DEARBORN PARTNERS

**<u>Year End 2020 Commentary</u>** **Carol M. Lippman, CFA**

We made it through year 2020. We hope that you and all those dear to you are virus free and staying safe. If so, good work! If not, we hope you are on the mend and will have no lingering effects. Now that a few vaccines have been approved, distribution and inoculation have begun, and more vaccines are in the works, there are reasons for optimism. In the meantime, let's all remain prudent and patient until we all can receive the vaccine.

**No Companies in Our Portfolios Cut or Suspended Dividends in 2020**

What follows is a description of the dividend activity summarized in Figure #1 Dividend Activity on the next page.

**Standard & Poor's 500 Index**

Fewer companies in the Standard & Poor's 500 Index paid dividends in year 2020, 384 or 76.8%, down from 84% in year 2019. The 287 dividend increases announced by companies in the S&P 500 is the fewest number of increases since the 243 increases announced in year 2010—coming out of the Great Financial Crisis—or the 151 increases announced in year 2009, the depths of the Great Financial Crisis. In all of year 2020, 69 companies in the S&P 500, or 14%, cut or suspended dividends versus 7, or 1%, in all of year 2019.[1,2,3]

**Core Rising Dividend SMA portfolio:**

All 49 companies in our Dearborn Partners Core Rising Dividend separate account portfolio paid dividends in years 2019 and 2020. 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 year 2020. 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. In all of year 2020, 45, or 92%, of the 49 companies in this portfolio announced 52 dividend increases averaging about 7.6% more than those companies paid a year earlier. One company announced five dividend increases, another company announced four dividend increases throughout year 2020. Two companies declared special cash dividends and one company declared a 5% stock dividend. Two companies paid four-for-one stock splits. One company paid a two-for-one stock split. Four companies kept their dividends flat throughout the year. No companies in our Core Rising Dividend portfolio cut or suspended dividends.

**High & Rising Dividend SMA portfolio:**

All 25 companies in our Dearborn Partners High & Rising Dividend separate account portfolio paid dividends in years 2019 and 2020. In all of year 2020, 22, or 88%, of the 25 companies in the portfolio announced 26 dividend increases averaging about 5.9% more than those companies paid a year earlier. One company announced five dividend increases throughout the year. One company declared a 5% stock dividend. One company paid a four-for-one stock split. One company paid a two-for-one stock split. Two companies kept their dividends flat throughout the year. One company raised its dividend early in the year before we added its shares to this portfolio. No companies in our High & Rising Dividend portfolio cut or suspended their dividend in all of year 2020. Considering that only a little more than half, 287 or 57%, of the companies in the S&P 500 raised their dividends and 14% cut or suspended their dividends, we believe that we have done a commendable job of finding for our separately managed account portfolios stocks of high quality, conservatively managed, financially solid companies.

[1] "S&P 500 Issue Indicated Dividend Rate Change" S&P Dow Jones Indices: S&P 500, data by Howard Silverblatt, https://www.spglobal.com/spdji/en/documents/additional-material/sp-500-indicated-rate-change.xlsx.
[2] Bloomberg
[3] Factset

| Figure #1: Dividend Activity | **S&P 500** | | **Core Rising Dividend** | | **High & Rising Dividend** | |
|---|---|---|---|---|---|---|
| | **YTD through** | | **YTD through** | | **YTD through** | |
| | **12/31/2019** | **12/31/2020** | **12/31/2019** | **12/31/2020** | **12/31/2019** | **12/31/2020** |
| Issues with Indicated Dividend | **423** | **384** | **49** | **49** | **25** | **25** |
| Percent of Issues | **84%** | **77%** | **100%** | **100%** | **100%** | **100%** |
| Average Yield | **1.8%** | **1.5%** | **2.2%** | **1.9%** | **2.8%** | **3.1%** |
| Increases | **355** | **287** | **48** | **45** | **22** | **22** |
| Favorable Actions | **65%** | **57%** | **98%** | **92%** | **88%** | **88%** |
| Suspensions | **0** | **42** | **0** | **0** | **0** | **0** |
| Decreases | **7** | **27** | **0** | **0** | **0** | **0** |
| Unfavorable Actions | **1%** | **14%** | **0%** | **0%** | **0%** | **0%** |

YTD: Year to Date

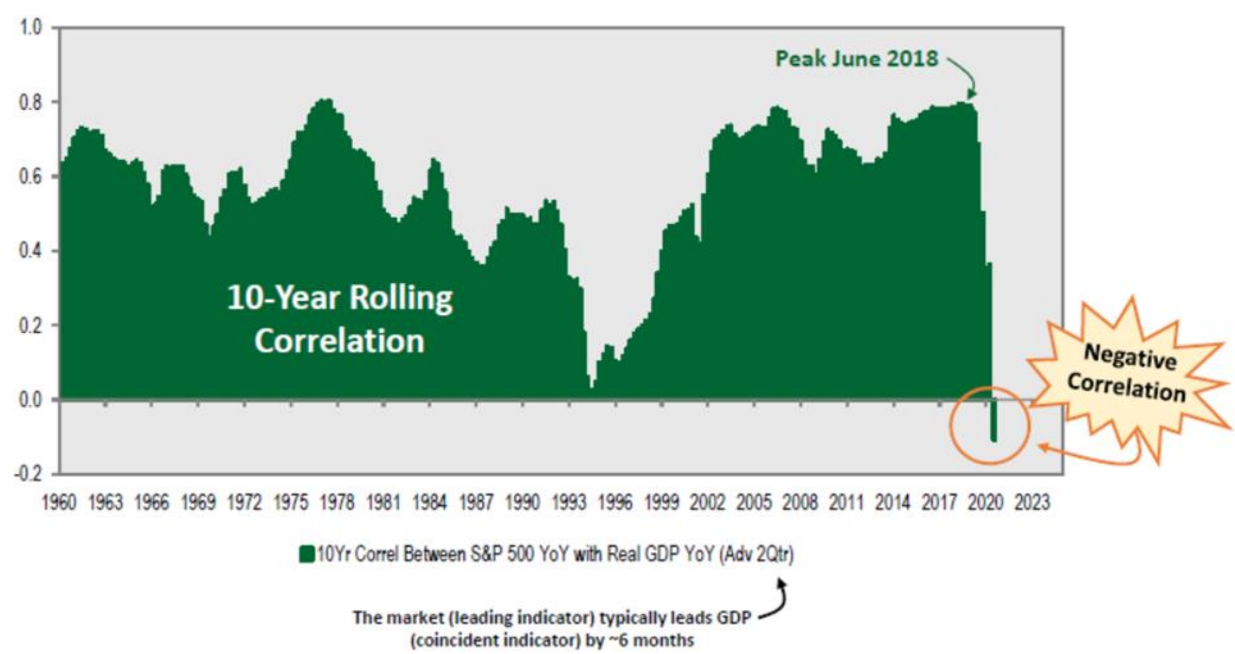
Source: S&P Dow Jones Indices A Division of S&P Global[4], Dearborn Partners

**The Great Disconnect**

Perhaps the most frequent comment I have heard from people is that with so many people sick and dying, so many restaurants and other businesses closed, so many people out of work, how can the stock market be doing so well?

Cornerstone Macro published a chart on December 21, 2020 in its report titled: A Unique Year for Markets. The chart in Figure #2 shows rolling 10-year correlations since 1960 between the stock market and real gross domestic profit (GDP). For the first time, the correlation in year 2020 is negative.

Figure #2: 10-Year Correlation of the Market & GDP



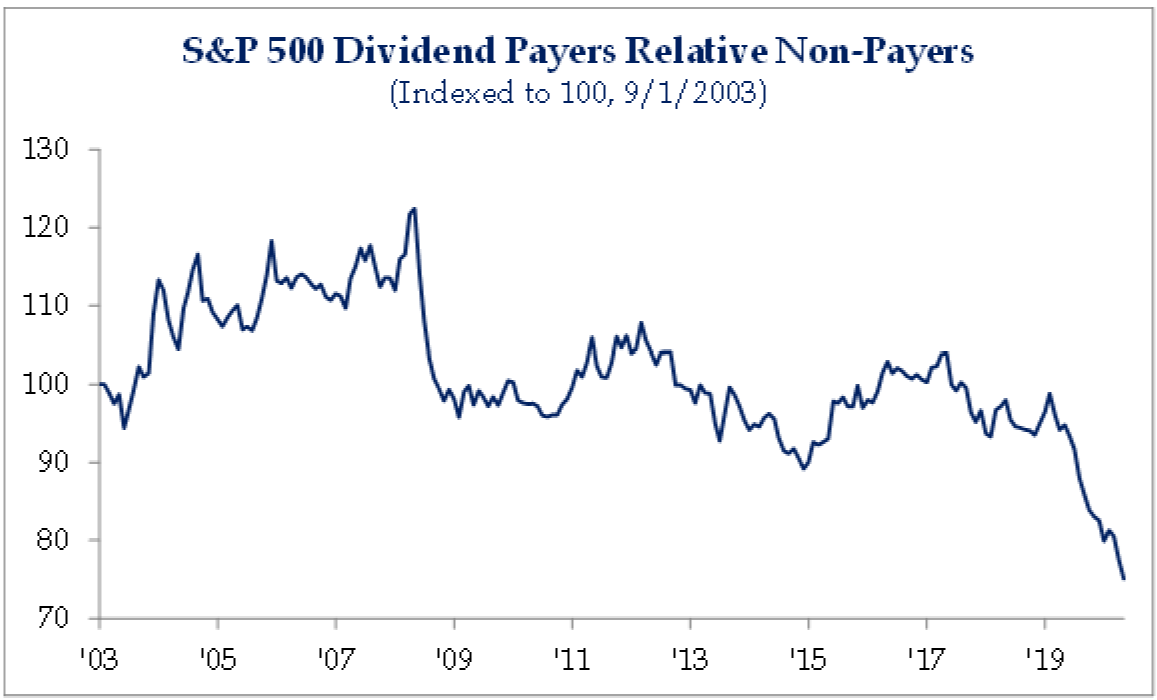

Source: Cornerstone Macro Research

[4] "S&P 500 Issue Indicated Dividend Rate Change" S&P Dow Jones Indices: S&P 500, data by Howard Silverblatt, https://www.spglobal.com/spdji/en/documents/additional-material/sp-500-indicated-rate-change.xlsx.

We certainly do not profess to know the answer to this question, but we think that no-cost trading, the extreme bifurcation of economic circumstances caused by COVID-19 shutting down some businesses and not others, and investors looking over the pandemic valley to the vaccine-induced recovery have contributed. For those fortunate enough to have excess savings to put to work, we think the stock market's action since March of this year reinforces the importance of being always invested in the stock market. Well diversified portfolios consisting of stocks of high quality, financially solid, well managed companies with consistent dividend growth potential tend to provide a palatable way to participate in the stock market even throughout times of great uncertainty and volatility. From March through September, when many businesses deemed nonessential declared bankruptcy, stocks of financially strong companies generally were prized.

There are times, however, that such generally conservative investments do not outperform. In this low interest rate environment in which the 10-year U.S. Treasury bond ended year 2020 with a yield of 0.92%, a screen of FactSet Research Data showed that 63% of stocks in the S&P 500 ended year 2020 with current yields greater than 0.92%. At the end of year 2020, 314 companies in the S&P 500 paid dividends with yields greater than that of the 10-year U.S. Treasury bond, representing 82% of the 384 companies indicated as paying dividends at the end of last year. Investors who need or like income might find such stocks to be appealing. In Figure #3, Strategas Research shows that from a performance standpoint, however, stocks of dividend paying companies have lagged those of non-dividend paying companies, especially in year 2020.

Figure #3: S&P 500 Dividend Payers Relative to Non-Dividend Payers




Source: Strategas Research

More than a few of the non-dividend paying companies in the S&P 500 have been labeled Zombies: poor quality businesses earning no profits and having extremely leveraged balance sheets with debt ratings well below investment grade. Yet, their stocks soared.

Beta is a measure of volatility whereby a beta of 1.0 represents volatility in line with the broad market as measured by the S&P 500. A beta greater than 1.0 represents a more volatile investment; a beta lower than 1.0 represents a less volatile investment. As a rule, stocks of high-quality companies tend to trade at betas of less than 1.0. Lower quality companies typically have riskier, more volatile stocks with betas greater than 1.0. Using Cornerstone Macro's Interactive Stock Screener, we ranked the companies in the S&P 500 into quintiles by beta, with the first quintile being stocks with the highest betas and stocks in the fifth quintile the lowest betas. Using FactSet Research, we obtained the price movement of each company in the fourth quarter of 2020, from September 30 to December 31, 2020. The performance of the highest beta, riskiest stocks averaged 28.4% in the quarter. The performance of the lowest beta stocks of generally higher quality companies averaged 11.0%. It isn't a fair fight for investors who like to sleep at night knowing that they own portfolios consisting of high-quality companies. We must remind ourselves that when we own stock, we own a piece of a company. Companies don't grow overnight; it takes time. Some low-quality companies don't grow at all and don't survive. Stocks of such companies may do well for a while but be careful about keeping money in them for too long.

**Dearborn Partners' Rising Dividend Philosophy**

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. As we know, companies don't grow overnight; growth takes years and investors must be patient. 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. 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.

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.**

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, such as the U.S. 10-year Treasury bond which ended year 2020 yielding only 0.92%. The Federal Reserve has promised to keep interest rates lower for longer. Here are excerpts from its latest statement, issued December 16, 2020:

"The Federal Reserve is committed to using its full range of tools to support the U.S. economy in this challenging time, thereby promoting its maximum employment and price stability goals. The COVID-19 pandemic is causing tremendous human and economic hardship across the United States and around the world. The path of the economy will depend significantly on the course of the virus. The ongoing public health crisis will continue to weigh on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term. The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. The Committee decided to keep the target range for the federal funds rate at 0 to 1/4 percent. The Committee expects to maintain an accommodative stance of monetary policy until these outcomes are achieved."[5]

U.S. Treasury bond futures, according to the Bloomberg's implied U.S. 10-year forward yield, forecast that rates are estimated to rise to about 1.4% by the first quarter of year 2023. Considering that the yield on this benchmark security back to 1963 has averaged about 6%, the yields predicted over the next few years are still relatively low. Of course, these are estimates and subject to change.

With our Dearborn Partners Core Rising Dividend portfolio offering an average current yield of 1.9%, and our High & Rising Dividend portfolio offering an average yield of 3.1%, we believe our portfolios can provide more income to those who need or like to receive income from their investments than by locking in about a 1% current yield over 10 years for the next few years. Plus, we believe that the income from our portfolios is expected to grow each year over time. 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

[5]"Press Release." News release, December 16, 2020. Accessed December 31, 2020.
https://www.federalreserve.gov/newsevents/pressreleases/monetary20201216a.htm

cash, it is not possible to receive the current or potentially increasing future dividends. So, we believe that our strategy offers reasons to stay invested and patient.

**Cumulative Income Summary**

Here is the cumulative gross (before fees) dividend income[6] 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 December 31, 2020:

| | Average Current Yield | Cumulative Income* |
|---|---|---|
| Core Rising Dividend SMA | 1.9% | $83,870 |
| High & Rising Dividend SMA | 3.1% | $109,732 |
| S&P 500 | 1.5% | $74,461 |

**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 December 31, 2020.*

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

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 after vaccines have been widely disseminated.

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

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

[6] Dearborn Partners

**Dearborn Partners Rising Dividend Separately Managed Account Average Calendar Dividend Increases**

| | Core Rising | High & Rising | CPI* |
|---|---|---|---|
| 2020 | 7.60% | 5.90% | 1.60% |
| 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 November. Updated December 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 December 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. Dividend yield is one component of performance and should not be the only consideration for investment.*

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