

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Using a Rising Dividend Strategy to Outpace the Cost of Living



CAROL MILIUS LIPPMAN, CFA, is Principal and Portfolio Manager at Dearborn Partners, L.L.C. She began her career at a broker/dealer in 1980 analyzing equity securities in a number of industries. During her tenure, she was instrumental in creating reports explaining prudent equity investment principles, equity education programs, and several successful investment strategies. She initiated one of the most successful strategies in November 1993. This strategy forms the foundation for the Dearborn Partners Rising Dividend strategy. Mrs. Lippman has earned the Chartered Financial Analyst (CFA) designation. She is past president and member of the Board of Governors of the St. Louis Society of Financial Analysts and the CFA Institute. Mrs. Lippman graduated with a Bachelor of Science degree from Northwestern University. In August 2011, Mrs. Lippman left the sell side and became a partner at Dearborn

Partners to pursue her passion of helping investors through financial advisers implement sound investment principles and participate in the long-term wealth-building potential of the stock market. In 2018, Mrs. Lippman, her co-portfolio manager Michael Andelman, and director of sales Richard Seitz purchased Dearborn from the founding partners.

SECTOR — GENERAL INVESTING

TWST: Please begin with a brief introduction to Dearborn Partners, with a view to your strategy and your role there.

Ms. Lippman: Dearborn Partners' Rising Dividend portfolios are for investors who are looking to outpace the rising cost of living through a combination of attractive income and long-term growth potential. I came to Dearborn Partners in August of 2011, after having started this strategy in the early 1990s, when I discovered the power of rising dividends. I was working on the sell side at the time for a broker/dealer and I wanted to move over to the buy side to actually manage portfolios by way of this strategy that I had discovered. I saw that it helped investors make their money work harder without potentially losing a lot along the way.

Dearborn Partners, which is an independent registered investment advisory firm out of Chicago, was started by three founders in 1997 to help individuals and families manage their wealth. I came to Dearborn with my rising dividends strategy, and launched two separately managed accounts in September of 2011. Then in 2013, we launched a mutual fund.

Our separately managed accounts are for investors with a minimum of \$100,000. We launched our mutual fund in 2013 to help investors who were interested in participating in this strategy, but who didn't have as much as \$100,000. So it's for IRAs, educational IRAs, that kind of account. But we're just trying to help as many people for whom this strategy may be appropriate as we can.

We take it very seriously when people entrust us with their hard-earned money. So our goal is to try to help people make their money work harder without losing a lot along the way. It's our experience that most people don't enjoy losing money. We've come up with a generally conservative strategy that is designed to help investors get into the stock market and stay in the stock market to participate in the wealth-building potential offered by the stocks of good-quality companies over the long term.

TWST: Currently, most investors have lost some money in a somewhat steep correction. How have your separately managed accounts performed in this challenging environment?

Ms. Lippman: In the fourth quarter, when the S&P 500 did fine, we outperformed, especially in December. Then when the market started to manifest a few more challenges after being in what was seemingly a one-way-up market since the digestion of the news of the emergence of the novel coronavirus in the Spring of 2020, we have actually held up better since the market has become more challenging.

If we go back to our inception in September of 2011, which is a little bit more than 10 years ago, we have tracked what we call "big down days" when the broad market, as measured by the S&P 500, declined 1% or more in a single day. On those days, our portfolios have declined less than the broad market about 90% of the time. So we call that the power of rising dividends to cushion the fall in challenging markets. That's what these portfolios are designed to do; they typically have held up better in challenging markets.

Many people have reported that it has really been about 10 stocks that have accounted for as much as 30% of the return on the S&P 500. Most of those 10 companies pay no dividend. That means they don't qualify for our strategy, because we are very disciplined and our goal is to include in our portfolios only companies that not only pay a dividend but possess the ability to consistently increase those dividends. Because we can't hold in our portfolios most of the stocks that accounted for so much of the S&P's return since midway through 2020, we have participated and generated respectable total returns, but we have not outperformed the benchmark. Now, when the market starts to be a little bit more challenging and has broadened beyond those 10 stocks, our strategy tends to hold up better.

Ned Davis Research has done a study that divides the S&P 500 into categories by dividend policy. The category that they call the "dividend growers," or the companies that increase their dividends, have outpaced all the other categories, which include the broad market as measured by the S&P 500. The dividend growers have outpaced since back to 1973 by a wide, wide margin and with less volatility, which they measure using standard deviation. Ned Davis shows that over the past nearly 50 years, stocks of companies that paid no dividends provided the second worst total returns, just ahead of companies that cut or suspended dividends, which lost money over 50 years. This is why we concentrate so hard on our companies' financial strength and ability to maintain and increase dividends with regularity, not cut them.

Back to the stocks of companies that pay no dividends, however, there have been relatively short periods when those kinds of stocks have outperformed the other categories. We have just gone through such a period. But over decades, typically the total returns of such stocks have fallen well behind the total returns of companies that have increased dividends.

TWST: Can you give us a closer view to the structure of your portfolio? And are your separately managed accounts tailored to specific clients or types of clients?

Ms. Lippman: We think this is a strategy that's appropriate for virtually any investor, primarily as a core portion of a well-diversified portfolio. It's designed to provide ballast to the portfolio; it's relatively low volatility if your measurement is beta, where a beta of one represents the volatility of the broad market as measured by the S&P 500. Our average five-year beta has been about 0.8 in our strategy, so about 20% less volatile.

We think this is a strategy that's appropriate for virtually anyone who is interested in trying to outpace the rising costs of living as manifested by the Consumer Price Index, which over the last 95

years has averaged about 3%. So what we're trying to do is find companies that are able to increase dividends by more than 3% year over year so that we can be outpacing the rising cost of living. We like to see companies whose payout ratios are below 50% so that they can plow the bulk of their earnings back into themselves for future growth, including dividend growth.

Many people don't remember times when markets have traded sideways or even gone down for sustained periods of time. Our strategy is designed to pay us while we wait. It's for very patient, long-term investors. This is based on the fact that when you own stock, you own a piece of a company. And any of us who've worked for companies know they do not grow overnight; it takes time. So it requires patience. Our minimum suggested time horizon is five years.

While we are being patient and participating in what we believe is the long-term wealth building potential offered by investing in common stocks of great companies, we believe it's important to get paid while we wait. So if we enter a period where stocks are sideways or down for a while, we're still getting pay raises through these dividend increases announced by the companies in our portfolios. So then at least something in our portfolios is increasing in value as we wait.

Ours is a simple strategy: We invest in well-diversified portfolios of what we consider to be great businesses that offer the potential to pay and increase dividends. What's not easy is finding companies that offer such dividend consistency and growth potential. Finding such an elite group of companies and assembling properly diversified portfolios is the objective of the Dearborn Partners Rising Dividend Portfolios.

TWST: What are sector weightings and cap size percentages

as represented in your Rising Dividend Fund?

Ms. Lippman: In all of our portfolios, we have representation from all 11 sectors into which Standard & Poor's divides the marketplace. We have two primary separately managed accounts. In our Core Rising Dividend separately managed account there are 49 stocks and one cash position.

Some sectors have lots of companies that manifest the disciplines that we look for — in other words, a lot of companies with the ability to raise dividends — and some sectors do not. For example, the communication services sector is one that Standard & Poor's recently reconfigured. It used to be almost primarily telephone companies. And those are the only ones that actually qualify for our portfolios, because many of the companies that S&P put into the communications services sector pay no dividends. With S&P's reconfiguration, communication services has a 10% weighting in the benchmark; we are underweighted in that sector. Because of the paucity of companies with an attractive

Highlights

Carol Milius Lippman discusses Dearborn Partners' Rising Dividend strategies, which are designed to outpace the rising cost of living through a combination of attractive income and long-term growth potential. She explains that their goal is to hold only those companies that not only pay a dividend but possess the ability to consistently increase those dividends; ideally companies that can increase dividends by more than 3% year over year and whose payout ratios are below 50%. Ms. Lippman says that they use the power of rising dividends to cushion the fall in challenging markets and that if we enter a period where stocks are sideways or down for a while, investors will still get pay raises through dividend increases. She notes that Dearborn's 49-stock Core Rising Dividend portfolio has a current yield of 1.8% and its 25-stock High & Rising Dividend portfolio is currently yielding 3%. The portfolios tend to be overweight in industrials, real estate and utilities and underweight in communication services and information technology, relative to the S&P.

enough yield and consistent dividend growth potential in the information technology sector, we are underweighted in that sector, too.

Then some sectors provide lots and lots of great businesses with the potential to increase dividends — notably the industrials, real estate and utilities sectors where we are overweighted versus the benchmark. Some sectors are more economically sensitive than others. We are always looking for the most defensive businesses in every sector.

Thinking about needs and wants, we concentrate on the needs. We're looking for businesses that people patronize throughout every kind of economic or market situation so that they can consistently see increased revenues, cash flow, and earnings, and pay out a prudent percentage of their earnings as dividends so that they're plowing the bulk of their earnings back into their company for future growth of revenues, cash flow, earnings, and therefore dividends. These are the primary objectives we're looking for.

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The average current yield right now on our Core Rising Dividend portfolio is about 1.9%. The average yield on the S&P 500 benchmark right now is 1.4%. Our objective with our Core Rising Dividend 49-stock portfolio is to have an average current yield that's 25 to 50 basis points higher than the broad market as measured by the S&P 500. Roughly 95% of the stocks in this portfolio are large caps, about 5% mid caps.

There are some investors who would like a little bit better current income. For those investors, we have our Dearborn Partners High & Rising Dividend Portfolio. It's more concentrated, with 25 stocks and one cash position. There is a lot of overlap between the 25 stocks in our High & Rising portfolio and the 49 stocks in our Core Rising Dividend portfolio: 17 of the 25 stocks in High & Rising are also in Core. This portfolio's sector weightings and capitalizations are about the same: roughly 95% large cap, 5% mid cap. The current yield is 1.8% from Core right now and 3% from High & Rising. We have representation from all 11 sectors into which the stock market is divided by Standard & Poor's in our High & Rising Dividend portfolio.

For our Core Rising Dividend portfolio, we're looking for mid- to high-single-digit annual dividend growth from each of these companies on average. Considering that the current yield on the S&P 500 is about 1.4% and the 10-year U.S. Treasury bond yield is 1.8%, the 3% average current yield of our High & Rising Dividend portfolio is above average. It's difficult to get both above-average yield and above-average growth in the same package. So from our High & Rising Dividend portfolio, we're looking for mid-single-digit annual dividend growth.

The fact is that over the last 10 years, we have accomplished this; the annual dividend increases of all the companies in our Core Rising Dividend portfolio have averaged about 10.3% greater than the dividends that each of those companies paid on average the year before. And the average dividend increases for our High & Rising Dividend

portfolio over the last 10 years have been about 7.5% greater than the year before. The Consumer Price Index, a measurement of inflation over the last 10 years has been 2.4% on average. So you can see that by way of the dividend growth, we are accomplishing our objective of trying to help our investors keep ahead of the rising costs of living.

TWST: How have these strategies — your portfolios — weathered the current very challenging investment scenario?

Ms. Lippman: We think they've weathered it quite well, and our experiences, and actually the testament to that, is that we're very fortunate and we've had very few redemptions. I think we've done a good job of trying to educate our investors as to what this portfolio strategy is and is not.

So, for example, we publish a report we call our dividend income bar graph report. We want to see the bars of the cumulative dividend income received each year going up, up, up, up, up stair

steps every year. And in fact, they have done just that. If an investor in September of 2011 had invested \$200,000, in our Core Rising Dividend portfolio, all the dividends would have returned nearly 50% of that original \$200,000 investment as of December 31st of 2021. And an investor in our High & Rising Dividend portfolio, all of those cumulative dividends would have totaled 64% of that original \$200,000 investment.

Also, what we think is interesting is that if an investor owns a stock that pays no dividend and if that investor needs to get some money out, wants to take out a return from that investment, the only way to get it is to sell the stock. And if one sells that stock, of course, one's no longer participating in the potential of that business. The beauty of our strategy where you own stocks that pay dividends and increase dividends is that you are seeing an increase in your income — and also, hopefully, an increase in one's total return, the price movement plus dividends, as well.

Of course, none of us has any control over what stock prices are going to do. Over time, stock prices move as earnings grow. Near term, greed and fear often affect stock prices, but over long periods, earnings drive stock prices. If we can have a high degree of confidence that the earnings and dividends can consistently grow, and the dividends represent a prudent percentage of earnings so that both can grow over time, this is what our rising dividend strategy is designed to do.

TWST: Have any companies in your portfolios been vulnerable to supply chain issues or rising cost of capital?

Ms. Lippman: Yes, absolutely. In fact, we're seeing some of them report more anemic dividend increases than we would have liked to have seen. We're in the middle of earnings being reported right now. On many earnings calls, managements are telling about constraints in terms of getting their raw materials. And COVID has affected their labor, and the ability to run their manufacturing and distribution facilities, etc.

So there's no question this is rippling throughout the economy to virtually every company. This is where being patient becomes important with otherwise solid businesses in these unprecedented times.

We think investors would be well advised to stick with quality, diversify properly, not panic if markets correct — corrections are normal, we just haven't had many in a while — and be patient. We view a dividend as tangible evidence of a company's health. We view a rising dividend as telegraphing a company's strength, and that is what we look for.

TWST: Thank you. (VSB)

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