020's third quarter, many seeking higher returns turned to the stock market.

Ned Davis Research reported on *September 1*, 2020 that the S&P 500 record high on August 18, 2020 (September 2 was the ultimate high) was the quickest reversal from a 30% or greater decline on record.[2] From June 30 to September 2, 2020, the S&P 500 was up on 71% of the trading days., i.e., virtually a one-way-up stock market.

Brokerage Firms Must Rue the Day That They Eliminated Commissions

At dinner together in mid-August, my 26-year old niece said she thinks that she and her peers are keeping the stock market elevated. When I asked her why she felt that way, she explained: Because they are working from home, when they take a break, there is no breakroom at which they can gather and chat for a few minutes over a cup of coffee or soft drink. Instead, via social media and e-mail, they are sharing hot stock ideas—she admits that they do no fundamental research or analysis—and using no-commission trading platforms to trade stocks and options, even for small amounts of money. I contend that if trading were not free and there were costs to doing business, such trading would not have been so abundant. Things have been different this time...until there is a scare.

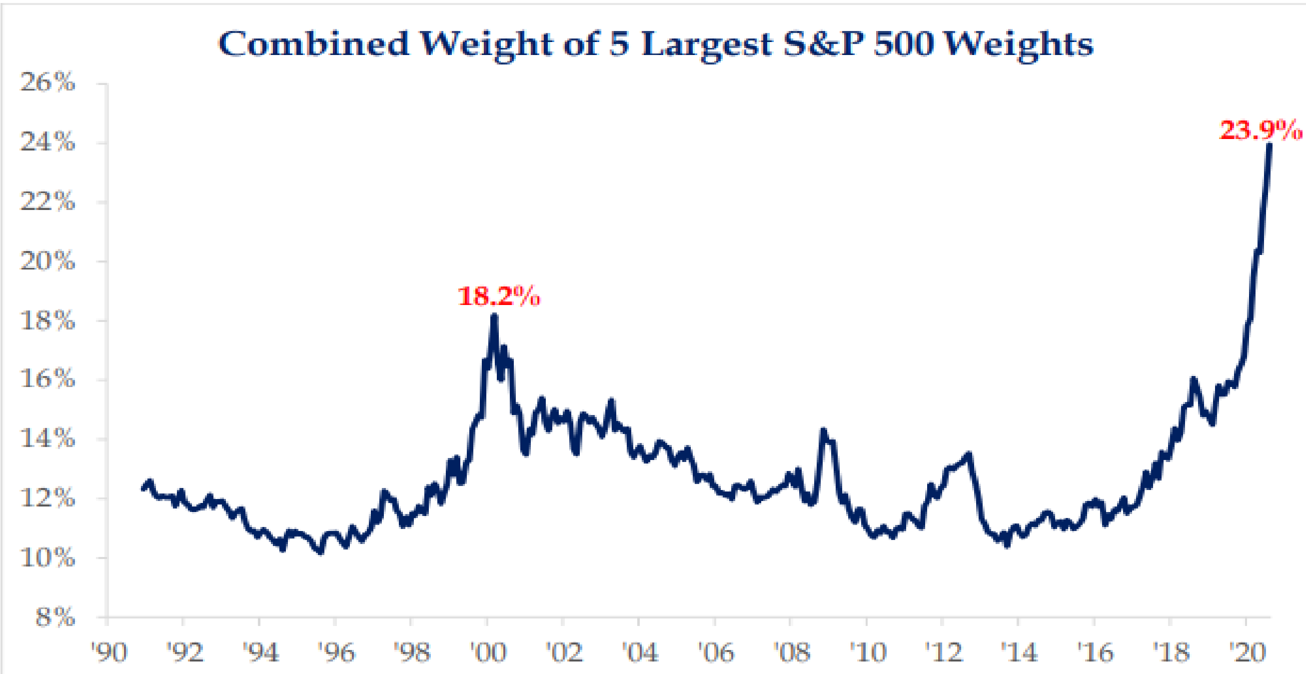
Year to date through September 30, 2020, the S&P 500's total return is +5.6%. This performance number for the index is misleading, however, because it masks the broader market return. On an absolute basis year to date, only 36% of the stocks in the S&P 500 exceeded the index's overall return; 64% underperformed. By another measure, 55% of the stocks in the S&P 500 had a negative return for the first three quarters of 2020. The Invesco S&P 500 Equal Weight ETF's (exchange traded fund, ticker RSP) total return for the first three quarters of year 2020 was -5.15%. Year to date, the average stock in the S&P 500 is down more than 3%. Over the 12 months ended September 30, 2020, RSP was up about 2% versus the market-cap weighted S&P 500, which was up about 15%, and the tech-heavy Nasdaq Composite, was up about 40%. Over

[1] Strait, Julia E. "Nasal Vaccine against COVID-19 Prevents Infection in Mice." Washington University School of Medicine in St. Louis, August 24, 2020. https://medicine.wustl.edu/news/nasal-vaccine-against-covid-19-prevents-infection-in-mice/.
[2] *Monthly Digest— August Research Summary*. Ned Davis Research, August 27, 2020.

the past three years ended September 30, 2020, RSP's total return was about +19% versus +42% for the S&P 500 and +72% for the Nasdaq Composite.

Strategas Research shows in Figure 1, Market Remains Top Heavy, that the five largest companies account for nearly one-quarter of the market capitalization of the entire market cap-weighted S&P 500 index. Three of the five largest companies pay no dividends and therefore do not qualify for Dearborn Partners Rising Dividend portfolios.

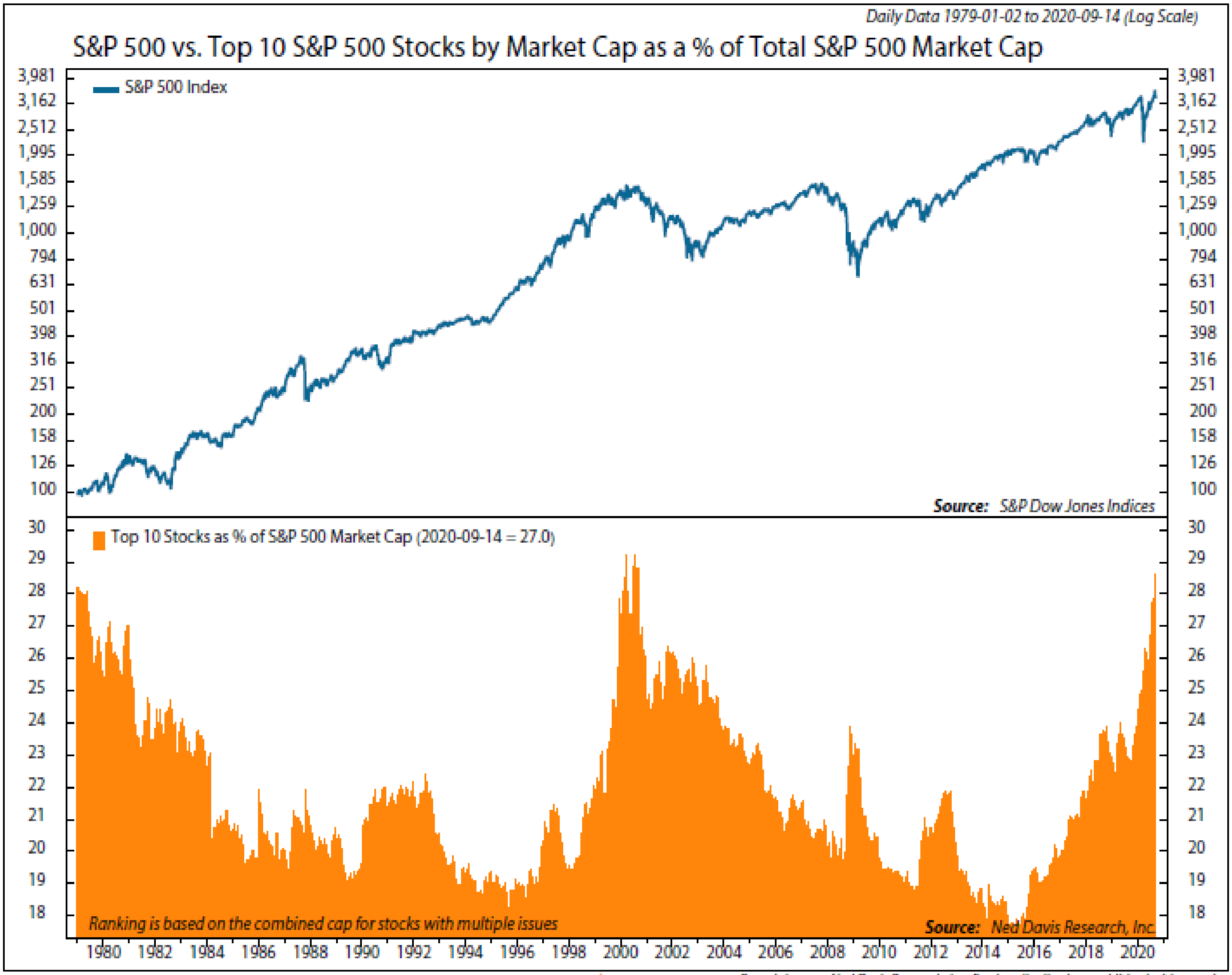
Figure 1: Market Remains Top Heavy



Source: Strategas Research

On the following page, Figure 2, Near-Record Concentration in Top 10 Stocks in S&P 500, from Ned Davis Research, going back to year 1979, shows the 40+-year return of the S&P 500 index with the blue line at the top. The orange bars at the bottom show the 10 largest stocks as a percentage of the S&P 500's market capitalization. The orange bars show the current concentration of the top 10 stocks near a record high. The two previous times in this illustration that the top 10 stocks' concentration (the orange bars) was as high as it is now were in 1979-1980 and 1999-2000. A reader of Figure 2 cannot help but notice that the magnitude of the orange bars fell off dramatically after those two previous peaks. Did the concentration of the top 10 stocks drop off because their market values declined, or because the rest of the market broadened out, or a combination of both? The answer will be clear to readers who remember (or who have studied) the 1979-1980 oil embargo/high inflation era—which led to six of the top 10 stocks being in the Energy sector, including Exxon (XOM) and Mobil Corp. (MOB)—and that in 1999-2000 WorldCom and General Electric were among the largest companies. Caveat emptor to those chasing hot stocks without owning well-diversified portfolios.

Figure 2: Near-Record Concentration in Top 10 Stocks in S&P 500



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When You're Hot You're Hot; When You're Not You're Not

The leading stock in the S&P 500 carries more than twice as much weight now as it did a decade ago. Today, Apple accounts for 6.7% of the index. In 2010 Exxon Mobil Corp. had the largest market capitalization with about 3.2%. On Monday August 24, 2020, Exxon Mobil was kicked out of the Dow Jones Industrial Average (DJIA). The Energy sector now accounts for 2% of the benchmark S&P 500 Index, down from 16% as recently as 12 years ago.

One of the stocks that replaced Exxon Mobil in the DJIA was salesforce.com Inc. (ticker CRM). Salesforce.com was already included in the S&P 500 index. The day after being added to the DJIA, on August 25, 2020 after the market closed, salesforce.com reported record sales. The next trading day, August 26, the CRM shares closed up 26%! Up 26% made CRM the biggest gainer in the S&P 500 that day. Salesforce.com pays no dividend, therefore shares do not qualify for portfolios that require each company included to pay a dividend. If the benchmark against which such dividend-paying portfolios are measured is the S&P 500, it isn't a fair fight.

How to Invest Around Elections

As we write this Commentary for the third quarter ended September 30, 2020, the November 3, 2020 elections are imminent. For months, numerous strategists and analysts have been prognosticating and recounting historic market results based on political outcomes. We make no predictions. Nonetheless, some have asked us how to proceed in the upcoming environment. Should investors reduce equity exposure and go to cash? Here is our response.

The Dearborn Partners Rising Dividend investment team works very hard to try to find companies that we consider capable of increasing dividends at rates that help investors keep ahead of the rising costs of living throughout any kind of environment—economic, interest rate, political, social, taxation, unprecedented pandemics, severe weather, etc. Some of the eleven sectors into which Standard & Poor’s divides the marketplace are more economically sensitive than others. From every sector, however, we look for what we consider to be the most defensive—i.e., consumers patronize their products or services in tough economic times as well as good times—and now the most essential businesses with strong balance sheets, high barriers to entry, and solid management. We insist that every company pays dividends. In fact, we insist that the dividends represent a prudent percentage of earnings and cash flow so that the companies can reinvest most of the cash generated for future growth of revenues, cash flow, earnings, and dividends. Historically, stock prices move as the earnings of the underlying company move. If the earnings and dividends can march upward over time, so should the stock prices and provide attractive total returns over the long term.

As we know, companies don't grow overnight; growth takes years and investors must be patient. We think our strategy of paying investors while waiting, and consistently getting pay raises through dividend increases should, we hope, give investors the fortitude to stay invested throughout any environment. We realize that stocks, even our generally conservative, high quality portfolios, are riskier than securities with the full faith and credit backing of the U.S. Government. But, with the U.S. 10-year Treasury bond yielding only 0.68%, our Core Rising Dividend portfolio offering an average current yield of 2%, and our High & Rising Dividend portfolio offering an average yield of 3.2%, we believe our portfolios can provide more income to those who need or like to receive income from their investments. As a reminder, it is necessary to own the stocks to receive the dividend income! If one reduces or eliminates equity exposure and goes to cash, it is not possible to receive the current or potentially increasing dividends. So, we believe that our strategy offers reasons to stay invested and patient.

Dearborn Partners’ Rising Dividend Philosophy

This pandemic-induced 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. Now 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 September 30, 2020:

	Average Current Yield	Cumulative Income*
Core Rising Dividend SMA	2.0%	$80,279
High & Rising Dividend SMA	3.2%	$105,572
S&P 500	1.7%	$71,873

**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 September 30, 2020.*

The table above shows that the average yield of both of our Rising Dividend SMA portfolios at the end of the third 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.

Dividend Increases: S&P 500 and Dearborn Partners SMA Portfolio Companies

What follows is a description of the dividend activity summarized in Figure 3 *Dividend Activity* on the next page.

Standard & Poor's 500 Index

Fewer companies in the Standard & Poor's 500 Index have indicated that they are paying dividends this year (through September 30, 2020), 76%, down from 84% in year 2019. So far this year, 67 companies in the S&P 500, or 13%, 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, 30 of the 49 companies have announced 35 dividend increases averaging about 7.6% more than those companies paid a year earlier. Two companies have announced three dividend increases in the first three quarters of this year. So far this year, no companies in our Core Rising Dividend portfolio have cut or suspended dividends.

High & Rising Dividend SMA portfolio:

All 25 companies in our Dearborn Partners High & Rising Dividend separate account portfolio are indicated to pay dividends. In the first three quarters of year 2020, 16 of the 25 companies in the portfolio announced 19 dividend increases averaging about 5.8% more than those companies paid a year earlier. One company has announced three dividend increases so far this year. No companies in our High & Rising Dividend portfolio have cut or suspended dividend so far this year.

Figure 3: Dividend Activity

	S&P 500		Core Rising Dividend		High & Rising Dividend	
	12/31/2019	YTD through 9/30/2020	12/31/2019	YTD through 9/30/2020	12/31/2019	YTD through 9/30/2020
Issues with Indicated Dividend	423	383	49	49	25	25
Percent of Issues	84%	76%	100%	100%	100%	100%
Average Yield	1.8%	1.7%	2.2%	2.0%	2.8%	3.2%
Increases	355	200	48	30	22	16
Favorable Actions	65%	40%	98%	61%	88%	64%
Suspensions	0	42	0	0	0	0
Decreases	7	25	0	0	0	0
Unfavorable Actions	1%	13%	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

Dearborn Partners Rising Dividend Separately Managed Account
Average Calendar Dividend Increases

	Core Rising	High & Rising	CPI*
YTD 2020	7.60%	5.80%	1.73%
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 August. Updated September 11, 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 September 11, 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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