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INVESTMENT RESEARCH, INC.

An Enhanced Approach to Dividend Investing

Introduction
Investing in stocks that pay dividends has many advocates, and for good reason. Many research studies have found that dividend-paying stocks historically have outperformed non-dividend payers while also being less volatile through time.

The potential to earn attractive risk-adjusted returns has led to the introduction of numerous dividend-based indexes, mutual funds, ETFs, and SMA's. These strategies cover different markets, vary their emphasis on dividend yield vs dividend growth, and can include non-dividend selection criteria. But they all tout that dividend-paying companies tend to be larger, more stable, and more profitable – of higher "quality" – than the average firm.

High Dividend Yield – a Free Lunch?
We all know that past performance is no guarantee of future results, and dividend strategies are no exception. The historical outperformance of stocks with the highest dividend yields implies that these stocks have somehow been "mispriced" by the market. Perhaps investor preference for growth stocks may have historically left slower growing, high dividend yield stocks somewhat undervalued. But this past outperformance has become well documented, and simple strategies such as holding stocks with the highest yields or baskets weighted by dividend payout clearly have no information edge or behavioral barriers to adoption. We believe that as money continues to flow into dividend strategies any remaining undervaluation of stocks with the highest dividend yields or payouts will soon be eliminated.

Dividend Growth Consistency
A somewhat more sophisticated dividend investing strategy focuses on companies that have been able to consistently increase their dividends over time. Firms able to raise their dividend payouts year after year usually have healthy growing businesses, whereas a high dividend yield can sometimes flag a firm in distress that could cut its dividend. Since stocks with consistent dividend increases also tend to have above-average dividend yields, these stocks can potentially provide investors with a dividend income stream that is both high and growing.

Two well-known indexes that embody the dividend growth consistency strategy are the Dividend Aristocrats and the Dividend Achievers. Standard & Poor's defines Dividend Aristocrats as S&P 500 Index firms that have raised their dividend payouts for at least 25 straight years. Nasdaq defines Dividend Achievers as firms that have increased their dividends for at least ten straight years. The Dividend Aristocrats index typically contains about 40-60 large market cap stocks, while the Dividend Achievers index is far more diversified and typically contains 200-300 stocks across the market cap spectrum.

Selecting Among Dividend Achievers
The Nasdaq US Broad Dividend Achievers Index was launched on April 30, 2006. With hundreds of member stocks and 12+ years of history, we have enough available data to research whether specific investment factors might be correlated with future total returns among the Dividend Achievers. Starting

on 4/30/2006, each month we ranked the Dividend Achiever member stocks into uniform "portfolios" according to a variety of investment criteria reflecting valuation, fundamentals, momentum, sentiment, and risk perspectives. We then computed average quintile returns over subsequent 12-month holdings periods. We repeated this process each month through 11/30/2018 and averaged the quintile portfolio returns for each selection criterion.

This research process revealed a variety of investment factors that historically have been correlated to future relative returns among Dividend Achievers (see table). The data show that Dividend Achievers with cheaper valuation, higher growth, greater profitability, positive analyst sentiment, and lower forecast uncertainty have historically outperformed their peers. Note also that stocks with the opposite characteristics (quintile 5) underperformed by a wide margin.

Stocks must meet a high dividend consistency standard to become Dividend Achievers, but it really should be no surprise to find that these stocks vary in valuation, growth prospects, profitability, analyst favor, or earnings predictability. More importantly, while future performance may be different, this research indicates it may be possible to create a portfolio strategy that improves upon investing in the entire Dividend Achievers Index.

Selected Factor Performance within Dividend Achiever Members: 2006-2018

Ranking Criterion	Investment Perspective	Avg 12-Month Return vs All Dividend Achievers				
		Quin1	Quin2	Quin3	Quin4	Quin5
Forecast EPS/Price	Valuation	1.37	0.86	0.66	0.68	-3.52
Sales/Price	Valuation	2.33	2.02	-1.02	-1.38	-2.01
(P/E) / (EPS Gth + DivYld)	Valuation	2.09	0.90	0.00	0.30	-3.68
5Y Forecasted EPS Gth	Growth	1.33	1.36	-1.40	-0.82	-0.78
4Q Chg Total Assets	Growth	1.13	0.13	0.56	-0.67	-1.26
Return on Equity	Fundamentals	2.72	0.45	-0.60	-1.29	-1.42
Earnings Quality (Accruals)	Fundamentals	2.83	1.44	0.19	-2.18	-2.44
3M EPS Forecast Revisions	Sentiment	1.89	0.93	0.45	-1.55	-1.51
Avg Analyst Rating	Sentiment	1.14	0.58	1.34	-1.52	-1.83
EPS Forecast Dispersion	Risk	0.51	0.80	0.99	1.04	-3.67
Average		1.73	0.95	0.12	-0.74	-2.21

Downside Risk Avoidance - An Innovative Approach

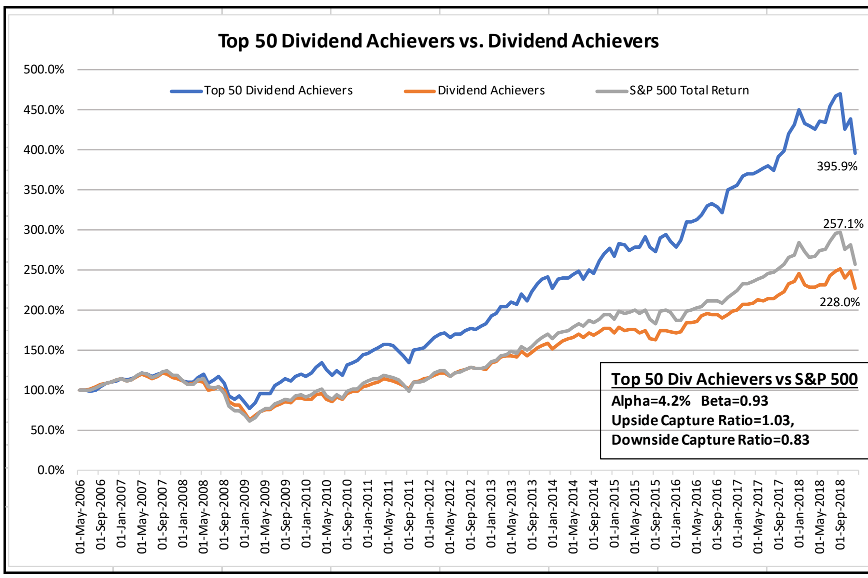
A main appeal of dividend investing strategies is their defensive nature. While dividend-paying stocks tend to have lower betas, less price volatility, and stronger down market performance than the average stock, this doesn't mean that every dividend-paying stocks is defensive. Furthermore, we have learned dividend payers with particular characteristics (e.g., expensive valuations and high forecast uncertainty) have historically been more likely to underperform. This research suggests that an innovative approach to building a better dividend investing strategy may be to focus on avoiding dividend stocks with high downside risk.

Revelation Investment Research is a firm that specializes in applying a "what could go wrong" perspective to researching equities. Revelation's Downside Risk Alert model analyzes stocks against nineteen criteria specifically chosen for their ability to identify stocks with the weakest risk-adjusted return prospects. Historically, stocks rated by Downside Risk Alert as having the greatest downside risk have underperformed the average stock while also being much more volatile. Stocks rated as having the least downside risk have outperformed with less than average volatility. This same performance pattern has held when using Downside Risk Alert ratings within the universe of dividend-paying stocks.

Building an Enhanced Dividend Achievers Portfolio
What is the potential benefit of managing a dividend strategy portfolio where stocks rated as having high downside risk are systematically avoided? To answer this question, we ran a portfolio simulation using the Dividend Achievers Index members through time.

We began by purchasing the 50 Dividend Achiever stocks with the best Downside Risk Alert ("DRA") ratings on 5/31/2006 (one month after the Dividend Achievers index was created). Portfolio positions were initially equal weighted and transaction costs of 0.15% were subtracted for each purchase. No other portfolio risk management constraints (e.g., limiting sector weights) were applied. The portfolio was first rebalanced six months later on 11/30/2006. Any portfolio holding no longer rated among the top 100 Dividend Achiever stocks by DRA was sold and replaced by the best-ranked stock not already owned. Any holding whose weight exceeded 3% of the overall portfolio was trimmed back to the 3% position size limit. Transaction costs of 15bps were subtracted for each sale and purchase. This same rebalancing process was applied at subsequent six month intervals and run through 12/31/2018. The portfolio simulation results do not include the deduction of any management fee which if included would reduce the strategy's returns.

The chart below shows the strong performance of the enhanced Dividend Achiever strategy. The "Top 50" portfolio outperformed the Dividend Achiever Index by over 4% annually while generally retaining the index's defensive characteristics relative to the overall U.S. stock market.



	Annual Top 50 Dividend Achievers	Annual Dividend Achievers (Cap Weight)	Annual S&P 500 Total Return
2006*	11.60%	13.31%	12.75%
2007	4.69%	1.61%	5.50%
2008	-20.57%	-28.88%	-36.99%
2009	30.00%	10.10%	26.45%
2010	19.74%	15.55%	15.05%
2011	6.33%	10.02%	2.12%
2012	19.09%	10.73%	15.98%
2013	32.11%	25.75%	32.41%
2014	15.07%	11.07%	13.69%
2015	2.81%	-1.90%	1.40%
2016	23.46%	14.89%	11.98%
2017	22.33%	18.65%	21.84%
2018	-8.32%	-3.82%	-4.38%
Annualized	**11.55%**	**6.77%**	**7.79%**

*Partial year beginning 5/31/06 through 12/31/06. Monthly portfolio returns and holdings available upon request.

Conclusion

Dividend investment strategies have historically provided attractive risk-adjusted returns, leading to a stampede of dividend-related product introductions in recent years. Given the money flow into these products and the simplicity of many of their underlying strategies, continued long-term outperformance is doubtful. We believe that a more innovative approach to dividend investing will be required.

One such approach is to narrow the dividend-paying stock universe not by dividend payout or yield, but by the more demanding hurdle of dividend growth consistency. Using the Nasdaq US Broad Dividend Achiever members as that starting point, selecting stocks according a downside risk avoidance perspective offers great promise. With most equity research focused on assessing a stock's growth opportunities and upside potential, inattention to downside risk can lead to some stocks being potentially mispriced. A disciplined strategy of holding stocks rated as having the least downside risk selected from a broader universe of Dividend Achievers looks very intriguing.