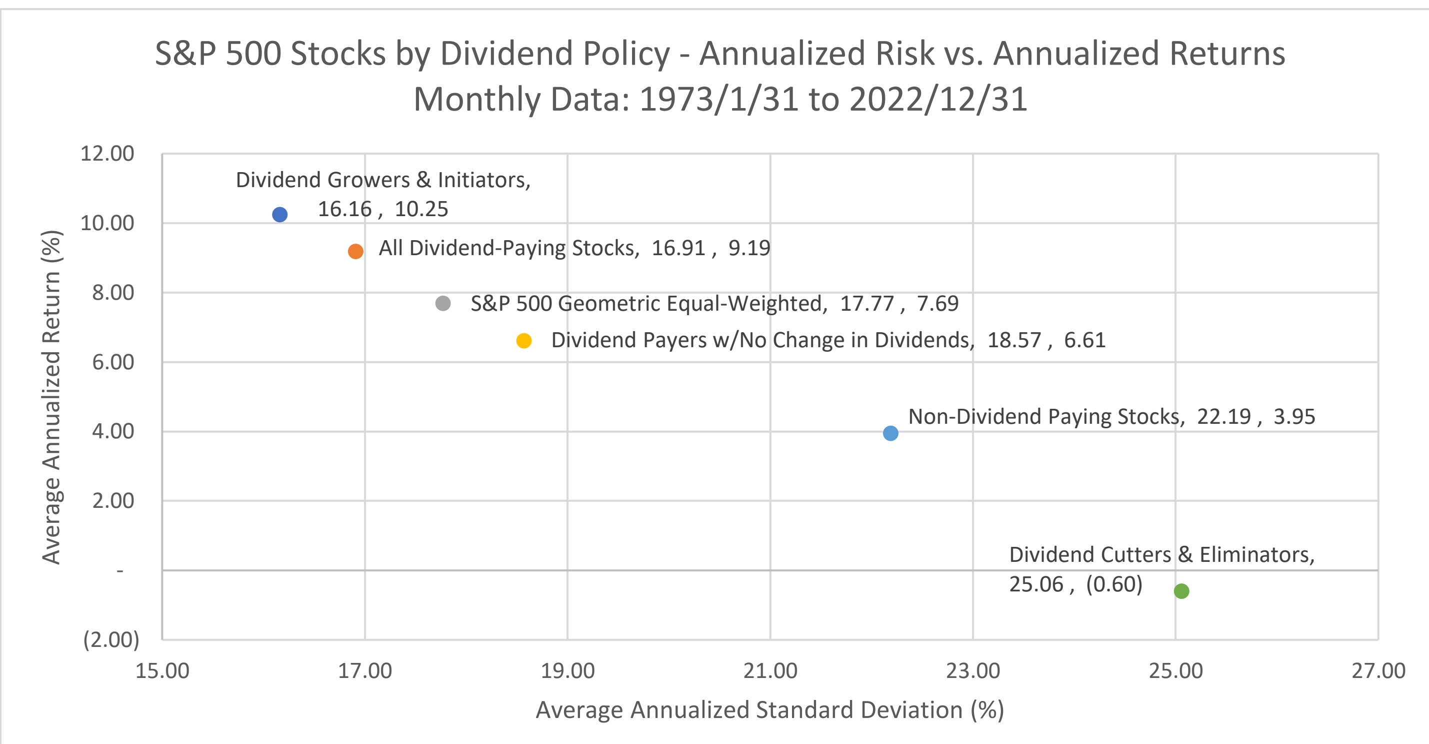
DEARBORN PARTNERS

<u>Year End 2022 Commentary</u> **Carol M. Lippman, CFA**

Risk Management

The legendary American Economist, Benjamin Graham, who is generally considered the father of securities analysis, published the first edition of <u>The Intelligent Investor</u> in 1949. Included is this important tenet about investing: “The essence of investment management is the management of risks, not the management of returns.” Ned Davis Research has divided the companies in the Standard & Poor’s 500 into five categories by dividend policy. Their study assumes investing $100 in each category on the last day of January 1973 and holding until the end of the measurement period. As illustrated in Figure #1, the results show that the companies that increased dividends provided the best annualized returns, 10.25%—measured on the vertical axis—with the lowest volatility, as measured by standard deviation, 16.16%—on the horizonal axis. (Remember that if one does not like a lot of volatility, a lower standard deviation is preferable to a higher one.) The “Dividend Growers & Initiators,” as Ned Davis calls them, outpaced the average annualized return and risk of the broad market as represented by the equal-weighted S&P 500’s 7.69% and 17.77%, respectively. At the other extreme over this nearly half century, companies that cut or eliminated their dividends provided the worst annualized return (-0.60%) with considerably greater risk (standard deviation of 25.06%). In other words, over nearly five decades, stocks of companies that consistently increased dividends have helped investors manage risk in their portfolios.

Figure #1: S&P 500 Stocks by Dividend Policy—Annualized Risk vs. Annualized Returns



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In percentage terms, the 2.56 percentage points by which the 10.25% average annualized return of the Dividend Growers exceeds the 7.69% average annualized return of the broad market may not seem that much greater. Figure #2 shows the ending value as of December 31, 2022 in dollars of an initial $100 investment in each category on January 31, 1973. You can see that the Dividend Growers' ending value of $13,061 is significantly greater than the $4,043.20 from the S&P 500. Wouldn't most of us be happy to end up with about $9,017.80 more?

Figure #2: Long-term Results by Dividend Policy

Payers > Non-Payers and Growers > Cutters in long run

Portfolio Performance Statistics

Analysis Dates: 1973-01-31 -- 2022-10-31

	Dividend Growers & Initiators	All Dividend-Paying Stocks	S&P 500 Geometric Equal-Weighted Total Return	Dividend Payers w/No Change in Dividends	Non-Dividend Paying Stocks	Dividend Cutters & Eliminators
Growth of $100	$13,061.0	$8,059.6	$4,043.2	$2,440.8	$693.7	$74.0
Gain/Annum %	10.2%	9.2%	7.7%	6.6%	4.0%	-0.6%

Dividends Can Help

In each of years 2019, 2020, and 2021, the stock market as measured by the S&P 500 generated strong, double-digit annual returns of +31.5%, +18.4%, and +28.7%, respectively. In 2022, the S&P 500 declined -18.11%. Dividends helped, however. Through 12/31/2022, as seen in Figure #3, stocks of companies in the S&P 500 that pay dividends, which Ned Davis calls "Payers," returned -6.99% whereas the stocks of companies that pay no dividend, called "Non-Payers" returned -25.31%.

Standard & Poor's divides the marketplace into 11 sectors. As is true every year, some sectors performed better in 2022 than others. Energy performed the best. Evidently every company measured in the Energy sector — as well as the Materials sector — pays a dividend. The three next best performing sectors — Utilities, Consumer Staples, Health Care — are generally considered defensive: businesses whose customers patronize the products or services offered in tough as well as good economic times. In every sector with the exception of Utilities, Consumer Staples and Real Estate, however, the returns of the Payers surpassed the returns of the Non-Payers, some by wide margins.

Figure #3: Payers/Non-Payers by Sector

Sector	**Payers (%)**	**Non-Payers (%)**
S&P	-6.99%	-25.31%
Energy	60.61%	N/A
Utilities	4.50%	8.91%
Consumer Staples	3.21%	5.72%
Materials	-10.26%	N/A
Health Care	-2.38%	-18.71%
Industrials	-6.40%	-18.58%
Financials	-9.26%	-36.86%
Communication Services	-14.40%	-36.81%
Consumer Discretionary	-21.49%	-28.89%
Information Technology	-21.77%	-26.16%
Real Estate	-25.06%	-22.92%

Stocks of dividend-paying companies cannot be expected to outperform stocks of non-dividend paying companies in every sector and in every market environment. Over long time periods and especially in volatile markets, however, our observation is that stocks of companies that have consistently increased dividends have provided admirable results.

We think it has always made sense to diversify portfolios with a strategy that emphasizes investing in high quality companies with the potential to increase dividends with consistency. Now in 2022 that markets have become more volatile and challenging, we think it makes a great deal of sense. 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.

Here are some details about the dividend increases announced by the companies in our separately managed accounts (SMAs) in the fourth quarter and full year.

Dividend Growth: Core Rising Dividend SMA portfolio

In the fourth quarter of 2022, 17 of the 49 companies in our Core Rising Dividend portfolio announced 17 dividend increases averaging about 11.1% more than those companies paid a year earlier. In full year 2022, 48 of the 49 companies in this portfolio announced 52 dividend increases averaging about 11.8% more than those companies paid a year earlier. One company declared a special dividend each quarter—four special cash dividends throughout the year. One company announced four dividend increases, each after only one quarter, and two companies announced dividend increases after only three quarters. No companies in our Core Rising Dividend portfolio cut or suspended dividends in 2022.

Dividend Growth: High & Rising Dividend SMA portfolio

In fourth quarter of 2022, 9 of 25 companies in our High & Rising Dividend portfolio announced 9 dividend increases averaging about 10.3% more than those companies paid as dividends a year earlier. In full year 2022, 24 companies announced 28 dividend increases averaging about 8.7% more than those companies paid a year earlier. One company announced four dividend increases, each after only one quarter. One company raised its dividend twice in 2022. No companies in our High & Rising Dividend portfolio cut or suspended their dividends in 2022.

Cumulative Income Summary

Here is the cumulative dividend income generated by the shares held in companies in both of our Dearborn Partners Rising Dividend SMA Portfolios from two actual accounts, each with an initial $200,000 investment on September 30, 2011 (the inception date of our SMA portfolios) through December 31, 2022:

	Average Current Yield	Cumulative Income*
Core Rising Dividend SMA	2.1%	$110,879
High & Rising Dividend SMA	3.3%	$148,760
S&P 500	1.7%	$96,969

**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, 2022.*

The table above shows that the average yield of both of our Rising Dividend SMA portfolios at the end of 2022 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 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

Dearborn Partners Rising Dividend Separately Managed Account Average Calendar Dividend Increases[1]

	Core Rising	High & Rising	CPI*
11-Year Average	10.4%	7.6%	2.6%
2022	11.8%	8.7%	6.0%
2021	9.9%	6.3%	5.5%
2020	7.6%	5.9%	1.6%
2019	9.6%	8.2%	2.3%
2018	12.9%	8.8%	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 for 12 months ending November 2022 Updated December 13, 2022. 11-Year Average represents December 2012-December 2022.*			

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 13, 2022.

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[1] 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.