BESPOKE BRIEFING

REICH FITZPATRICK PRIVATE WEALTH GROUP OF WELLS FARGO ADVISORS

A letter from Rob Reich, answering the question:
"So, What? What Can I Do with All This Information?"

> ***"Time is on your side when you own shares of superior companies."***
>
> ***-Peter Lynch***

In the closing paragraphs of our ***April Newsletter***, which examined the markets' current fixation on guessing the Fed's next steps, I promised to answer the question, "so what?" Always trying to put myself in the reader's place, I imagined you saying, "well this is all very interesting, but how do I use this often contradictory and conflicting information to make better decisions?"

The Principles Guiding Our Answer

Our team believes that the answer to this question lies within the cornerstones of our guiding principles. First, our investment philosophy and processes are driven by the fact that we are "goals-focused, plan-driven" advisors. Second, we are "macro aware," and yet we don't allow short term major events or trends to distract us from our long-term focus.

Decades of experience, studying history, and participation in the capital markets has taught us that the economy cannot be accurately forecasted. Darrell Cronk, President, Wells Fargo Investment Institute, drove home this point in our ***April Newsletter: "I agree everyone wants to play the Fed Parlor game*** [referring to all the speculation around when the Fed will cut rates], ***and most are horrifically bad at it, including the bond market."***

Cronk's assessment supports our unshakable belief that markets cannot be timed. This realization ensures that we remain laser-focused on what we believe to be the most important, relevant, and -- over the long-term--"predictable" issues. Our focus doesn't shift, even as we notice the media and other market participants concentrating on what we regard as the "wrong variables." We think these overreactions to near- and intermediate-term market gyrations frequently lead them to the wrong conclusions. On the other hand, the over-response by some investors may create opportunities for those focused on the long

term.

As Warren Buffet said, ***"The stock market is designed to transfer money from the Active to the Patient."***

Headlines, current events, the next economic reading, a single report from a company or industry, or even the markets' "zig zag" reactions do not demand action. We joke that the most unusual "Breaking News" in the financial media would be an announcement that was not labeled "breaking news."

We acknowledge that our work is part science, part art, and part philosophy. Most people we share this with get the science and art, but the inclusion of philosophy sometimes raises questions. One of our favorite bits of philosophy here comes from Roman Emperor Marcus Aurelius' book "**Meditations**," where he said, ***"You always have the option of having no opinion. There is never any need to get worked up or trouble your soul <u>about things you can't control.</u>"*** [Emphasis ours]

Now that I've explained how we resist over-responding to news items, I offer this straightforward model that drives our processes and will explain our answer to the questions, "So what? What do I do now?"

GOALS ➤ PLAN ➤ PORTFOLIO

With most eyes now focused on the Fed, there is a tremendous amount of attention being paid to interest rates. Having finally recovered from nearly a decade and a half of historically low levels, 4%+ U.S. Treasuries have suddenly become one of Wall Street and the financial media's favorite topic.

Harkening back to our ***April Newslette***r, and our thesis that inflation is sticky and likely to remain higher for longer, it is our view that bonds in the 4% to 5% range are not a panacea or an opportunity that investors should overweight in their portfolios.

That is not to say we don't believe in holding bonds. Certainly, we do agree that "fixed income" investments have a place in many portfolios.

We believe, however, that some other potential solutions are more attractive than bonds because they have historically kept pace with and even exceeded the rate of inflation. And we prefer a strategy that not only has the potential to accumulate wealth, but also can transform your portfolio into a robust income stream: ***investing in stocks with historically rising dividends.***

As you approach retirement, or aim to fund other financial goals, understanding the power of the potential for growing dividends can be a beneficial strategy for income and growth needed to live your best life and support the people and organizations you care about most.

Not The Market, But a Portfolio of The Finest Companies in the World
Another cornerstone to our investment philosophy and processes is simple, but elemental: we're not just investors; we're owners. We seek out the finest companies in the world—ones with solid fundamentals, strong management teams, and a history of respecting shareholders' interests. As Sean Fitzpatrick often says when discussing our investment philosophy and process, **"We're not in the business of chasing the market. Instead, we're here to serve you, our clients, and help you achieve your financial goals and experience the freedom and joy that come with financial security."**

"The stock market is a giant distraction to the business of investing."

-John Bogle, Founder of Vanguard

The Historical Power of Dividends
Dividends have historically been a critical component of total returns in the stock market. Over the past century, dividends have accounted for a significant portion of the total returns of the S&P 500. According to a study by Hartford Funds, from 1930 to 2020, dividends contributed approximately 41% of the S&P 500's total return. Breaking this down further, when dividends are reinvested, the compounding effect amplifies total returns substantially.

To put this into perspective, consider the following data:

Price Appreciation vs. Dividends (1930-2020):

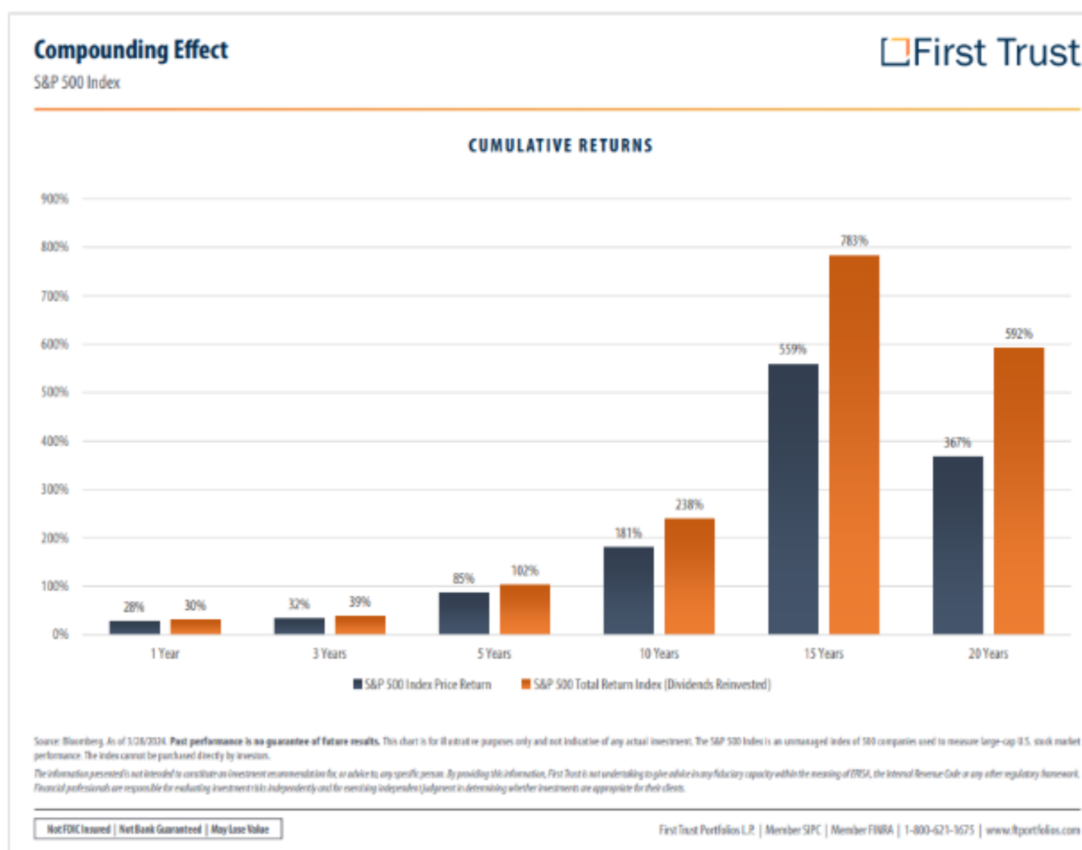
- Price Appreciation: 5.6% annually
- Dividends: 4.2% annually
- Total Return: 9.8% annually (with dividends reinvested)

*This example is for illustrative purposes only and does not reflect any actual investment available.

The growth of dividends often outpaces inflation, providing a persistent, durable, and dependable income stream. For instance, the average inflation rate in the U.S. from 1970 to 2020 was about 3.9%, whereas many blue-chip companies have consistently raised their dividends by higher percentages annually.

The Compounding Effect: Reinvesting Dividends
Reinvesting dividends has the potential to significantly boost your portfolio's growth. For instance, if you invested $10,000 in the S&P 500 in 1980 and reinvested all dividends, your investment would have grown to approximately $934,000 by 2020. Without reinvesting dividends, the same investment would be worth about $627,000. This difference underscores the power of compounding dividends over time.

The chart below shows the cumulative impact that compounding dividends can have on the cumulative returns of portfolios over the long term.



Dividend Growth vs. Inflation

In an inflationary environment, the dividends of companies with a history of raising their payouts has the potential to outpace inflation and bond returns. The 10-year U.S. Treasury note, a common benchmark for bond returns, has historically offered lower returns compared to rising dividend stocks. For example:

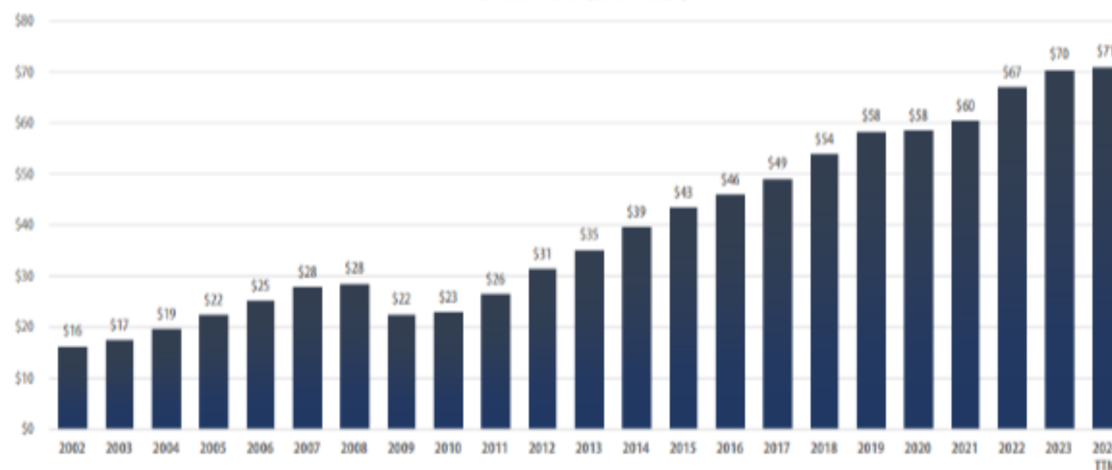
10-Year U.S. Treasury Note Yield (1960-2020):

- Average Yield: 5.9%
- Current Yield (as of May 14, 2024): ~4.45%

In contrast, many companies in the S&P 500 have increased their dividends at rates well above the inflation rate, providing a growing income stream that maintains purchasing power over time.

*Investors do need to consider that Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and fixed principal value. Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of securities. There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and are subject to change or elimination.

The chart below, courtesy of our colleagues at "First Trust," illustrates how many corporations have consistently increased their dividends year after year.



A Further Refinement to Our Dividend Approach

The charts above simply take into account the impact dividends have had on the S&P 500, a broad market index. Our dividend philosophy favors and focuses on companies with a long history of not only paying dividends, but also of consistently increasing the dividends they pay to shareholders over time. This may seem like a small difference but the impact it has on returns, dividend levels, and even risk is material.

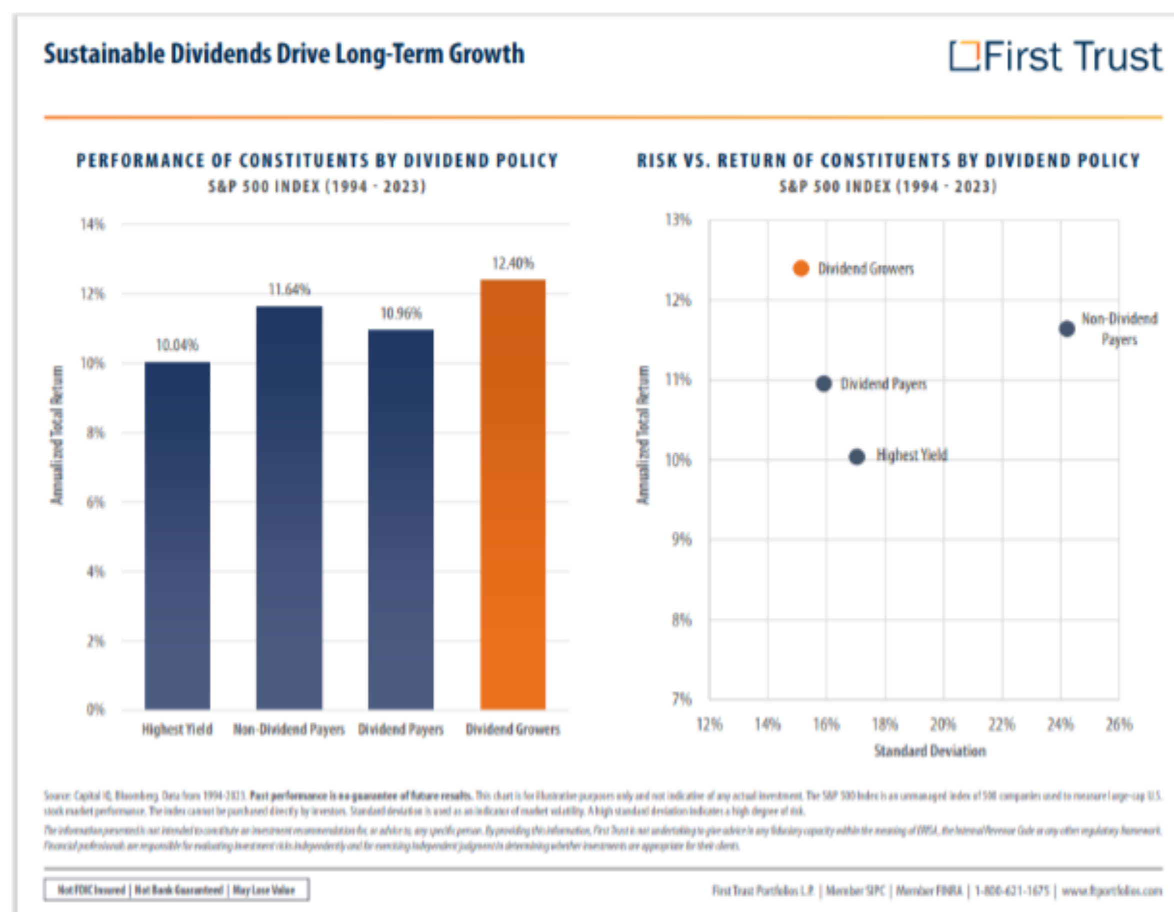
Why is this? One common way for the CEO of a public company to come under serious fire and risk termination, is to cut the company's dividend. A dividend reduction nearly ensures that stock prices will plummet, shareholders will revolt, and professional investors will dump your stock en masse. As a result, executive teams are very deliberate when declaring and raising dividends. They understand that this is not a one or two quarter decision, but a nearly irrevocable move. Therefore, they take great care to ensure that the company's current financial condition and projected future state, will allow them to pay this level of dividend now and into the future. A steady dividend is regarded as a reliable indicator that management is confident in the near- and medium-term of the company.

So now let's look at what happens when we refine our discussion and consider what Wall Street generally refers to as "dividend growers." That is the stock of companies that have historically raised their dividends in a generally consistent manner.

The first chart we will look at breaks the stock of publicly traded companies down into three categories: "Non-dividend payers," dividend payers with "No change to dividends," and finally "Dividend growers & initiators," The chart looks at [how a $100 invested in each of these groups would have grown between 1980 and 2021.]

* Source: BlackRock. Data from 1/1/1980 through 12/31/2020. The investment universe is the 500 largest U.S. stocks by market cap during each respective month. Dividend policy constituents are calculated on a rolling 12-month basis and are rebalanced monthly. Category cumulative total returns are calculated on a monthly basis and include dividends. Shown for illustrative purposes only and does not represent the performance of a specific investment product. Past performance is not indicative of future returns. The “Dividend growers & initiators” category represents performance for companies which either increased or initiated their dividend distribution. The “No change to dividends” category represents performance for companies which paid a dividend but have not increased nor decreased their dividend distribution. The “Non-dividend payers” category represents performance for companies which did not pay a dividend. Dollar amounts in USD. Information shown is hypothetical and for illustrative purposes only. Past performance is not an indication of future results. Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of securities. There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and are subject to change or elimination.

Not only did the “Dividend growers & initiators” outperform the other two categories, in the last few decades they have done so with less risk. The series of charts below illustrates this as “Sustainable Dividends Drive Long-Term Growth.” The chart on the left titled “Performance of Constituents By Dividend Policy,” reveals that from 1994 to 2023, “Dividend Growers” outperformed all other constituents. The right side of the chart shows “Dividend Growers” have the best risk adjusted returns, as compared to the other categories during this time as well.



Why This Matters

Investing in rising dividend stocks not only provides income but also offers "visibility and transparency"; into the sources of your income streams. This can be crucial in meeting your obligations and pursuing your highest aspirations, whether it’s funding a comfortable retirement, supporting loved ones, or contributing to charitable causes.

As we navigate uncertain economic times, by incorporating rising dividend stocks into your portfolio, you shape a financial strategy that can be resilient and capable of adapting to inflationary pressures, ultimately with the goal of helping you to live your best life.

June Newsletter

Next month we will explain why we believe now might be an especially opportune time to

look at increasing our exposure to “dividend growers.” We will also clarify how we intend to express this conviction in our portfolio management process.

By understanding and leveraging the power of rising dividends, you can foster a financially prudent strategy designed for income and growth potential.

Thanks, Rob

Sources

1. Hartford Funds. (n.d.). "Dividends: A Significant Portion of Total Return." Retrieved from Hartford Funds.
2. U.S. Treasury. (n.d.). "10-Year Treasury Note Historical Data." Retrieved from U.S. Treasury.
3. U.S. Census Bureau. (n.d.). "Median and Average Sales Prices of New Homes Sold in United States." Retrieved from Census Bureau.
4. National Center for Education Statistics. (n.d.). "Tuition Costs of Colleges and Universities." Retrieved from NCES.

* Past performance is not an indication of future results. An index is not managed and is unavailable for direct investment.
* Investments in fixed-income securities are subject to market, interest rate, credit and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can cause a bond’s price to fall. Credit risk is the risk that an issuer will default on payments of interest and/or principal. This risk is heightened in lower rated bonds. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.
* Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer a fixed rate of return and fixed principal value. Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. Investments in equity securities are generally more volatile than other types of securities.
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