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Second Quarter 2024 Commentary **Carol M. Lippman, CFA**

How to Become a Millionaire by the Age of Normal Retirement

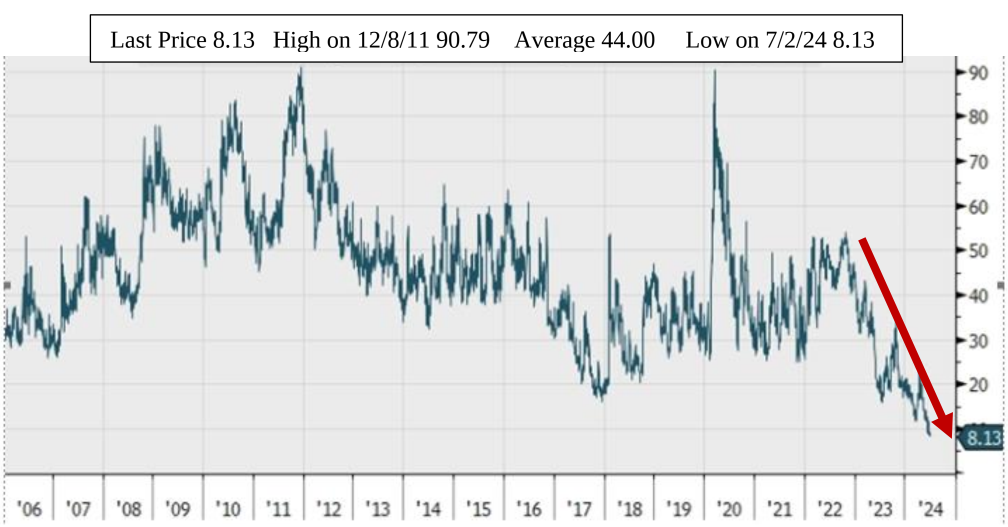
Ned Davis Research on February 12, 2024 published an excellent reminder titled: "The long-term trend is up and the power of compound returns." It is also an excellent reminder that the sooner one can begin investing, the better it typically works and that it is important to patiently stay invested.

This illustration started to appear in the 1970s. In 1974, the Individual Retirement Account (IRA) was created to help people save for retirement. IRA contributions must be from earned income; the maximum annual contribution at that time was $2,000. Over the past century, the average compounded annual total return of the S&P 500 has been about 10%. To help convince people about the benefits of opening and contributing to an IRA, this illustration has appeared in a number of publications over the years. This illustration assumes that a person begins earning income at age 19 and contributes $2,000 to an IRA that year and each of the next seven years, for a total of eight years. Compounding the returns of the total $16,000 contributions—and never adding another penny thereafter—at the historic average 10% per year, that individual would have $1 million by age 65, the normal age of retirement. If, on the other hand, a person did not invest the first eight years but at age 27 started adding $2,000 each year, with all those contributions compounding at the assumed 10% annual return, by age 65, that investor's total return would be slightly more than $800,000. Clearly $800,000 is a substantial amount to have saved, but it falls short of the $1 million generated by starting early and adding consistently. **Please see the Appendix for details.** Under age 50, the maximum allowable contribution in 2024 to a Roth or Traditional IRA is $7,000. If a 19-year-old earned money and invested up to $7,000 per year in an IRA, (a Roth IRA would probably be preferable to avoid the hassle of required minimum distributions later), using the same assumptions, that individual could have more than $3 million by age 65.

Stock Market Concentration Continues

For several quarters, we have been writing about how much of the stock market's performance has been driven by only a few large capitalization stocks. Figure #1 shows that such concentration started late in 2022 and continues through 2024 (red arrow). In its July 3, 2024 Strategy/Macro Research note, Piper Sandler showed that back to 2006, the correlation between the S&P 500 benchmark index's performance and the performance of the 500 stocks has averaged 44%. Lately, however, the dominance of a few large stocks in the popular market capitalization-weighted S&P 500 index renders the benchmark to now have by far the lowest correlation with all the stocks in the index: 8.13% on July 2, 2024.

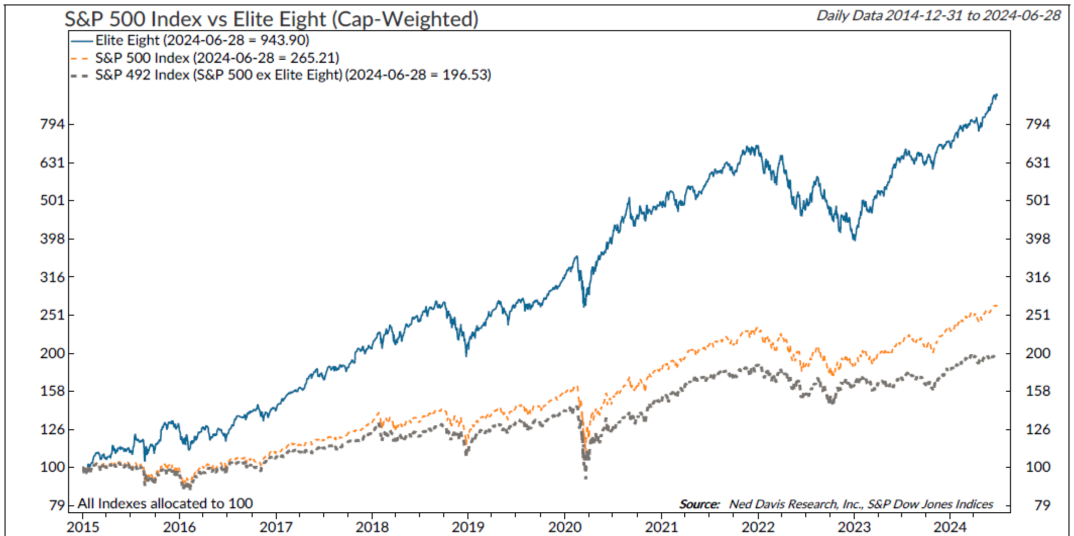
Figure #1: <u>The Market (S&P 500) No Longer Represents the Stocks in the Market</u>



Source: Piper/Sandler July 3, 2024 Strategy/Macro Research; COR 3M Index (CBOE 3-Month Implied Correlation Index) S&P 500 Correlations Daily 04JUL2006-03JUL2024 Copyright 2024 Bloomberg Finance L.P.

Ned Davis Research identifies "Elite Eight" stocks that have dominated returns of the stock market, as measured by the capitalization-weighted S&P 500, in a graph (Figure #2). For the past decade, the S&P 500 Index's average annual total return has been 10.81%, the Elite Eight have returned an average 26.66%, and the other 492 stocks in the Index have returned only 7.37%. The relationship has been similar for the first half of this year: the Index's total return was 14.48%, the Elite Eight was 31.89%, and the other 492 returned 7.54%.

Figure #2: <u>All-Time High Concentration for the Largest Stocks in the S&P 500</u>



Ticker	Name
META	Meta (Facebook)
AMZN	Amazon.com
NFLX	Netflix
MSFT	Microsoft
AAPL	Apple
GOOGL	Alphabet
TSLA	Tesla
NVDA	Nvidia

Index (Cap-Weighted)	Gain/Annum % 2014-12-31 to 2024-06-28	YTD % 2023-12-29 to 2024-06-28
Elite Eight	26.66	31.89
S&P 500 Index	10.81	14.48
S&P 492 Index (S&P 500 ex Elite Eight)	7.37	7.54

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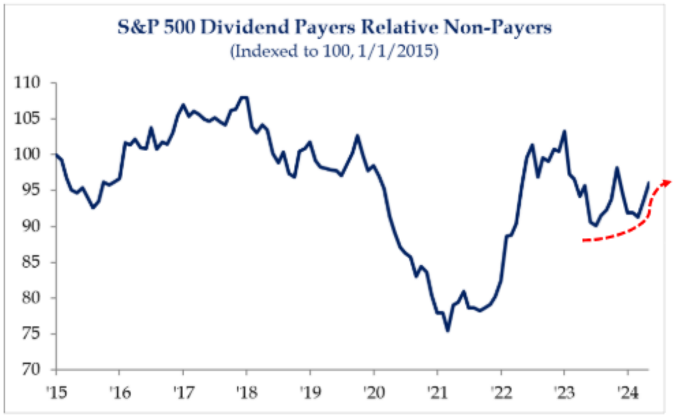
Among the Elite Eight, Microsoft and Apple have paid dividends consistently for many years; Microsoft since March 2003, Apple since August 2012. NVIDIA paid its first quarterly dividend in December 2012 and even raised the dividend for a few years. Starting in December 2018, however, NVIDIA paid a flat dividend of $0.04 for 22 consecutive quarters until March 2024. (We would not characterize NVIDIA as a rising dividend company.) On May 22, 2024, NVIDIA announced a 150% increase in its quarterly cash dividend from $0.04 to $0.10 and a 10-for-1 stock split effective June 28, 2024. The current yield is what we consider to be an insignificant 0.03%. Microsoft, Apple, and NVIDIA are the only Elite Eight companies that paid dividends until Meta announced its first dividend in February 2024 and Alphabet announced its first dividend in April 2024. Amazon, Netflix, and Tesla pay no dividends. In other words, when analyzing the performance of the Elite Eight until recently, it would be fair to state that more companies paid no dividends than paid dividends. In these kinds of markets, portfolios with stated commitments to holding stocks of companies with the potential to increase dividends have difficulty keeping up with the performance of a benchmark dominated by the Elite Eight.

In mid-May 2024, Strategas showed that the performance of dividend payers and non-dividend payers has flipped back and forth this year. Figure #3 starts on the first day of 2015. When the blue line is high, and especially above 100 on the vertical axis as was the case for much of 2016 through late 2019, the performance of dividend payers was superior. When the blue line is below 100, as was the case in 2015 and then when Covid emerged in early 2020 and through mid-2022, performance of non-dividend payers was superior. Figure #3 shows that since 2023, stock market performance has flipped back and forth between the two groups.

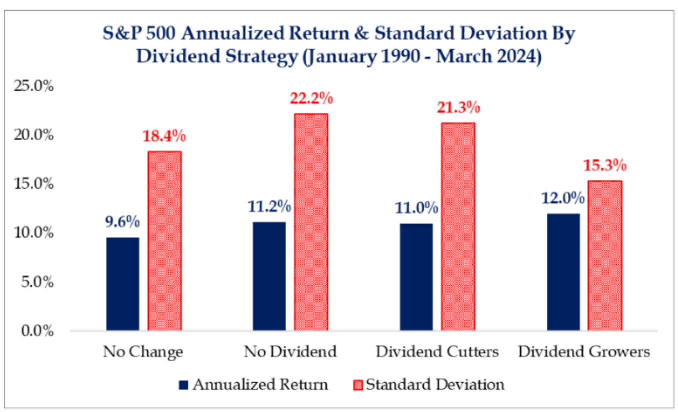
Figure #3: <u>Dividend Payers and Nonpayers Have Flipped Back and Forth This Year</u>



Source: Strategas Securities--Investment Strategy May13, 2024

There have been periods, usually relatively brief, when stocks of non-dividend paying companies have provided returns greater than those from dividend-paying and dividend-increasing companies. Strategas Research shows that over longer periods, however, Dividend Growers' returns have been higher and with less volatility. Strategas divides the S&P 500 into four categories with respect to dividends: companies with no change in dividend, companies that pay no dividend, companies that have cut their dividend, and companies that have increased their dividends (Strategas calls these Dividend Growers). In Figure #4, the blue bars show the average annual returns for each category, the red bars represent the average annual standard deviation, or volatility. (Remember that if one does not like a lot of volatility in a portfolio, a lower standard deviation is better.) In other words, investors typically would like to see the highest blue bar (return) and the lowest red bar (volatility). Figure #4 shows that over the more than 34 years between January 1990 and March 2024 Dividend Growers (farthest to the right) provided the best returns with the least volatility.

Figure #4: <u>Long term, Dividend Growers Provide Higher Returns with Less Volatility</u>



Source: Strategas Research, June 2024

Volatility has subsided lately. Historically the long-term trend of the stock market has been up, and lately that has been essentially a one-way trend. According to Strategas Research, since the year 2000, the S&P 500 has declined at least -2% on average every 117 trading days. From February 21, 2023 through June 28, 2024, however, the S&P 500 has not had a one-day decline of -2% for far longer than the 252 trading days in a year—340 consecutive trading days. This reinforces our premise that investors should always stay invested rather than trying to time the stock market.

Prudent Investors Stay Patiently Invested in Good Quality Securities at All Times

The Dearborn Partners Rising Dividend Strategy offers a way for investors to get into the stock market and stay in the stock market throughout any environment getting paid while patiently waiting. The Dearborn Partners investment team does not try to time when to get into or out of stocks. We do not make predictions about the direction of markets or interest rates or other macroeconomic factors. We constantly work hard trying to find for our portfolio good quality companies that we consider capable of increasing dividends year after year offering the potential for attractive total returns over time.

We on the Dearborn Partners investment team try to analyze the companies for our portfolio so well before adding them that we hope to be able to own them "forever." In fact, our average turnover is very low: less than 12% annualized since inception. Sometimes, however, companies lose their disciplines or unforeseen developments change the dividend's position relative to other important fundamentals. Our discipline emphasizes assessing our view of a company's ability to not just maintain a dividend but to be able to increase it with regularity and consistency. We believe that enforcing such a strict criterion provides for removing a company before the security of the dividend becomes a concern.

The companies in our Dearborn Partners Rising Dividend portfolio have on average continued to increase dividends at rates in accordance with our stated objectives of mid- to high single-digit annual growth. Here are some details about the dividend increases announced by the companies in our separately managed account (SMA) in the first half of 2024.

Dividend Growth: High & Rising Dividend SMA portfolio

In the second quarter of 2024, 4 of 25 companies in our High & Rising Dividend portfolio announced 5 dividend increases averaging about 3.3% more than those companies paid as dividends a year earlier. In the first half of 2024, 14 companies announced 16 dividend increases averaging 5.2% more than these companies paid a year earlier. One company announced a dividend increase in May only two months after reporting its first dividend increase in 2024 and another increase in June, i.e., after only one month. No companies in this portfolio have reduced or suspended dividends so far this year.

Cumulative Income Summary

Here is the cumulative dividend income generated by the shares held in companies in our Dearborn Partners Rising Dividend SMA Portfolio from an actual account, with an initial $200,000 investment on September 30, 2011 (the inception date of our SMA portfolio) through June 30, 2024:

	Average Current Yield	Cumulative Income*
High & Rising Dividend SMA	3.2%	$182,548
S&P 500	1.3%	$115,811

**The S&P 500 dividend income in the table above is calculated by creating investable "share units" by dividing an actual $200,000 investment by the price of the index (1131.42) on September 30, 2011 (the inception date of our Rising Dividend SMA portfolio), 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, 2024.*

The table above shows that the average yield of our Rising Dividend SMA portfolio at the end of the second quarter of 2024 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 yield 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—with strong balance sheets, high barriers to entry, and solid management.

It's true that short-term U.S. Treasury bill yields are finally offering rates that provide decent alternatives to stocks of companies that offer attractive dividend yields. As of June 30, 2024, the 6-month U.S. Treasury bill yield was 5.33%. Since before the Global Financial Crisis in 2008, savers are now no longer being punished and securities with the full faith and credit backing of the United States government can provide decent returns risk free and thus viable diversification to portfolios. Remember, however, that U.S. Treasury instruments offer no growth. The Federal Reserve is signaling that they may cut the Fed Funds Rate at upcoming meetings. If so, when current 6-month bills mature, rolling into the next ones may provide lower yields. We make no market forecasts; instead, we continue to believe that owning a well-diversified portfolio of high-quality companies that offer the potential to consistently increase dividends over time makes sense as a core component of investors' portfolios.

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 portfolio and those that may be candidates for our portfolio 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 portfolio 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 portfolio 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 Year Dividend Increases[1]

	High & Rising	CPI*
12-Year Average	7.5%	2.7%
YTD 2024	5.2%	3.4%
2023	6.9%	4.0%
2022	8.7%	6.0%
2021	6.3%	5.5%
2020	5.9%	1.6%
2019	8.2%	2.3%
2018	8.8%	2.2%
2017	5.8%	1.7%
2016	6.5%	2.1%
2015	7.5%	2.1%
2014	7.4%	1.6%
2013	8.7%	1.7%
2012	9.6%	1.9%

** Core Consumer Price Index for All Urban Consumers Unadjusted 12-month Percent Change for 12 months ending May 2024 Updated June 14, 2024. YTD=Year to Date. 12-Year Average represents December 2012-December 2023.*

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 14, 2024.

[1] On the date that a company in our SMA portfolio announce 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.

Appendix:

Investing early has a major impact on future returns

The Magic of Compound Interest — 10% Annually

This table illustrates the difference in future value for Investor A who invests $2,000 a year for the first eight years for the time period shown (for a total of $16,000), and Investor B who invests $2,000 per year for the remaining 39 years (for a total of $78,000) — excludes trading costs/expenses.

	Investor A		Investor B		
Age	**Contribution**	**Value**	**Contribution**	**Value**	**Annual Return**
19	$2,000.00	$2,200.00	$0.00	$0.00	10.0%
20	$2,000.00	$4,620.00	$0.00	$0.00	10.0%
21	$2,000.00	$7,282.00	$0.00	$0.00	10.0%
22	$2,000.00	$10,210.20	$0.00	$0.00	10.0%
23	$2,000.00	$13,431.22	$0.00	$0.00	10.0%
24	$2,000.00	$16,974.34	$0.00	$0.00	10.0%
25	$2,000.00	$20,871.78	$0.00	$0.00	10.0%
26	$2,000.00	$25,158.95	$0.00	$0.00	10.0%
27	$0.00	$27,674.85	$2,000.00	$2,200.00	10.0%
28	$0.00	$30,442.33	$2,000.00	$4,620.00	10.0%
29	$0.00	$33,486.57	$2,000.00	$7,282.00	10.0%
30	$0.00	$36,835.22	$2,000.00	$10,210.20	10.0%
31	$0.00	$40,518.75	$2,000.00	$13,431.22	10.0%
32	$0.00	$44,570.62	$2,000.00	$16,974.34	10.0%
33	$0.00	$49,027.68	$2,000.00	$20,871.78	10.0%
34	$0.00	$53,930.45	$2,000.00	$25,158.95	10.0%
35	$0.00	$59,323.50	$2,000.00	$29,874.85	10.0%
36	$0.00	$65,255.85	$2,000.00	$35,062.33	10.0%
37	$0.00	$71,781.43	$2,000.00	$40,768.57	10.0%
38	$0.00	$78,959.57	$2,000.00	$47,045.42	10.0%
39	$0.00	$86,855.53	$2,000.00	$53,949.97	10.0%
40	$0.00	$95,541.09	$2,000.00	$61,544.96	10.0%
41	$0.00	$105,095.19	$2,000.00	$69,899.46	10.0%
42	$0.00	$115,604.71	$2,000.00	$79,089.41	10.0%
43	$0.00	$127,165.18	$2,000.00	$89,198.35	10.0%
44	$0.00	$139,881.70	$2,000.00	$100,318.18	10.0%
45	$0.00	$153,869.87	$2,000.00	$112,550.00	10.0%
46	$0.00	$169,256.86	$2,000.00	$126,005.00	10.0%
47	$0.00	$186,182.55	$2,000.00	$140,805.50	10.0%
48	$0.00	$204,800.80	$2,000.00	$157,086.05	10.0%
49	$0.00	$225,280.88	$2,000.00	$174,994.65	10.0%
50	$0.00	$247,808.97	$2,000.00	$194,694.12	10.0%
51	$0.00	$272,589.87	$2,000.00	$216,363.53	10.0%
52	$0.00	$299,848.85	$2,000.00	$240,199.88	10.0%
53	$0.00	$329,833.74	$2,000.00	$266,419.87	10.0%
54	$0.00	$362,817.11	$2,000.00	$295,261.86	10.0%
55	$0.00	$399,098.82	$2,000.00	$326,988.05	10.0%
56	$0.00	$439,008.71	$2,000.00	$361,886.85	10.0%
57	$0.00	$482,909.58	$2,000.00	$400,275.53	10.0%
58	$0.00	$531,200.53	$2,000.00	$442,503.09	10.0%
59	$0.00	$584,320.59	$2,000.00	$488,953.40	10.0%
60	$0.00	$642,752.65	$2,000.00	$540,048.74	10.0%
61	$0.00	$707,027.91	$2,000.00	$596,253.61	10.0%
62	$0.00	$777,730.70	$2,000.00	$658,078.97	10.0%
63	$0.00	$855,503.77	$2,000.00	$726,086.87	10.0%
64	$0.00	$941,054.15	$2,000.00	$800,895.56	10.0%
65	$0.00	$1,035,159.56	$2,000.00	$883,185.11	10.0%
Total Invested	**($16,000.00)**		**($78,000.00)**		
Net Earnings		**$1,019,159.56**		**$805,185.11**	

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