DEARBORN PARTNERS

Second Quarter 2022 Commentary Carol M. Lippman, CFA

Inflation

Inflation has been the center of attention for financial markets. Inflation is what the Federal Reserve is trying to bring down by raising interest rates. Helping investors keep ahead of inflation has always been a primary objective of the Dearborn Partners Rising Dividend Strategy. How? By concentrating on finding companies that pay dividends with attractive current yields, but most important, with the potential to consistently increase annual dividends at rates that can help investors stay ahead of the rising costs of living, i.e., inflation.

Since 1926, inflation has averaged about 3% per year.[1] We on the Dearborn investment team look for companies for our portfolios that we believe are capable of increasing annual dividends at least 3% on average. Figure #1 shows that so far, we have accomplished these goals: (1) each year the dividend increases reported by the companies in both of our separately managed account (SMA) portfolios have averaged rates greater than the historic average 3%, and (2) at rates greater than that year's rate of inflation, as measured by the Core Consumer Price Index (CPI), even so far in 2022 when inflation has risen to levels not seen since 1982.

Figure #1: Dearborn Partners Core Rising Dividend Separately Managed Account Average Calendar Dividend Increases

	Core Rising	CPI*
YTD 2022	13.2%	6.0%
2021	9.9%	5.5%
2020	7.6%	1.6%
2019	9.6%	2.3%
2018	12.9%	2.2%
2017	7.8%	1.7%
2016	8.0%	2.1%
2015	9.7%	2.1%
2014	12.2%	1.6%
2013	12.2%	1.7%
2012	13.0%	1.9%

** Core Consumer Price Index for All Urban Consumers Unadjusted 12-month Percent Change for 12 months ending May 2022 Updated June 10, 2022. YTD = Year to Date*

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, 2022.

[1] Source: Morningstar Direct. All values in decimal format. "SBBI" stands for "Stocks, Bonds. Bills, and Inflation". "Stocks, Bonds, Bills, and Inflation", "SBBI", and "Ibbotson" (when used in conjunction with a series or publication name) are registered trademarks of Morningstar, Inc. ©2022 Morningstar. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

Here are some details about the dividend increases announced by the companies in our Core SMA in the second quarter and first half of this year.

Dividend Growth: Core Rising Dividend SMA portfolio

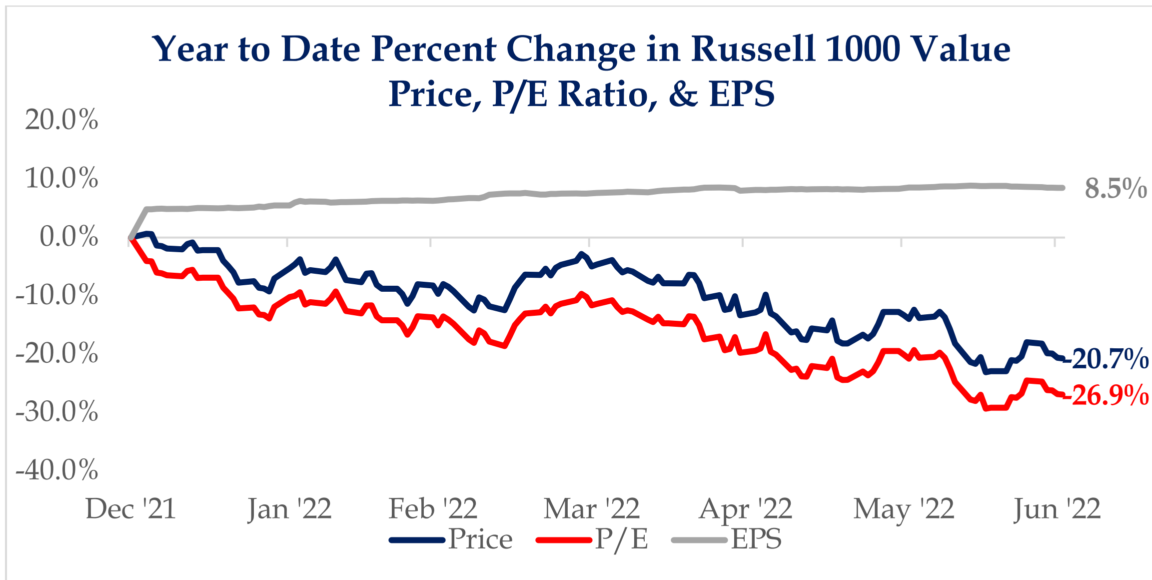
In the second quarter of 2022, 6 of the 49 companies in our Core Rising Dividend portfolio announced 6 dividend increases averaging about 10.7% more than those companies paid a year earlier. In the first half of 2022, 25 of the 49 companies in this portfolio announced 26 dividend increases averaging about 13.2% more than those companies paid a year earlier. One company declared a special $1.00 cash dividend. One company announced a dividend increase after only one quarter, and two companies announced dividend increases after only three quarters. No companies in our Core Rising Dividend portfolio have cut or suspended dividends so far in 2022.

Correction Is Warranted. Valuations Were Excessive.

Here are a few illustrations showing that a primary reason that stocks are pulling back is because valuations, as measured by price/earnings (P/E) multiples, had climbed to extremely unsustainable levels. The signs were there to grizzled investors (such as yours truly) who remember the excesses that drove the dot.com bubble of the late 1990s/early 2000, as well as the complacency about risk in the Financial sector leading up to the Great Financial Crisis. Sometimes such excesses last longer and go farther than most people can predict. This time the excesses included a few stocks of popular companies that pay no dividends; relatively thinly traded, heavily shorted so called “meme” stocks of companies with little to no fundamental value that were touted in Internet chat rooms and traded with what appeared to be no commissions; cryptocurrencies; NFT (non-fungible token) art; SPACs (special purpose acquisition company—a faster, less expensive way for a company to go public than through a traditional Initial Public Offering) and other hot, new ideas fueled by a zero-interest rate environment and the belief that making money in such markets is easy. In fact, what drove up the prices of many of these largely virtual, essentially intangible concepts was the momentum created by the hype and the suction of the irresistible temptation not to miss out on the frenzy. Real investment professionals understand that there is nothing easy about making money in financial markets; it takes years of study and a lot of constantly diligent work.

Figure #2 from Strategas Securities’ Jason Trennert on June 13, 2022 shows that earnings per share (grey line) so far this year have increased 8.5%, stock prices declined -20.7% (blue line), but P/Es dropped more: -26.9% (red line).

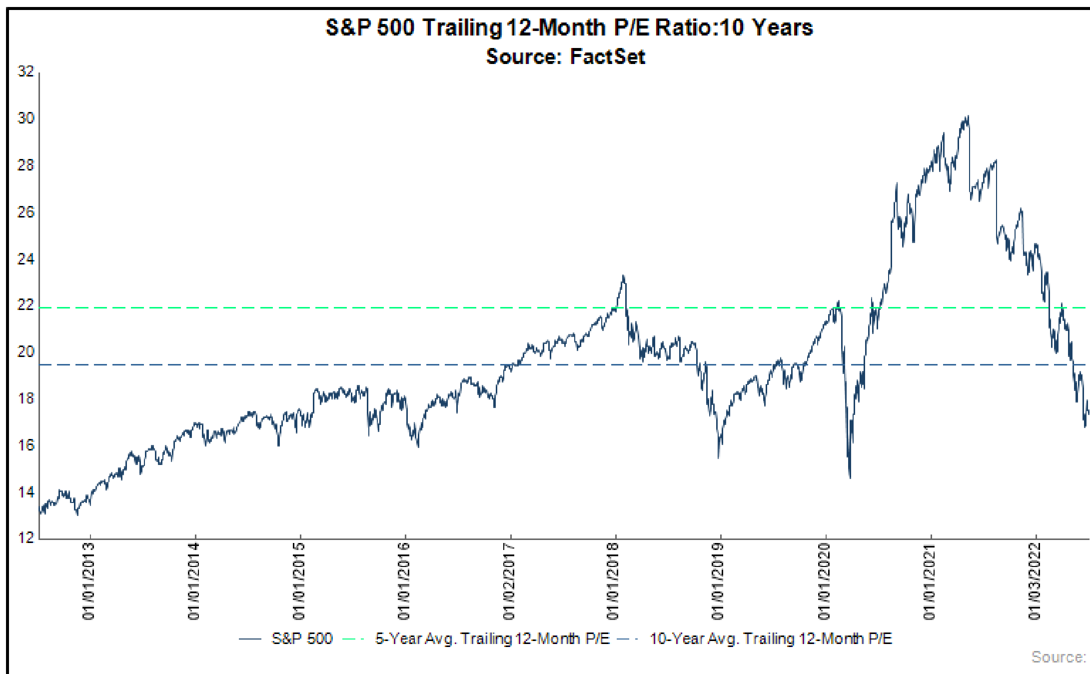
Figure #2: This Year's Decline Is All About Multiple Compression



Source: Strategas Securities, LLC Investment Strategy

Figure #3 from FactSet's Earnings Insight shows that the trailing 12-month P/E multiple for the S&P 500 has averaged about 20 times over the past 10 years (the broken blue horizontal line). Its peak P/E in mid-2021 was about 30 times. As of June 30, 2022, that P/E has dropped below the 10-year average to about 17.4 times.

Figure #3: S&P 500 Trailing 12-Month P/E Ratio: 10 Years

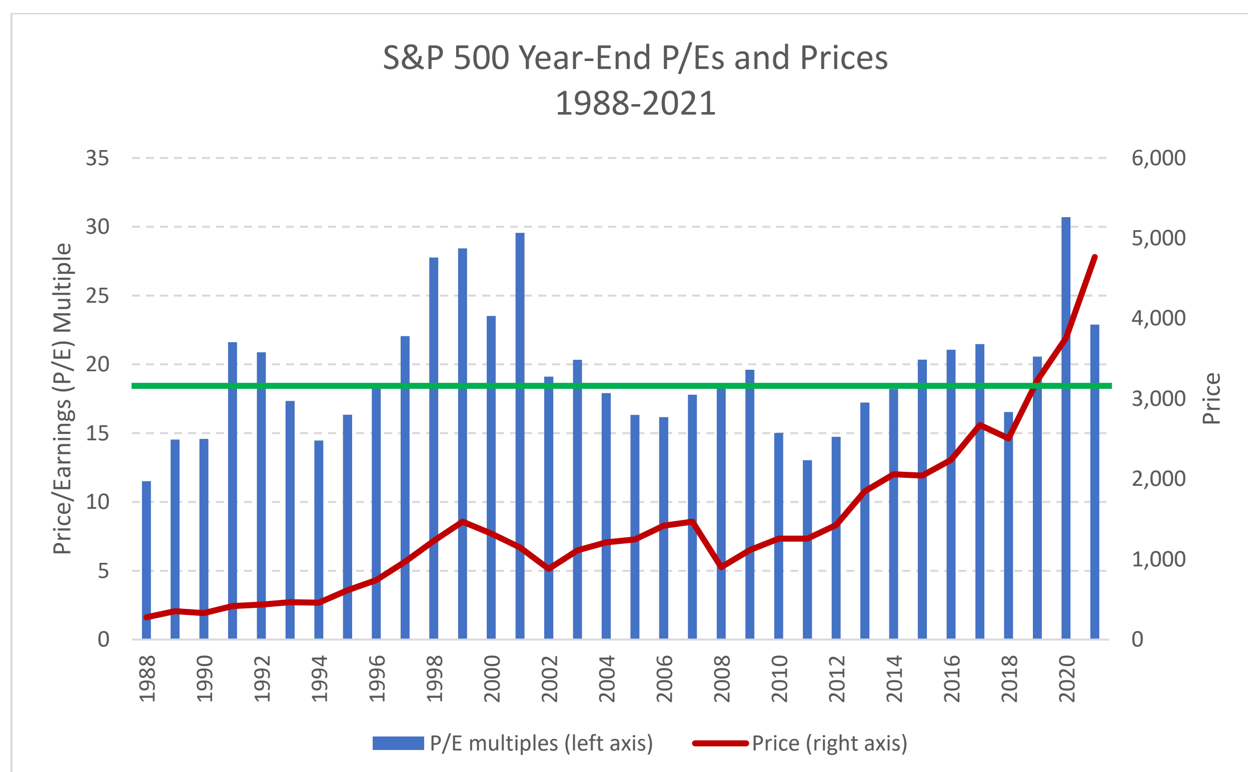


Source: FactSet Data Services

The right-hand sides of Figure #3 above and Figure #4 below look similar. Figure #4, however, goes back to 1988 (Figure #3 goes back to 2012); Figure #4 shows the price/earnings multiples as blue bars based on S&P 500 full year operating earnings per share (EPS), superimposes the year-end prices as a red line each

year for the S&P 500; and the median P/E during these 33 years was about 18 times earnings (green line) (the average P/E in Figure #3 is 20X).

Figure #4: S&P 500 Year-End Price/Earnings (P/E) Multiples and Stock Prices 1988-2021



Source: S&P Dow Jones Indices, S&P 500 Quarterly Data (annualized)

This graph shows that where the P/Es are the highest—14 of the 33 years in this graph had above-average P/Es of 20 or more—such valuations were not sustainable and a market pullback, or correction, ensued. We think the graphs in Figures #3 and #4 help visualize how extended markets had become the past few years and that such valuations were not sustainable.

Let's keep some important facts in mind as we live through what we believe is an overdue correction in the stock market. The long-term trend of stocks of good quality companies has been up. Over the three-plus decades illustrated on Figure #4, the broad market's stock prices increased 17-fold (the S&P 500 red line closed year 1988 at 277.72 and ended year 2021 at 4,766.18). There have been times in the past, however, that markets have corrected and have even been characterized as textbook-defined bear markets: declines of -20% or more. The graph in Figure #4 shows two big bear markets: 1999-2002 peak to trough -50.5%; and 2007-2009 peak to trough -57.7%. Yet, stock prices always recovered.

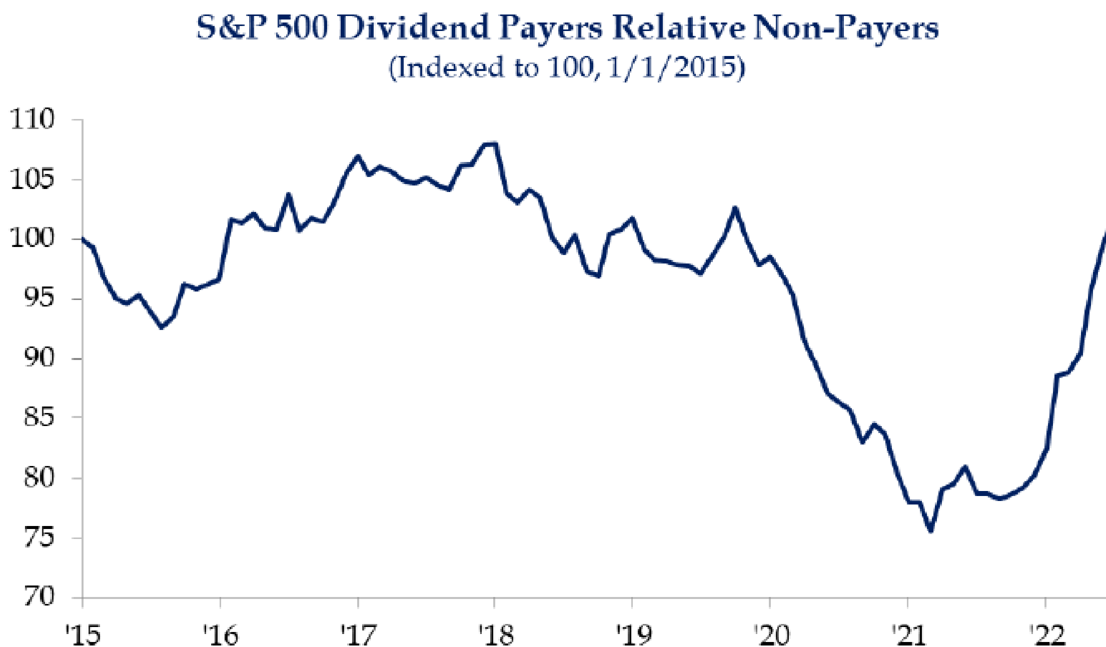
Although past performance cannot assure future results, there are reasons why we think that uptrend can continue over the long term. Owning stock is owning a piece of a company. Historically over the long term, stock prices have moved in recognition of companies' fundamentals, especially earnings. As earnings have moved up over time, over time stock prices have moved up, too.

When markets decline -20% or more, it is frequently human nature to fear permanent loss of investment value and succumb to the urge to sell equity holdings. History has shown, however, that patiently holding onto stocks of good quality companies and collecting their dividends has provided investors with attractive total returns over time.

Our strategy emphasizes companies that pay out a prudent portion of earnings as dividends, plowing the bulk of their earnings back into their business to assure future growth of revenues, cash flow, earnings, and dividends. We look for companies with a commitment to increasing dividends as earnings grow. Although past performance cannot assure future results, our view is that if companies can consistently increase earnings and dividends, over time, stock prices should move higher as well, and provide attractive total returns. It is our hope that the generally conservative, high quality, defensive tilt of our portfolios—consistently paying us potentially rising dividends while we patiently wait—will help investors participate in the long-term wealth building potential offered by common stocks. We believe that stock market participation is critical. Risk reduction along the way is even more important, in our opinion. We view a well-diversified portfolio of stocks of high-quality companies as helping long-term investors participate while potentially modifying risk.

One more illustration, Figure #5 from Strategas Research's June 15, 2022 Daily Macro Brief, shows that from 2019 through early 2021, stocks of companies that pay dividends had a tough time keeping up with stocks of companies that pay no dividends. Since late 2021, however, dividend payers have been outperforming non-payers. We think it always makes sense to own the stocks of strong, financially solid companies with the potential to consistently increase dividends, such as those in our Dearborn Partners Rising Dividend portfolios. Figure #5, in our opinion, shows that now is an especially good time to be invested in such a strategy.

Figure #5: Dividend Paying Companies Continue to Perform Well



The vertical (y) axis represents the relative performance between stocks of dividend-paying companies and non-dividend paying companies. When the line rises, it shows that stocks of dividend-paying companies outperformed those of non-dividend paying companies.

Source: Strategas Research, Daily Macro Brief, June 15, 2022

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, 2022:

	Average Current Yield	Cumulative Income*
Core Rising Dividend SMA	2.1%	$103,653
S&P 500	1.7%	$90,950

**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, 2022.*

The table above shows that the average yield of our Core Rising Dividend SMA portfolio at the end of the first half of 2022 exceeded the average yield of the S&P 500. As a result of its above average yield, lower volatility, and generally conservative features, our portfolio may appeal to some generally risk-averse investors who are in search of yields greater than those offered by the broad market.

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, war, peace, 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.**

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.

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

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. This commentary presents general views on the securities markets and should not be construed as financial or investment advice on any subject matter. This commentary may not be redistributed without Dearborn's written consent. Some of the information herein has been obtained from third party sources. We believe such information is reliable, but we have not in each case verified its accuracy or completeness. All securities investing involves risks, and this commentary is not intended to address such risks. Dearborn may make securities recommendations to clients that are inconsistent with the views herein. Any opinions herein are as of the date of this report and are subject to change without notice. Dearborn Partners L.L.C. is an investment adviser registered under the Investment Advisers Act of 1940, as amended. Registration does not imply a certain level of skill or training.