

***When the Going Gets Tough,  
The Tough Get...Income***

In our first-quarter newsletter, we discussed our principles of asset allocation, and our preference for income-generating assets in the low-growth environment that we expect to persist. Too, we suggested traditional asset allocation methods exist in practice primarily for the “herd safety” of investment advisers. In our second newsletter, we delve a bit deeper into philosophies underlying our equity investment strategy.

Equity markets have staged a steady retreat from their euphoric opening quarter, and will close out May with a second consecutive month of losses. Similar to this same period in 2011, and 2010, investors’ fears are fully stoked. Greece is back, and so is Spain. China’s growth is slowing. And the bluest blue-chip bank, JP Morgan, recently announced a trading loss of \$2 billion, a loss growing larger by the day it seems, and taking Morgan’s share price with it, only in the opposite direction.

So consider why we invest anything, anywhere, in the first place – it’s to make money, more than from competing investment choices, at a tolerable level of risk. *An investor is paid to take risk.* Investors need to be paid to own stocks, the quintessential “risky” asset. That payment comes in two forms, a stock’s expected price appreciation, plus its dividend income return. Taken together, this is the total return for the stock. **At Ascent, we’re very keen on owning**

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**those companies that are returning cash to their shareowners through dividends,** after reinvesting suitably in the business. While markets sort through their current headwinds, which can make capital gains as fleeting as JP Morgan’s share price, we take comfort in the steady income stream our equity picks deliver.

Some powerfully simple ideas underscore the appeal of dividends:

**The dividend “habitat” is an appealing one.** Dividend-paying equities are typified by larger, financially stable companies. The best companies are profitable (we’re not interested in the unprofitable ones), operating in relatively mature, though still-growing markets, and generating excess cash. A portion of this cash is normally directed back to the business, for reinvestment in markets and products, or to pay down debt, while the rest is returned to shareholders in the form of share buybacks and increased dividends. The finest dividend payers have well-articulated policies for their priorities in

deploying excess cash, and supporting dividend growth.

**The dividend habitat is also a growing one.** Despite the fragile-seeming economy, corporate America remains in some of its best financial health in memory. Depending on the measure employed, corporate profitability is at or near record highs, and overall balance sheet health is very strong. Furthermore, managements have been cautious in outlays for new equipment and hires, preferring a wait-and-see approach to these uncertain times. The result has been growing cash stockpiles, and additional flexibility to return cash to shareowners. In recent years, several notable companies in the technology sector have initiated or boosted their payouts. The dividend universe for us at Ascent has never been more diverse.

**A growing dividend is the investing equivalent of a rising paycheck.** At Ascent, we are interested in dividend growers, and not simply dividend maintainers. We tread carefully around the very highest-yielding companies, which are concentrated in limited-growth businesses, such as utilities, or telecom. We greatly prefer a balanced approach; owning companies that remain capable of growing the bottom line meaningfully, thereby offering investors the prospect of share price growth *and* dividend growth – the total return idea.

We think the chart below shows the power of dividend investing, in which we present the ten-year dividend histories of three leading American companies: Chevron, Colgate-Palmolive, and McDonald's.

Taking Chevron as an example, a shareholder in 2011 collected \$3.09 for every share owned, up from \$1.40 per share ten years earlier. Chevron grew its dividend by an average of 8.2% annually over this period, and a shareowner fortunate enough to have held her position through the thick and thin of the prior ten years would have collected \$538 in cash for every \$1,000 invested in the company. (That's with the investor still owning her original Chevron shares, of course.) At the 2011 dividend rate, she'd be earning 7.7% annually on her initial investment. None of the preceding assumes reinvestment of dividends.

**Dividend equities are an appealing alternative in a fixed income desert.** We expect the Federal Reserve will continue to manage interest rates toward historic low levels, in a bid to boost economic growth. Make no mistake, present government bond yields are below any reasonable estimate of inflation, meaning one is losing real purchasing power in holding the current yield on US Treasuries or other Agencies.

Elsewhere, AA-rated Abbott Laboratories is

Company	Divs Per Share 2002	Divs Per Share 2011	Annualized Div Growth Rate	Yield on Cost	Total Divs Pd Per \$1,000 invested	Cumulative Price-Only Return 2002-2011
Chevron	\$1.40	\$3.09	8.2%	7.7%	\$538	137.5%
Colgate-Palmolive	\$0.72	\$2.27	12.2%	4.4%	\$278	60.0%
McDonald's	\$0.24	\$2.53	26.6%	11.0%	\$552	279.0%
					<b>S&amp;P 500</b>	<b>9.5%</b>

- Yield on Cost = 2011 Dividends Paid/2002 Average (high-low) Share Price
- Sources: Value Line, Company Websites, Standard & Poor's
- Disclosure: For illustration purposes only. These positions are currently held widely in Ascent client accounts.

typical of high-grade credit. It has a bond issue maturing in May, 2020, with a coupon of 4.125%, priced to yield 2.25%. (The bond trades at a premium of about \$113.7 to own \$100 of face value. An investor holding it to maturity would earn a 2.25% yield.) The common stock of Abbott presently yields 3.30%, *already more* than the yield on the Abbott paper, and 2012 marks the **fortieth** consecutive year that Abbott has raised its payout. An investor owning Abbott's 2020 bond has only the current, fixed payout to anticipate. The odds greatly favor rising payouts in the future on Abbott stock. Incidentally, Abbott is splitting itself into two companies, and we are excited at the stock's future prospects. We own it widely in client accounts.

**Finally, within our dividend strategy, in addition to investing in comprehensible business models, we strongly favor owning companies that “make stuff.”** We will close this note by returning to the case of JP Morgan. Until its recent trading fiasco, JPM enjoyed a gilt-edged reputation in the markets, and a premium valuation to accompany it. Still, we need to remember that the raw material of any and all financial companies is capital, which is joined with leverage and “products” and risk management to make the company profits. The market had concluded that JPM was among the best in its business, and deserving of a premium price. Much has changed in the course of a few short weeks, however, as the bank's trading losses have been revealed. They originated in a London-based office of the bank that resembles nothing as much as an internal JP Morgan hedge fund. Some things never change.

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