DEARBORN PARTNERS

<u>First Quarter 2021 Commentary</u> **Carol M. Lippman, CFA**

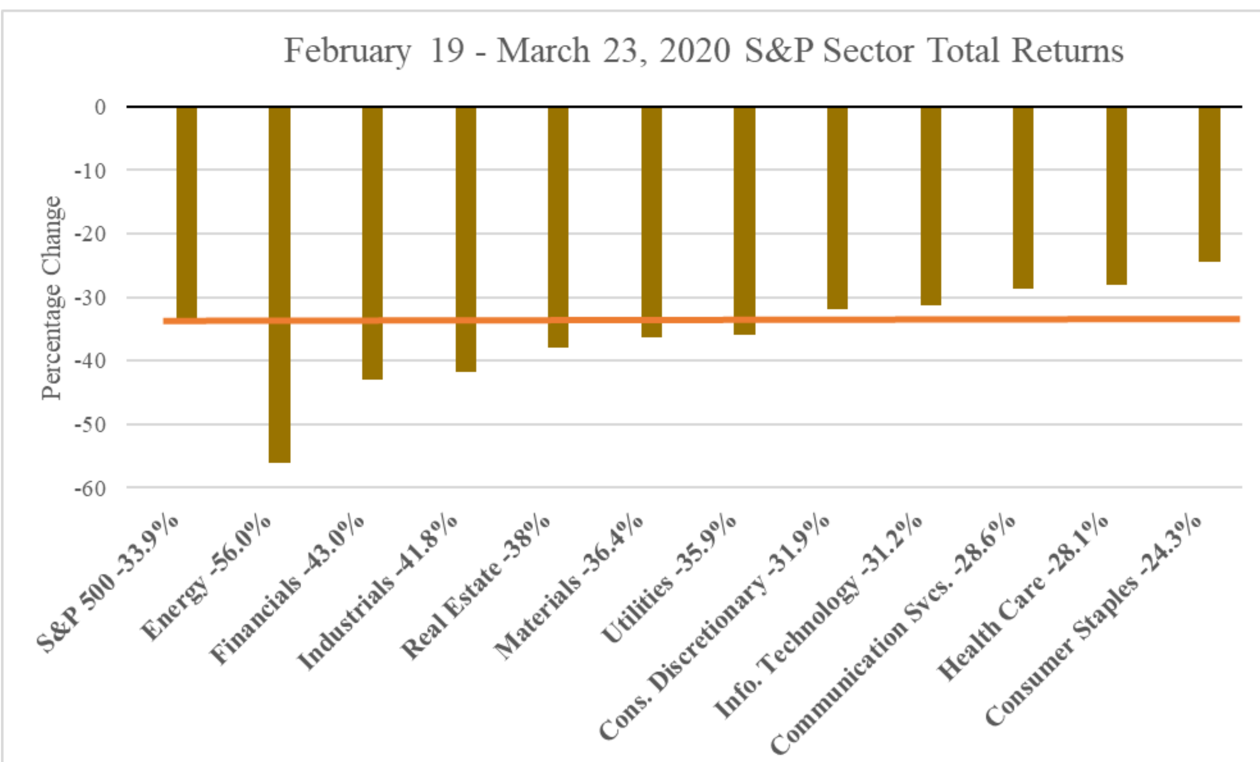
Year One with COVID-19 in Review

Just over a year ago, the novel coronavirus emerged. In the absence of known treatments or cures, in an effort to limit the virus' spread, on March 11, 2020 the Center for Disease Control (CDC) ordered a nationwide shutdown of all but the most essential activity. We on the Dearborn Partners investment team redoubled our efforts in scrutinizing every company in our portfolios to try to ascertain the likelihood as to whether or not each one would remain open, generating business in support of payment of its dividend. Because a primary criterion of this rising dividend strategy has always been defensiveness—i.e., companies generating products and/or services that people patronize under any circumstances—nearly every company in our portfolios appeared to be capable of remaining open and conducting operations. In fact, several of the companies in our portfolios provide products and services that were so essential, their business flourished beyond expectations.

Figure #1 is a graph of the S&P 500 and all 11 sectors from the peak in the broad market before reacting to the emergence of the novel coronavirus through March 23, 2020, the trough in the broad market. As would be expected, the most economically sensitive sectors declined more than the broad market as measured by the S&P 500, i.e., their bars dropped below the orange line representing the -33.9% decline of the S&P 500. The worst performing sector, for example, Energy—already hobbled by curtailed demand with the ordered shutdown of passenger air and sea travel and limits to driving—was further hindered by the March 8, 2020 oil price war declared by Saudi Arabia against Russia.

The generally more defensive sectors declined less than the broad market. Our Dearborn Partners Rising Dividend portfolios include stocks of companies with representation from all 11 sectors into which Standard & Poor's divides the marketplace, but this graph illustrates why we search for the most defensive businesses in each sector. Many investors find it quite alarming to see their portfolios lose so much in one month. A primary objective of our strategy is to attempt to lose less money in challenging markets. The initial research that formed the basis of this rising dividend strategy revealed that stocks of companies that consistently increased dividends over the years generally declined less in bad markets. That same research revealed that in strong markets, such stocks participated but might not outperform.

Figure #1: Market Reaction to Novel Coronavirus Peak to Trough Total Returns



Source: FactSet

In year 2020, 42 S&P 500 companies suspended their dividends. No companies in Our Dearborn Rising Dividend Portfolios cut or suspended dividends in year 2020.

According to S&P Dow Jones Indices, in March, April, and May of 2020, 42 companies in the S&P 500 suspended their dividends. More than half, 23, were in the Consumer Discretionary sector. This makes sense when we consider needs and wants. When the CDC shut down virtually all businesses except those that provide essential products and services (i.e., "needs") many businesses providing "wants" (i.e., discretionary) were unable to generate revenues with which to pay expenses, much less to pay dividends. Industries within the Consumer Discretionary sector in which companies suspended dividends include:

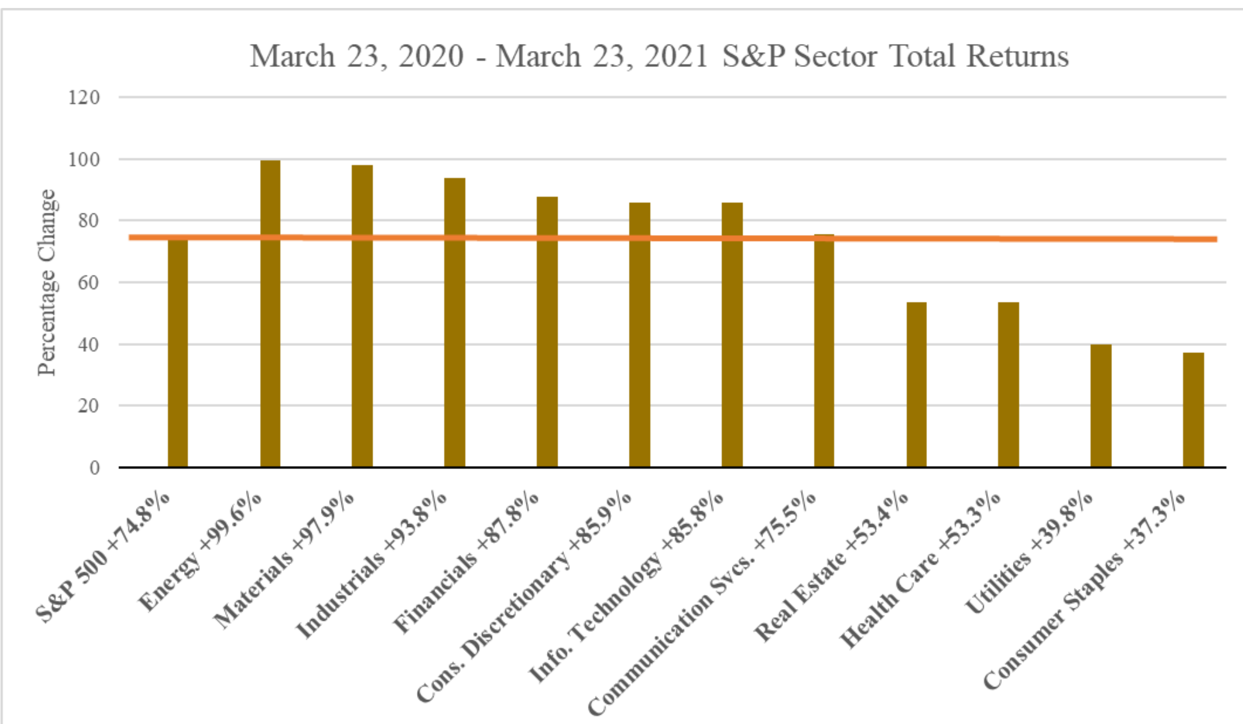
- Three in Automobiles and Auto Parts,
- Seven in Hotels, Restaurants & Leisure (this category includes cruise lines), plus one Hotel & Resort REIT (real estate investment trust)
- Eight Retailers, plus one Shopping Center REIT
- Three in Textiles, Apparel & Luxury Goods

The sector with the next largest number of companies that suspended dividends was Industrials. Four Airlines and one Aerospace & Defense company suspended their dividends last year. These businesses are generally too economically sensitive to qualify for Dearborn Partners Rising Dividend portfolios.

On to the recovery

COVID-19 is still very much with us, yet several vaccines have been developed and are being disseminated. Stocks are part of the Leading Economic Indicators because historically they anticipate actual fundamentals by an average six to nine months in advance of reality becoming apparent. True to form this time, stocks have acted in the same historic way: looking over the valley, past the current still partially shut down environment to the recovery. As we look at the one-year returns in Figure #2 below, it is important to keep in mind that over the last nine and one-half decades, the historic compounded annual total return (stock prices plus dividends) of stocks as measured by the S&P 500 has averaged about 10%. The COVID-induced unprecedented-in-our-lifetimes curtailment of activity has led to significant pent-up demand and largely equally unprecedented euphoria in the stock market.

Figure #2: Market Reaction to Anticipation of Economic Recovery



Source: FactSet

Energy, the worst-hit sector a year ago, has recovered the most robustly. Although the sectors in Figure #2 do not look like an exact mirror image of the bar graph in Figure #1, they are pretty close. Overall, the most economically sensitive sectors that were hurt the worst in Figure #1 have rebounded most strongly, and the more economically defensive sectors that declined the least in Figure #1 have recovered, but not as robustly. This exuberance is reflected in Consumer Staples, a generally defensive sector that declined the least a year ago, has recovered the least, yet its roughly 37% one-year return is nearly four times the broad market's historic 10% average annual total return.

Furthermore, the financial results for many such defensive companies in Consumer Staples and other sectors benefitted from the "stock up" environment a year ago. Now that business has become more normal, viewed against last year's uncharacteristically strong financial results, current levels of revenues and earnings—although frequently solid and steady—may pale in comparison. Stock prices of defensive businesses may reflect such relatively weaker fundamental comparisons. Conversely, economically sensitive businesses that were shut down a year ago and, as a result, reported losses or poor revenues and earnings, in this more normalized environment may be reporting significantly more favorable financial results, with their stocks acting favorably, too.

Many economically sensitive businesses, which were closed through no fault of their own when the CDC ordered the shut-down of non-essential activity, required government assistance to stay afloat and to pay employees. Some businesses, unfortunately, still have not survived. Although we applaud the government for helping so many of our citizens by creating rescue packages, such as the Paycheck Protection Program (PPP), it is our preference to invest our hard-earned money in the stocks of companies that can survive and thrive on their own in any environment, without the need for government assistance (also known as taxpayers' money).

This unforeseen, unprecedented-in-our-lifetimes crisis poignantly illustrates why we established the stringent disciplines—including defensiveness, high quality, strong balance sheets—for companies to qualify for our Rising Dividend Strategy. In strong markets led by stocks of lower quality companies—such as many days in the market over the past year—this generally conservative, defensive strategy may participate but not perform as well. In volatile markets characterized by fear and extreme uncertainty, however, this strategy should hold up better, if history can be a guide. Sometimes it takes many years to appreciate the advantages of this "tortoise and hare" approach, but we should also be getting paid dividends throughout, as well as receiving numerous dividend increases along the way.

Core Rising Dividend SMA portfolio:

In the first quarter of year 2021, 20 of the 49 companies in this portfolio announced 20 dividend increases averaging about 10.9% more than those companies paid a year earlier. No companies in our Core Rising Dividend portfolio cut or suspended dividends in the quarter.

High & Rising Dividend SMA portfolio:

In the first quarter of year 2021, 11 of the 25 companies in the portfolio announced 11 dividend increases averaging about 6.1% more than those companies paid a year earlier. No companies in our High & Rising Dividend portfolio cut or suspended their dividend.

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 examine 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 March 31, 2021:

	Average Current Yield	Cumulative Income*
Core Rising Dividend SMA	1.9%	$86,709
High & Rising Dividend SMA	2.9%	$114,458
S&P 500	1.5%	$77,056

**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, 2021.*

The table above shows that the average yield of both of our Rising Dividend SMA portfolios at the end of the first quarter of year 2021 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

Dearborn Partners Rising Dividend Separately Managed Account Average Calendar Dividend Increases

	Core Rising	High & Rising	CPI*
2021 YTD	10.9%	6.1%	1.3%
2020	7.6%	5.9%	1.6%
2019	9.6%	8.2%	2.3%
2018	13.3%	9.5%	2.2%
2017	7.8%	5.8%	1.7%
2016	8.0%	6.5%	2.1%
2015	9.7%	7.5%	2.1%
2014	12.2%	7.4%	1.6%
2013	12.2%	8.7%	1.7%
2012	13.0%	9.6%	1.9%

** Core Consumer Price Index for All Urban Consumers Unadjusted 12-month Percent Change. Year to Date (YTD) 2021 CPI through February. Updated March 10, 2021.*

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 March 10, 2021.

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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