The Enduring Qualities of Dividends

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Enduring: defined as “lasting over a period of time; durable.”

Attractive Returns with Lower Risk

Over time, dividend-paying stocks have outperformed non-dividend stocks, and this achievement has come with lower risk (volatility). Past performance does not guarantee future performance. However, we offer some compelling evidence that emphasizing dividend-paying investments and dividend reinvestment as a component of a broader investment strategy has withstood the test of time. This includes environments with rising interest rates and ever-changing income tax rates, as well as periods of time with unusual market volatility (e.g., the U.S. “great recession” of December 2007 – June 2009).

The 12 Key Principles

In May 2013, we introduced The 12 Key Principles to Long-term Wealth Generation Through Disciplined Dividend Growth Investing. This update features updated market data. The basic premise of the report remains the same.

Consider the Risks

Investing in equities involves risk and the possibility of material investment losses, especially over relatively short time horizons. We strongly recommend implementing the strategies and concepts highlighted in this report as part of a broader long-term asset allocation and investment diversification strategy. We urge investors to work with a financial advisor and also a tax advisor – starting early with professional advice could potentially mitigate risks and losses down the road.

<table>
<thead>
<tr>
<th>Dividend Yield and Relative Performance 1957 - 2013</th>
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<tr>
<td>Dividend Yield Quintile</td>
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<td>Highest</td>
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<td>High</td>
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<tr>
<td>Low</td>
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<tr>
<td>Lowest</td>
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<tr>
<td>S&amp;P 500</td>
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</table>

Each stock in S&P 500 is ranked from highest to lowest by dividend yield on December 31st of every year and placed into “quintiles,” baskets of 100 stocks in each basket. The stocks in the quintiles are weighted by their market capitalization. The dividend yield is defined as each stock’s annual dividends per share divided by its stock price as of December 31st of that year.

Beta is a statistical measure of risk (volatility). A beta higher than 1 implies more risk (volatility) than the benchmark; a beta less than 1 implies less risk (volatility) than the benchmark.

Past performance is not a guarantee of future results. It is not possible to invest directly in an index.

Source: Siegel, Jeremy, Future for Investors (2005), With Updates to 2013; Ameriprise Financial Services, Inc.
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THE ENDURING QUALITIES OF DIVIDENDS

Challenge: Name an investment strategy which

- Offers potential for growth and compounded income
- Hedges against inflation
- Is transparent
- Receives favorable tax treatment (under current law)
- And denotes quality and strength

Answer: Stocks paying growing dividends

“Enduring” is defined as lasting over a period of time; durable. And this is precisely how we view the fundamental qualities of dividends and dividend-paying companies.

From a macro perspective, dividend income is growing faster and more steadily as a percentage of personal income than other forms of personal income. According to research from Aye Soe at S&P Dow Jones Indices (based on Bureau of Economic Analysis data), dividend income in 2012 was 5.64% of per capita personal income in the U.S., up from 4.39% in the prior ten years and 3.51% in the prior 20 years. Interest income still outranks dividend income as a percentage of personal income, however the trend is down, partially due to the low level of current interest rates. In 2012, interest was 7.39% compared to 13.51% in 1992. The total value of dividend income was $757 billion in 2012, up from $188 billion in 1992 (growth of over 300%). Interest income grew less than 100% during that same period.

We believe an investment strategy emphasizing dividends and dividend growth can be effective in nearly all market cycles and business environments: inflationary, expansionary, contracting, and even sideways. Over the long-term, dividends have been a major component of stock market returns. According to S&P Dow Jones Indices, from 1926 – 2013 dividends accounted for 34% of the long-term total return of the S&P 500 Index. During some decades, such as the relatively high inflationary periods of the 1940s and 1970s, dividends amounted to 50%+ of long-term total returns.

Further, as demonstrated in the next chart from Ibbotson, a leading authority on asset allocation and long-term market returns, the difference between capital appreciation without, and with, dividends reinvested, is enormous. We note this is an exceptionally long time horizon (86 years) versus a “normal” real-life investment time horizon. Nonetheless, the concept is valid, and later in this report we build out some examples based on a more realistic 20-year time horizon.

<table>
<thead>
<tr>
<th>Capital Appreciation Without Dividend Reinvestment</th>
<th>Total Return with Reinvested Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>$145</td>
<td>$4,677</td>
</tr>
</tbody>
</table>

**Value of $1 Invested in Large Company Stocks 1926 - 2013**

Setting the Stage: Defining the Enduring Qualities of Dividends

We summarize our observations and thoughts as follows:

- Unlike many income statement lines such as sales, general, administrative and other expenses, taxes, and to a lesser extent, cost of goods sold, dividends are an exceptionally transparent measure of value and financial health for a company. This holds true because dividends cannot succumb to over or understatement by accounting vagaries, or other purposefully deceptive tactics
  - Many business decisions and expenditures can be timed as needed – accelerated, delayed, or otherwise adjusted – to achieve a pre-determined earnings target
  - Current accounting rules allow for numerous exceptions and adjustments, which can also cloud the true picture of a company’s financial health and profitability
  - Dividends are fully transparent – you will know when it was paid, how much was paid, and whether the payment was the same as the prior payment, higher, or lower. You will also clearly know if it was NOT paid or if it was delayed, and if necessary, you can adjust your portfolio accordingly

- Dividends can imply a higher value, since over time dividend-paying stocks tend to outperform those that do not pay a dividend (or that have cut or eliminated their dividend)
Dividends have historically grown faster than the U.S. inflation rate and can be a significant contributor to an investment’s total return

- A disciplined dividend reinvestment strategy reduces the payback period for an equity investment, and this positive impact can be magnified when combined with a dividend growth investing strategy.

- Dividends mitigate volatility. This is demonstrated by historically lower beta and standard deviation (beta is a common statistical measure of historical price volatility of a stock versus an appropriate benchmark; standard deviation measures the variability of returns over time for a stock or index).

- Dividends provide a measure of downside market protection, especially when coupled with a dividend reinvestment strategy, as investors tend to focus on the long-term when dividends are paid and accumulated over time.

- Dividends indicate financial strength and greater management discipline, as companies that pay dividends tend to be well-managed in order to meet the board’s dividend policy and avoid dividend cuts.

- Demographic shifts across the U.S. and many other developed-market countries reflect a gradually aging population, and appear to be a long-term macro condition; this dictates that collective retiree investment needs may continue to grow for decades to come.

The 13-year Secular Bear Market: 2000 to 2012

We discussed at length the secular bear market of 2000 – 2010 in a prior dividend growth investing white paper. As time marched on, we now believe the secular bear market persisted through 2012. In reviewing the 2013 – 2014 market climate with our Senior Market Strategist, Marc Zabicki, CFA, we believe the U.S. equity markets may have exited secular bear territory and now resemble the early stages of a long-term secular bull market. Some of this thought process is gleaned simply from price charts where, throughout the 2013 – 2014 timeframe the S&P 500 index set multiple consecutive record highs. Part of the thought process is also based on fundamentals – the U.S. economy is improving; consumer and corporate balance sheets are in arguably the best shape ever due to deleveraging (debt reduction); the housing market appears to be on a sustainable upward trajectory; and the Fed remains accommodative (although rates will rise at some point). Time will tell if the secular trend has shifted. However, we wish to revisit briefly our secular bear discussion, because the importance of dividends is magnified during secular bear markets for multiple reasons:

Dividends create wealth by providing a cash return to the shareholder on an ongoing basis. This cash return can be used to purchase additional shares, which allows the investor to build equity and potentially increase future dividend distributions.

Furthermore, dividends can increase over time as the invested company’s profit grows. The combined result provides a compounding effect that can create wealth regardless of stock market performance.

Finally, a stable cash income (yield) can provide a cushion in down markets.

A look at the performance of two representative dividend-oriented indices demonstrates the positive impact that dividends have had on performance since the beginning of the most recent secular bear market in 2000.

- The Dow Jones U.S. Select Dividend Index includes the 100 highest yielding stocks in the broad-based, Dow Jones U.S. Total Stock Market Index, with a non-negative dividend growth rate over the last five years, and a payout ratio of less than or equal to 60%.
- The S&P 500 Dividend Aristocrats index contains companies in the S&P 500 that have not only paid, but have increased their dividends for 25 consecutive years.

Both Indices outperformed the S&P 500 Index by a wide margin during the secular bear market. A $100,000 investment made at the start of 2000 through the end of December 2013 would have grown to approximately $358,175 and $366,056, if invested in the Dow Jones U.S. Select Dividend and the Dividend Aristocrats indices, respectively. The same amount invested in the S&P 500 Index would have gained considerably less, reaching $125,492 over the same 13-year period (and notably, when measured at the end of 2012, would have actually amounted to a loss of $3,170). These figures exclude the impact of taxes and fees. If taxes and fees had been included, results would have been lower.

Despite the solid relative performance, both indices have inherent weaknesses that we believe can be overcome by a more actively managed portfolio solution. We have two main concerns with the Dividend Aristocrats. First, it is limited to large, very established companies, providing no exposure to smaller, faster growing, dividend payers. Second, there is no...
minimum yield requirement. Therefore, even an overvalued company with a relatively low yield can be maintained in the portfolio, as long as the dividend was increased for 25 consecutive years. The Dow Jones U.S. Select Dividend Index is a broader based index than the Aristocrats, and is focused on the highest yielding stocks, but at times can lack adequate sector diversification. Furthermore, there is no requirement for dividend growth. An actively managed portfolio can seek to overcome both of these issues.

The Demographic Trend Is Your Friend

We often hear market technicians say “the trend is your friend” when they have identified a particularly compelling buy or sell opportunity based on an historical price chart or other indicators. However, more to our point here, from a long-term fundamental investment perspective, we believe the demographic trend is your friend when it comes to dividend investing. While stocks usually do not move higher in a straight line (just consider the 13 years during the most recent secular bear market to experience this), we believe there are compelling long-term tailwinds at hand which could provide a terrific environment for dividend-paying equities over the coming decades. While we acknowledge that most investors do not look out decades for a typical investment portfolio, it is important to keep in mind that there are some very long-term aspects to investment portfolios – 401K plans, IRAs, and college savings plans (when started at birth) do indeed have multi-decade time horizons. Even saving for a vacation home or a dream tour of the world the current environment and the long-term projections regarding the aging U.S. population. The 65-plus population is continuing to expand as baby-boomers age. This in turn reduces the ratio of peak-savers to retirees. Couple this with the fact that the number of people who receive pensions is on the decline, and barring a major legislative and structural overhaul, the risk that Social Security benefits for seniors may eventually need to be reduced, it appears inevitable that retirees will need to rely ever-more on their own savings (for example, qualified plans such as IRAs and 401-K plans). We believe this trend sets up an environment where savers (investors) will increasingly demand dividend-paying stocks in defensive sectors (Consumer, Health Care, and Utilities, for example), along with relatively higher dividend yields. This could help set up a long-term bull market environment in these types of stocks, in our view.

What About Rising Interest Rates?

Interest rates, already in a long-term downtrend since about 1980, have remained close to multi-decade lows since 2008, due to aggressive FOMC intervention and ongoing massive quantitative easing during and following the “great recession” of December 2007 – June 2009. The point of this paper is not to argue for or against the historically unprecedented monetary and fiscal policy actions of the prior and current administrations. However, now that interest rates have been scraping along the bottom for several years, coupled with our belief that the U.S. economy is showing slow but steady improvement, it is our belief that interest rates have the propensity to rise from here.

So how do rising rates impact stocks? Conventional wisdom dictates that rising rates have the potential to knock down equity valuations, because investors will sell stocks and move back into interest-bearing instruments when yields become more attractive. It is our belief, however, that this is not necessarily the case. Steady, predictable, rising interest rates, in our view, generally point to an economy that is experiencing positive growth and modest inflation...which is conducive to increasing corporate profitability, and thus, potentially higher stock prices. There can be exogenous factors, of course, which impact short-term market valuations. However, this does not change our view over the long-term impact.
Short-term Examples

Morningstar recently published a study on interest rate cycles and dividends during some representative time periods where interest rates (as measured by the Fed Funds Rate and the 10-year Treasury rate) were generally rising. The table below was published in an April 17, 2013, paper entitled “Demographics and High-Dividend Equities” by Josh Peters, CFA (used with permission). During these representative periods of rising interest rates, the S&P 500 Index turned in healthy gains, as did the DJ U.S. Select Dividend Index. Note, though, the downdraft in dividend-paying stocks in 1999 – 2000 – we attribute this sell-off to the “tech bubble” period, as opposed to a reaction to rising interest rates.

<table>
<thead>
<tr>
<th>Start</th>
<th>End</th>
<th>Equity Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 1994 - Feb 1995</td>
<td>Fed Funds 3.25% 6.00% Total Return: DJ U.S. Select Div. +5.88%</td>
<td>10-Year Treasury 5.75% 7.47% Total Return: S&amp;P 500 +4.45%</td>
</tr>
<tr>
<td>May 1999 - May 2000</td>
<td>Fed Funds 4.75% 6.50% Total Return: DJ U.S. Select Div. -10.46%</td>
<td>10-Year Treasury 5.54% 6.44% Total Return: S&amp;P 500 +10.48%</td>
</tr>
<tr>
<td>May 2004 - June 2006</td>
<td>Fed Funds 1.00% 5.25% Total Return: DJ U.S. Select Div. +25.32%</td>
<td>10-Year Treasury 4.72% 5.11% Total Return: S&amp;P 500 +17.75%</td>
</tr>
</tbody>
</table>


Past performance is not an indicator or guarantee of future performance, and it is not possible to invest directly in an index. These figures do not include transaction fees or taxes, which would have reduced returns.

Long-term Viewpoint

Rising interest rates would make us concerned, as shown in the chart below (used with permission from S&P Capital IQ), in unusually high interest rate environments. Historically, when 10-year Treasury yields are higher than 6%, stocks have generally decreased in price. The worry here is that rates are high because expected inflation is high. High inflation erodes purchasing power for consumers, and can also negatively impact corporate profit margins. This type of environment is generally not conducive to expanding equity valuations.

Source: S&P Capital IQ. Indexes are unmanaged, statistical composites and it is not possible to invest directly in an index. The returns shown do not reflect payment of any sales charges or fees an investor would pay to purchase the securities they represent. The imposition of these fees and charges would cause actual and back tested performance to be lower than the performance shown. Returns exclude dividends and taxes. Past performance is no guarantee of future results.
Why do we Emphasize Dividend Growth?

**The 12 Key Principles to Long-term Wealth Generation Through Disciplined Dividend Growth Investing** we believe, are important for building a successful dividend growth investment strategy. We also provide a demonstration of how the combination of yield, modest growth, and reinvestment can provide substantial return over a twenty year period. Dividend growth investors understand that stock prices can be impacted by factors outside of corporate fundamentals, even over long periods of time. They choose not to rely solely on prices to generate return and create wealth. They realize a shareholder is an owner in a business, and as an owner, they are entitled to a share of corporate profits. They shy away from businesses that use the majority of profits to fund growth regardless of cost, often through over-priced acquisitions or high risk capital projects. Instead, they look for cash generating companies, with sensible management teams, that are committed to providing shareholders with cash return, while at the same time making prudent investments in future growth.

Dividend growth investors realize that dividend stocks offer something that few income-oriented investments offer...growth potential. This can significantly enhance return over the long-term and acts as a hedge against inflation. That is why an attractive yield is not enough. Dividend growth investors look for companies with attractive yield, coupled with solid long-term growth prospects, and management teams that will share this growth with shareholders through dividend increases.

Dividend growth investors embrace the power of compounding and the impact it can have on wealth creation, but realize it is a long-term process. They stay invested in down markets because they realize their dividends are reinvesting at depressed prices, thus enhancing the impact of compounding. Conversely, they remain grounded in strong bull markets and resist the urge to invest in the hottest industries and stick with their requirement for consistent cash return.

Dividend growth investors know that historically dividends have been more stable and easier to project than earnings, and significantly easier to project than stock prices; and they manage their portfolios accordingly. They are primarily concerned with generating and growing portfolio cash return through investments in growing, cash-generating businesses, and are less concerned about the day-to-day stock price movements, which can be influenced by a variety of factors.

**THE 12 KEY PRINCIPLES TO LONG-TERM WEALTH GENERATION THROUGH DISCIPLINED DIVIDEND GROWTH INVESTING**

1) **CONCENTRATE ON YIELD**

**Yield Equals Cash Return:** A dividend growth investment strategy starts with generating cash return from a growing business. Dividend yield refers to the annual cash return expected from a stock. This cash return is much more stable and can be relied upon more than share appreciation. This is a significant advantage, especially when market valuations are stagnant or contracting.

A $10,000 investment in a stock with a stable pre-tax 5% dividend will generate $500 in cash return each and every year it is paid, even during market downturns and economic recessions. Over the long-term, cash yield can have a significant impact on return. For example, stocks with a pre-tax 3%, 5%, and 7% yield will pay for themselves with the dividend alone in 34 years, 20 years, and 15 years, respectively. Thus, the investor has been paid back the original purchase price, and still owns the original stock. And while 20 years sounds like a very long period of time, keep in mind that all of the stocks in the Dividend Aristocrat Index have paid increasing dividends for 25 consecutive years. These are companies built to last, and investments that can be an enduring part of an investment portfolio.

**Annual Cash Return**

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
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<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
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<tbody>
<tr>
<td>$0</td>
<td>$100</td>
<td>$200</td>
<td>$300</td>
<td>$400</td>
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**Payback Period = 20 years**

**Yield is an Indicator of Value:** In addition to providing an indication of expected cash return, yield also provides a gauge on how expensive a stock is. The dividend yield (annual dividend / price) describes the annual dividend relative to price. The requirement for attractive yield helps to prevent overpaying for a stock, and may enhance the chance for future capital gains. Assume the yield on a stock with a stable dividend that normally provides a 5% yield gradually trends down to a 2% yield. That decline indicates investors have bid up the stock price. That’s a signal to the dividend investor to reexamine the fundamentals of the company and determine if the stock is over-valued.

**Avoid Yield Traps:** While a high dividend yield can indicate an attractive cash return and low stock valuation, it does not mean we should simply go out and buy the highest yielding stocks. A high dividend yield could indicate the market perceives some risk that has not yet manifested. Thus, the seemingly generous dividend may not be sustainable. A “yield trap” is a stock with an attractive yield but deteriorating fundamentals that put future dividend payments at risk. It is referred to as a “trap” because the high yield attracts investors who then could experience a dividend cut or elimination and potential decline in stock price.

Investors can protect themselves against yield traps by:

- valuing stocks to projected earnings and cash flow in addition to dividends.
The Enduring Qualities of Dividends

• investing in companies with strong balance sheets and free cash flow in excess of dividend requirements that can potentially support the dividend even in the event of a business downturn
• placing an emphasis on both yield and growth in dividends
• allocating to active managers who adhere to the principles mentioned above

2) REQUIRE GROWTH

Growth is the other key component in the dividend growth investment strategy. The ability to grow cash return is the primary differentiator between dividend stocks and other income-generating investments like bonds. Investments should be made in growing firms that generate ample cash flow to fund capital expenditures, new business opportunities, and an attractive level of cash return to shareholders. These firms should also have management teams that are committed to providing attractive cash returns to shareholders.

Dividend growth offers several advantages to an investor. First, an increasing dividend can reflect management’s optimism on the direction of future cash flows. Second, dividend increases can act as a hedge against inflation. This is extremely important for retired investors who want to maintain purchasing power. Third, a growing dividend typically reflects a growing business, which should increase in value over time through share price appreciation. Finally, the incremental cash provided by the dividend increases can be a significant contributor to cash return over time.

Annual Cash Return

20 year cash return = $16,533 (165%)
Yield on Investment in Year 20 = 12.6%
Payback Period < 15 Years

$16,533). The dividend grows from $500 in the first year to $1,263, providing a pre-tax yield on investment of almost 13% in year 20 (see Appendix). Also, the cash return payback period decreases from 20 years to less than 15 years.

3) REINVEST TO BUILD EQUITY

As we have already noted, ongoing cash return is the most significant advantage of owning a dividend paying stock. Investors can use this cash for anything they want, but if not needed for living expenses, re-investing the dividend is a wise option, in our view. Dividend reinvestment allows an investor to build additional equity without adding more capital, which will create a compounding effect over time. Again, this is a significant enhancer to return over time, in our opinion.

Annual Cash Return

20 year cash return = $28,637 (286%)
Yield on Investment in Year 20 = 30.6%
Payback Period < 12 Years

Let’s go back to our previous example of $10,000 invested in a stock with a pre-tax 5% dividend yield, with both corporate earnings and the dividend growing 5% annually. We will add the following assumptions: (1) the stock price at purchase time was $10 and 1,000 shares were purchased, (2) dividends are reinvested at the end of each year, and (3) for reinvestment purposes, the stock price increases at the same 5% rate as business growth.

Under these assumptions, reinvestment provides a total cash return of $28,637 pre-tax. This is an additional $12,104 in cash from our previous example. The 5% dividend increases, coupled with dividend reinvestment, enhance returns by more than 186%, compared to our original no-growth, no reinvestment example.

Furthermore, dividend reinvestment historically has built equity over time. In our example, shares under ownership increased more than 150%, from 1,000 to 2,536. The cash return payback period is reduced to less than 12 years. Total dividends received in year 20 increased to $3,058 (compared to $500 in year 1), providing a pre-tax yield on investment of nearly 31% (see Appendix).
To now, our discussion has focused on cash return. This is why a dividend growth investor is not tied to the mood of the stock market in order to generate return and create wealth. However, common sense tells us that a growing company becomes more valuable over time, especially one that hands out a growing cash distribution every year.

Total return is equal to cash return plus share price appreciation. While not as predictable as cash return, capital appreciation can have a significant impact on wealth creation over time.

Going back to our example, we invested $10,000 for 20 years in a stock trading for $10 (1,000 shares). The stock provided a pre-tax dividend yield of 5% and both the business and the dividend are growing by 5% annually. We already know the dividend alone will allow us to double our investment over a 20 year period ($10.00 x 5% x 20 years). However, during that period the dividend was increasing 5% per year (from $500 in year one to $1,263 in year 20); this provided an additional $6,533 in pre-tax cash return. By reinvesting our dividends, we increased our equity position from 1,000 shares to 2,536. The additional 1,536 shares generated $12,105 in cash dividends over the 20 year period, bringing the total pre-tax cash return generated to $28,637.

We will now assume that the stock valuation (the P/E multiple) remains stable over the 20 year period (neither expanding nor contracting). Under this assumption, the stock price grows at the same rate as corporate earnings, resulting in stock price appreciation from the $10.00 purchase price to $26.53 at the end of year 20. Our original 1,000 share purchase will generate capital appreciation of $16,533 (1,000 x ($26.53-$10.00)). Furthermore, dividend reinvestment allowed us to increase our equity position over time. These additional shares generate another $12,105 in appreciation. When all is said and done, our $10,000 investment has grown to $67,275 pre-tax, up nearly six-fold, from a company with a modest 5% growth rate (see Appendix).

In the real world, stock prices and P/E multiples are not consistent and can be influenced by both short-term and long-term factors that are beyond corporate fundamentals. However, as long as we have not significantly overpaid for a stock (our yield requirement helps to prevent that), we expect that share prices of growing companies could increase in value over time. Furthermore, price volatility can have a positive impact if reinvestment is employed, because of dollar cost averaging.

Going back to our example, our investment has grown to $67,275 pre-tax, up nearly six-fold, over 20 years. We视10% as a threshold for identifying potential investment candidates. We recommend the sum of the dividend yield and the projected long-term dividend growth rate to be 10% or more. Note, this rule assumes relatively muted inflation (3% or less); the threshold should be adjusted upward should inflation increase above that amount.

The question becomes...What is the right mix between yield and growth? For the most part, the two have an inverse relationship: higher yield stocks will typically have lower projected dividend growth rates, and stocks with lower yields will typically have higher dividend growth rates.

We are proving the 10% hurdle rate as a general guideline. A well-constructed dividend growth portfolio will have a combination of higher-yield, lower-growth investments and lower-yield, higher-growth investments. However, since dividends are more stable than projected growth rates, lower-yielding stocks should require a sum that is higher than our 10% guideline.

Diversification is typically a prudent way to lower overall portfolio risk. The first question an investor should ask is “how many stocks are needed to be properly diversified?” Many studies have demonstrated that the majority of the
diversification benefit can be obtained with around 15-20 stocks. We recommend holding 15 stocks as a minimum.

More important than the number of stocks, however, is how those stocks are allocated across economic sectors. The dividend growth investment strategy is a bottom-up investment approach, and sector allocation should be determined by yield and dividend growth opportunity; not based on sectors with the most price momentum or which emulate a particular stock index.

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<table>
<thead>
<tr>
<th>S&amp;P 500 Sector</th>
<th>Dividend Yield %</th>
<th>Constituents Paying Dividends</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilities</td>
<td>3.43%</td>
<td>100%</td>
</tr>
<tr>
<td>Telecom Services</td>
<td>4.68%</td>
<td>100%</td>
</tr>
<tr>
<td>Materials</td>
<td>2.03%</td>
<td>97%</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>2.49%</td>
<td>95%</td>
</tr>
<tr>
<td>Industrials</td>
<td>1.98%</td>
<td>94%</td>
</tr>
<tr>
<td>Financials</td>
<td>1.72%</td>
<td>91%</td>
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<tr>
<td>Energy</td>
<td>2.43%</td>
<td>89%</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>1.43%</td>
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</tr>
<tr>
<td>Information Technology</td>
<td>1.45%</td>
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<tr>
<td>S&amp;P 500</td>
<td>1.90%</td>
<td>84%</td>
</tr>
</tbody>
</table>

Yield data as of 11/21/2014
Source: S&P Capital IQ; Bloomberg. Past performance is no guarantee of future performance.

With that said, the table above shows that dividend paying stocks are more plentiful in sectors like Utilities, Materials, Industrials, Consumer Staples, and Financials. While it is important to gain exposure across the economic spectrum, we recommend avoiding overexposure in any specific sector.

Overexposure to a sector can significantly increase portfolio volatility. For example: during the market downturn of September 30, 2007 to March 31, 2009, the Dow Jones Select Dividend Index under-performed the S&P 500 index (down 51.7% vs. down 44.7%), despite the fact that dividend stocks generally hold up better than average in market declines. The reason? 45 of the 100 stocks held in the index operated in the financial sector, which was one of the hardest hit in the downturn. In contrast, the better diversified Dividend Aristocrats Index was down 37.0% over the same timeframe.

The Diversification "Rule of Thumb"

15 or more investments

Invest in at least 7 of the 10 economic sectors

No more than 25% in any one sector

This is a generalized example and does not represent a specific investment or strategy. Please consult with your financial advisor.

Source: Ameriprise Financial Services, Inc.

In general, we believe a properly diversified dividend growth portfolio should be invested in at least seven of the 10 economic sectors, with no more than 25% invested in any one sector.

7) LOOK BEYOND THE OBVIOUS

One way to enhance both diversification and yield is to look beyond the blue chip companies with long histories of dividend increases, and consider some relatively high-yielding alternatives with dividend growth potential that trade on the U.S. stock exchanges.

These alternatives often experience more volatility than the typical blue chip dividend payer, and can add some complications at tax time, as discussed below. However, in our opinion, the enhanced yield and diversification they provide may be worth consideration in diversified dividend-oriented portfolios, in appropriately-sized allocations.

**ADRs:** An American Depository Receipt (ADR) is essentially stock of a foreign company held by a U.S. bank or trust. ADRs allow investors to conveniently purchase shares in companies based in other countries without hassles like currency conversions and safekeeping charges. Dividends may vary due to currency conversion, and we note that some ADRs pay their distributions only two times a year versus the traditional quarterly payouts for U.S.-based companies. ADR dividends get the same preferential tax treatment as U.S. stocks, but some foreign countries will withhold local country taxes on them. Investors who paid or accrued foreign taxes to a foreign country on foreign source income and are subject to U.S. tax on the same income may be able to take either a credit or an itemized deduction for those foreign taxes on their U.S. federal income tax return. Please consult with your tax advisor.

**Pass-Throughs:** The next three equity investments are referred to as “pass-through” equities. These companies can be exempt from corporate taxation as long the majority of their business is derived from certain business activity and meets other requirements as defined by the IRS. Because they are not taxed at the corporate level, the tax attributes are passed through to the investors, who are then taxed based on the type of income the entity makes, instead of the dividends which qualify for the lower qualified dividend tax rates currently in place for corporations. Pass-throughs generally have significantly higher yields than common stocks. The type of pass-through securities mentioned here trade on exchanges just like ordinary stocks.

- **REITs:** A Real Estate Investment Trust (REIT) is a corporation or trust that buys and manages shares in a real estate portfolio, direct real estate or real estate loans. Companies operating under REIT status are generally not taxed at the corporate level as long certain requirements under the Internal Revenue Code are met. For example, REITs are obligated to distribute at least 90% of taxable income to shareholders. Because of the generally tax-free status at the corporate level, REIT dividends paid to shareholders can be taxed at ordinary income, capital gain, return of capital, or even qualified dividend rates, depending on the activity in the REIT.

- **MLPs:** Master Limited Partnerships (MLPs) are partnership interests that trade on a stock exchange just like shares of ordinary stocks. Like REITs, MLPs are not taxed at the corporate level, so distributions are taxed based on the types of income the entity makes. However, a significant portion of the investor’s tax
The Enduring Qualities of Dividends

November 26, 2014

Source: Bloomberg; Ameriprise Financial Services, Inc.

Past performance does not indicate or guarantee future performance. It is not possible to invest directly in an index. See additional risk disclosures.

Looking Beyond the Obvious: Representative Dividend Yields

<table>
<thead>
<tr>
<th>Year-end 2010 - 2013</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500 Index</td>
<td>1.88%</td>
<td>2.12%</td>
<td>2.24%</td>
<td>1.89%</td>
</tr>
<tr>
<td>Consumer Price Index (CPI)</td>
<td>1.42%</td>
<td>3.02%</td>
<td>1.76%</td>
<td>1.51%</td>
</tr>
<tr>
<td>MSCI EAFE Index</td>
<td>3.01%</td>
<td>3.97%</td>
<td>3.55%</td>
<td>3.06%</td>
</tr>
<tr>
<td>DJ US Select Dividend Index</td>
<td>3.96%</td>
<td>3.95%</td>
<td>4.31%</td>
<td>3.63%</td>
</tr>
<tr>
<td>Bloomberg REIT Index</td>
<td>3.44%</td>
<td>3.63%</td>
<td>3.65%</td>
<td>3.98%</td>
</tr>
<tr>
<td>Alerian MLP Index</td>
<td>5.74%</td>
<td>5.73%</td>
<td>6.15%</td>
<td>5.69%</td>
</tr>
<tr>
<td>Wells Fargo BDC Index</td>
<td>n/a</td>
<td>9.60%</td>
<td>8.49%</td>
<td>8.23%</td>
</tr>
</tbody>
</table>

Case Study: Total Return During the Great Depression – Learning From History

To demonstrate the positive impact dividends have had on total return over time, we can look at the worst economic period our country ever faced. “The Great Depression” started with the stock market crash of 1929. For this analysis, we referred to the Ibbotson SBBI 2014 Classic Yearbook, which provides historical market price and total return data. In all cases, we are referring to Large Company stock returns, which for the time period studied, reflects the S&P 90 Index (predecessor to the S&P 500 Index).

From the stock market high in August 1929 to the low in February 1933, the market declined more than 85%. It took more than 25 years (1929 – 1954) on a price return basis for the market to get back to breakeven (where it was trading before the crash of 1929).

However, based on total return data (capital gains plus distributions) for the period, the results are quite different. According to Ibbotson total return data, an investor would have reached break-even by 1944, a full ten years earlier, when taking into account dividends and dividend reinvestment.

During the 25-year period in which it took prices to get back to break-even, an investor who invested $100,000 and reinvested the dividends would have seen his or her portfolio grow to $431,000 pre-tax (a return of 331%). This is despite the fact that dividends declined materially from the market peak in 1929 through the trough in 1933.

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2. The dividend is at risk of being reduced or eliminated or is no longer providing the required projected growth. While this might mean taking a loss, it is important to exit a position when corporate fundamentals no longer meet requirements. This requires very close monitoring of the company and its fundamentals; a financial advisor can help.

3. Another stock is identified with a better yield and/or dividend growth opportunity, compared to a current holding. Periodically trimming profits from over-weighted positions and reinvesting in under-weighted positions is also something that can be done to maintain a balanced portfolio, potentially reduce risk, and enhance returns over the long-run. Selling stock in a non-qualified portfolio can give rise to taxable gains or losses. A tax advisor can help determine what is best from the tax point of view.

9) DON'T SWEAT THE MARKET DOWNTURNS

When the majority of an investment’s return is tied to capital appreciation, price is the primary determinate of profit or loss. When stock prices are going up it feels gratifying to sit back and watch your investments grow. However, when prices trend downward, it can be quite stressful to watch your wealth decline. Many investors will reach a pain threshold and sell an investment regardless of the underlying fundamentals. This tends to happen en masse at market bottoms.

Conversely, a dividend growth investor still generates cash return in down markets, and has less cause for distress. Believe it or not, market downturns can greatly enhance the benefit of dividend reinvestment because reinvestment is effectuated at lower price points. This allows the investor to build portfolio equity at a faster rate than in a lower yield, higher-priced environment.

10) DON'T WORRY ABOUT INCOME TAX RATES

In our view, the long-term market and economic environment overshadows the taxation environment when it comes to determining equity valuations (this story is different for bonds, although this topic is out of scope here). Macro factors such as economic growth, monetary and fiscal policy, and overall market sentiment, combined with micro-level sector and company fundamental factors including management skill, market growth, product positioning, financial condition, and the regulatory environment, all serve to collectively influence valuations, regardless of overriding income tax rates.

We reviewed various historical studies covering the performance of dividend-paying stocks during different tax environments, two of which we present from Miller/Howard Investments, a New York-based registered investment advisor. For a short-term view, the chart above shows the performance of each of the ten S&P economic sectors in 2003, the year that the Bush tax cut bill was passed by Congress. As the table demonstrates, it is difficult to discern any meaningful long-lasting impact on returns related to the lowering of the dividend tax rate to 15% on qualified dividends from the previous maximum rate of about 39% (the top income tax bracket in 2003). Indeed, stocks had a good year in 2003 following the headwinds of the bursting of the technology sector bubble, the recession that followed the World Trade Center attacks, the spate of corporate scandals such as WorldCom and Enron, and conflicted Wall Street research, all which severely undermined investor confidence.
The next study we reviewed, also courtesy of Miller/Howard Investments, shows a much longer term view of the performance of high dividend yielding stocks (dividend deciles 7 - 9) versus the broader S&P 500 Index. According to the Miller/Howard study, the maximum dividend tax rate has been as high as 70% (1970s) to as low as 15% on qualified dividends (the current maximum rate on qualified dividends is 20% which applies to tax payers in the top 39.6% federal tax bracket). The study also overlays the long-term capital gains tax rate, which had been 15% from 2003 to 2012 (the top 25.3% federal tax bracket). An additional tax was imposed in 2013 which can impact high-yield stocks outperformed the S&P 500 Index in 6 of the 10 periods studied, including, notably, the periods when the current maximum rate is generally 20% on long-term capital gains tax rate, which had been 15% from 2003 to 2012 (the top 39.6% federal tax bracket). The study indicates that high-yield stocks outperformed the S&P 500 Index in 6 of the 10 periods studied, including, notably, the periods when the maximum dividend tax rate was 20% which apply to tax payers in the top 39.6% federal tax bracket. The study also overlays the long-term capital gains tax rate, which had been 15% from 2003 to 2012 (the current maximum rate is generally 20% on long-term capital gains for people in the 39.6% tax bracket), down from a much higher peak of 35% in the 1970s. This study indicates that high-yield stocks outperformed the S&P 500 Index in 6 of the 10 periods studied, including, notably, the periods when the tax rate on dividends ranged from 50% to 25% (1972 – 1986). Please see the chart notations regarding methodology for this study. Similar to the shorter-term study, income tax rates appear to have no long-term material adverse impact on the performance of dividend-paying stocks. Please see the chart above.

An additional tax was imposed in 2013 which can impact dividend taxation. Since 2013, tax payers with modified adjusted gross income in excess of $200,000 for singles or $250,000 for married filing jointly, are subject to a 3.8% net investment income tax on certain unearned income. Unearned investment income subject to the tax includes dividends. Please consult with your tax advisor.

The appendix near the end of this report provides a summary of certain current taxation rules governing dividends and other distributions.

11) PLAN YOUR ASSET LOCATION STRATEGY IN ADDITION TO YOUR ASSET ALLOCATION STRATEGY

While we showed that income tax rates probably do not have a meaningful impact on overall stock market returns, tax rates do indeed have a measurable impact on how much of your income from dividends and net capital gains you get to keep. Therefore, we believe building a tax efficient investing strategy is paramount.

In our view, “asset location” is the backbone of building a long-term, successful, tax-efficient investment strategy. We strongly believe in concepts such as portfolio diversification, seeking tax-advantaged investments where appropriate, and investing for the long-term. However, to drive a potentially even greater positive impact to long-term returns, investors should take into consideration where certain types of assets and investments are placed, in order to achieve the most efficiency in the accumulation phase of investing as well as the distribution phase at some point down the road. Note, placing certain investments where they can grow in a more tax efficient manner (assuming all requirements are met) – 401-Ks and IRAs, for example - can improve long-term after
In other words, a mutual fund, with a long-tenured management team who has beaten their benchmark in 10 of the past 12 years, which has low fees and low turnover – is still the exact same fund with the same risk measures and other characteristics, whether it is located in a non-qualified (taxable) account or a qualified account (like an IRA). But, in a qualified account, you will keep more of what you earn over time before taxes are applied. However, the challenge comes in balancing the after-tax returns. Some of the income of the fund in the non-qualified account like qualified dividends and long-term capital gains could be taxed currently at the lower long-term capital gains rates. That income in a qualified account like a traditional IRA or 401-K plan will be taxed later at ordinary income tax rates that apply at the time of withdrawal.

A third and fourth dimension – time horizon and risk profile – need to be taken into consideration in conjunction with the asset allocation and portfolio diversification are important drivers of long-term investing risks and returns. Investors with a longer time horizon may be more comfortable taking on an additional degree of risk in their portfolios, especially earlier in life. So for example, in our chart, we list growth-oriented stocks as being more efficiently held in a taxable account versus a qualified account, and we also list taxable bonds and bond funds as being most efficiently held in a tax deferred (qualified) account.

Depending on time horizon and risk profile though, and in order to potentially meet long-term savings and investing goals, investors may require exposure to growth-oriented stocks in their qualified accounts. Long story short, taxes are not the sole driver to consider, which is why working with a tax advisor and a financial advisor is so important.

All of that being said, one important item to keep in mind is with increased use of qualified accounts comes a certain decrease in liquidity. For example, money placed into a traditional IRA or a 401-K must be kept there until age 59 ½; early withdrawals in all but a few circumstances are penalized by the IRS. For other types of tax-advantaged accounts, such as 529 plans, restrictions are placed on what the money in the account can be used for, and if it is used for something other than qualified expenses, tax and penalties on any earnings will apply. Depending on the circumstances and dollar amounts involved, the penalties may exceed the long-term tax benefit gained by using a qualified account in the first place.

<table>
<thead>
<tr>
<th>ASSET CLASS</th>
<th>LEAST TAX EFFICIENT</th>
<th>PLACE IN...</th>
<th>RATIONALE</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-yield bonds or stocks</td>
<td>Tax-deferred Accounts</td>
<td>401(k); 403(b); Traditional IRA</td>
<td>These securities generally pay relatively larger dividends, distributions, or interest payments</td>
</tr>
<tr>
<td>Taxable bonds/bond funds</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income-oriented REITs</td>
<td>Tax-free Accounts</td>
<td>Roth IRA; Roth 401(k); Roth 403(b); 529 Plans</td>
<td>These securities generally pay little to no dividends, but might have the most appreciation potential, leading to capital appreciation</td>
</tr>
<tr>
<td>Income-oriented funds</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>TIPS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BABs</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Stock trading account</td>
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<td></td>
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<tr>
<td>Value stocks</td>
<td></td>
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<tr>
<td>Small cap stocks</td>
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<tr>
<td>Balanced funds</td>
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<tr>
<td>Growth-oriented REITs</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Growth-oriented stocks</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity index funds/ETFs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax-advantaged equity funds</td>
<td></td>
<td></td>
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<tr>
<td>U.S. savings bonds</td>
<td></td>
<td></td>
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<tr>
<td>Tax-exempt bonds (Munis)</td>
<td></td>
<td></td>
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<tr>
<td>Emergency funds</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>The ASSET LOCATION CONCEPT FOR RETIREMENT ASSETS</td>
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<tr>
<td></td>
<td>MOST TAX EFFICIENT</td>
<td></td>
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<tr>
<td></td>
<td>Taxable Accounts</td>
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<td>Emergency funds</td>
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<td>U.S. savings bonds</td>
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<td></td>
<td>Tax-exempt bonds (Munis)</td>
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<td></td>
<td>Growth-oriented REITs</td>
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<td></td>
<td>Growth-oriented stocks</td>
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<td></td>
<td>Equity index funds/ETFs</td>
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<td></td>
<td>Tax-advantaged equity funds</td>
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<td></td>
<td>Stock trading account</td>
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<td></td>
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<tr>
<td></td>
<td>Balanced funds</td>
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</tbody>
</table>

Ameriprise Financial Services, Inc. does not provide tax advice. This generalized example does not take into consideration time horizon, risk profile, return, or other constraints. This generalized example also does not take into consideration liquidity, fees, or specific participation rules and limitations. Further, this example is not reflective of any specific investment product or strategy and it does not represent any specific asset allocation strategy. Please consult with your tax and financial advisor.

1 Real Estate Investment Trust
2 Treasury Inflation-Protected Securities
3 Build America Bonds; issued in 2009 and 2010
4 Generally for taxpayers in the higher income tax brackets; consult with your financial advisor. Munis = municipal bonds.
5 For example, an appropriate mix of an FDIC insured savings account, short-term certificates of deposit (CDs) of varying maturities, and money market funds.

Source: Ameriprise Financial Services, Inc.
12) UNDERSTAND THE RISKS

Dividend Cuts: Cash dividends are paid at the discretion of a company’s board of directors, driven by the recommendation of corporate management. There is no contractual obligation with dividends, like there is with a bond coupon. When business conditions deteriorate and profits decline, companies may be forced to lower their distributions to shareholders. According to research from S&P Capital IQ, an abnormally large number of companies in the S&P 500 Index cut or eliminated their dividends between 2008 and 2009. Investors can reduce this risk by performing due diligence on corporate fundamentals and staying away from companies with high dividend-to-cash flow ratios. Further, this also points to another reason why diversification across economic sectors is critical – a disproportionate number of the cuts in 2008 and 2009 were in the financial sector (or in companies with large finance subsidiaries). A consultation with a financial advisor is also recommended.

<table>
<thead>
<tr>
<th>S&amp;P 500 INDEX COUNT OF DIVIDEND ACTIONS YEAR-TO-DATE</th>
<th>INCREASING THEIR DIVIDEND</th>
<th>STARTING TO PAY</th>
<th>DECREASING THEIR DIVIDEND</th>
<th>STOPPING PAYMENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004 YTD through Sept. 2004</td>
<td>292</td>
<td>15</td>
<td>17</td>
<td>6</td>
</tr>
<tr>
<td>2013</td>
<td>366</td>
<td>15</td>
<td>12</td>
<td>0</td>
</tr>
<tr>
<td>2012</td>
<td>333</td>
<td>15</td>
<td>11</td>
<td>1</td>
</tr>
<tr>
<td>2011</td>
<td>330</td>
<td>22</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>2010</td>
<td>243</td>
<td>13</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>2009</td>
<td>151</td>
<td>6</td>
<td>68</td>
<td>10</td>
</tr>
<tr>
<td>2008</td>
<td>235</td>
<td>5</td>
<td>40</td>
<td>22</td>
</tr>
<tr>
<td>2007</td>
<td>287</td>
<td>11</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>2006</td>
<td>299</td>
<td>6</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>2005</td>
<td>388</td>
<td>10</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>2004</td>
<td>272</td>
<td>10</td>
<td>3</td>
<td>2</td>
</tr>
</tbody>
</table>

Notes:
1. Does not include issues where dividend per share is unchanged (i.e. no dividend action)
2. The same issue can be counted in multiple columns
3. Does not include issues where dividend per share is unchanged (i.e. no dividend action)

Source: S&P Capital IQ, from a study by Howard Silverblatt. Used with permission.

Volatility risk: Stocks are volatile, particularly in secular bear markets. Investors should not use capital that might be needed over the next few years in any equity investing strategy, because of the risk of declining prices and loss of capital.

Taxes: The tax rate on dividends can also have an impact on returns in taxable (non-qualified) investment accounts. Higher taxes will reduce the benefit of dividend reinvestment, because the after-tax amount available for reinvestment is reduced. A sound asset location strategy can help mitigate this risk. Please consult with your tax advisor.

Interest rates: A prolonged rise in interest rates can reduce the relative attractiveness a dividend paying stock has over fixed income (bond) investments. A stock with a non-growing dividend may be impacted more because there is no growth component that will distinguish it from other yield-based investments. Requiring dividend growth (key principle # 2) can help offset the impact of rising rates.

Yield risk: Ultra high dividend yields, coupled with a downward-trending share price, might signal deteriorating fundamentals and a situation where the payout is at risk of being cut or eliminated altogether.

Portfolio concentration risk: We have covered at length the benefits of building portfolios of stocks which can sustain and grow their dividends over time. But also keep in mind, dividend paying stocks can have up and down cycles, and thus, do not always increase in value. The technology bubble in the late 1990s is a good example. Dividend-payers vastly underperformed for a couple of years. This does not invalidate our thesis, but it does point to the need to diversify across sectors, asset classes, geography, and investment strategy.

Summary

A dividend growth investment strategy starts with one common sense thought process: “Invest in a portfolio of stocks that provides an attractive, growing cash return.” It has three primary components: yield, growth, and reinvestment. Yield provides expected cash return from a business and can be an indicator of value over time. Growth in the dividend increases cash return, which can provide a hedge against inflation, and an avenue for capital appreciation. Reinvestment allows the investor to build ownership and employ the benefits of dollar-cost-averaging. The overall strategy, historically, has allowed for long-term wealth creation, regardless of market environment.

The Enduring Qualities of Dividends is especially prescient during a secular bear market. A secular bear market is a prolonged period of market valuation contraction and stagnation, making price appreciation in stocks harder to come by. Dividend paying stocks tend to perform better in a secular bear market because of the cash return provided even in flat and down periods. Furthermore, a dividend can often help to buffer price declines.

It is important to do your homework...it is our steadfast belief that the overarching fundamentals of a stock generally win in the end. While the interest rate and tax rate environment may not meaningfully impact long-term total returns for dividend growth equities, it is critical to invest in companies with growing cash flows and solid financials, in order to increase the probability that dividends will continue to grow. Also, pay attention to asset location, a process which may help you keep more of what you earn from your long-term savings and investing strategies.

It is also paramount to diversify investments across the ten economic sectors. Fundamental conditions may vary considerably over time, and in turn, risks and returns across sectors will be variable as well. For example, look at the pain experienced in the financial services sector in 2008/09. Broad portfolio diversification, including exposure to bonds...
and alternative investments, can help mitigate this risk. Please consult with your financial advisor.

Above all, use common sense, and recognize that dividend yields are only one investment consideration. An investment should not be undertaken based solely on its current or projected yield. The old adage, “If it appears too good to be true, it probably is” is a wise adage indeed, in our opinion.

Investors interested in a dividend growth strategy can invest in several ETFs designed to track various dividend-oriented indices. But as we discussed earlier, these indices have some potential weaknesses in our view. Thus, investors might be better off by employing an actively managed solution through mutual funds or a professionally managed portfolio of diversified equities.

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Data sources: 2013 and 2014 data updates from Bloomberg; S&P Dow Jones Indices (study by Howard Silverblatt, used with permission); www.freelunch.com
Dividend Growth Example

Initial Investment $10,000
Number of Shares 1,000
Share Price $10
Dividend Yield 5%
Dividend Growth Rate 5%
Stock Appreciation 5%

<table>
<thead>
<tr>
<th>Year</th>
<th>Flat Dividend</th>
<th>5% Dividend Growth</th>
<th>Beginning Balance</th>
<th>Dividend Reinvestment</th>
<th>Ending Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shares</td>
<td>Share Price</td>
<td>Value</td>
<td>Div. Per Share</td>
<td>Dividend</td>
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<tr>
<td>1</td>
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<td>$500</td>
<td>$10,000</td>
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<td>$1,330</td>
<td>$99,656</td>
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Total Cash Return $10,000 $16,533 $28,637
Total Shares Purchased via Dividend Reinvestment 1,536

Source: Ameriprise Financial Services, Inc.

This illustration is hypothetical, and does not take into account any fees, expenses, or taxes associated with an actual investment. If these costs had been taken into consideration, the results would have been lower.

Taxation Summary

Presented here is a summary of certain current taxation rules governing dividends and other distributions, as well as the 3.8% net investment income tax. Tax laws can and do change over time, so be sure to consult with a tax and financial advisor when making investment and asset location decisions.

Dividends and Other Distributions

Qualified Dividends

The 2012 American Taxpayer Relief Act established revised tax rates for qualified dividends: 0% for dividends taxed in the 10% and 15% tax brackets; 20% for dividends in the 39.6% bracket; and 15% for all other brackets. For dividends received from domestic and qualified foreign corporations to qualify, the investors are required to hold the stock from which the dividend is paid for more than 60 days in the 121-day period beginning 60 days before the ex-dividend date. Special rules apply to certain dividends from preferred stock. If a taxpayer receives dividends that are attributable to a period or periods aggregating more than 366 days, the required holding period is more than 90 days during the 181-day period beginning 90 days before the ex-dividend date. Thus, the holding period for such preferred stock is at least 91 days during a 181-day period beginning 90 days before the ex-dividend date.

An additional tax was imposed in 2013 which can impact dividend taxation. Since 2013, tax payers with modified adjusted gross income in excess of $200,000 for singles or $250,00 for married filing jointly, are subject to a 3.8% net investment income tax on certain unearned income. Unearned investment income subject to the tax includes dividends. Please consult with your tax advisor.

Real Estate Investment Trust (REIT) Distributions

Assets that qualify for a REIT structure are generally restricted to real estate, mortgage debt, and other REITs. These entities generally do not pay income tax themselves and are obligated to pay out at least 90% of their taxable income as distributions to shareholders. Distributions paid to shareholders are generally taxed as ordinary income or capital gains, although often times there can also be return of capital.

Source: Ameriprise Financial Services, Inc.
The Enduring Qualities of Dividends

November 26, 2014

Business Development Corporation (BDC) Distributions

A Business Development Corporation (BDC) provides debt and equity financing to small and mid-cap companies. Generally, a BDC is required to invest 70% of its assets in “qualifying assets.” Qualifying assets generally consist of securities of “eligible portfolio companies” plus cash and government securities or short-term high quality debt securities. An “eligible portfolio company” is a domestic issuer that meets certain requirements and either (1) is not listed on a national securities exchange, or (2) has a class of equity securities listed on a national securities exchange, but has an aggregate market value of outstanding voting and non-voting common equity of less than $250 million. BDCs may be organized either as limited partnerships or as regulated investment companies (RICs) in order to avoid entity-level tax. However, to obtain pass-through tax treatment, a BDC organized as a partnership must be operated to avoid treatment as publicly traded partnership. If the BDC is organized as a RIC, distributions will be taxable as either ordinary income or capital gains in the same manner as distributions from other mutual funds and closed-end funds.

Master Limited Partnership (MLP) Distributions

MLPs are usually structured and maintained in a way that allows them to be taxed as partnerships, although some may be owned in corporations or Regulated Investment Companies. Investors in MLP partnerships are considered unit-holders as opposed to stockholders and cash payments are not actually considered dividends but partnership distributions. MLPs are under no obligation to pay a set percentage of income like BDCs or REITS. These partnerships generally do not pay corporate income taxes; partnership income, deductions, gains, losses, and tax credits (not distributions) are passed through to the unit-holders and taxed accordingly. However, many MLPs have significant depreciation deductions or depletion allowances and can make distributions greater than taxable income. The excess distribution is considered a return-of-capital (to the extent of the investor’s basis in the partnership) and is not taxed when received. The distribution is used to reduce the investor’s basis in the partnership interest, which will increase the gain or reduce the loss when the partnership unit is sold. Typically, gain or loss from the sale of a partnership interest is capital gain or loss, but some gain may be treated as depreciation or depletion recapture and taxed as ordinary income or otherwise be subject to Unrelated Business Taxable Income (UBTI).

MLPs have three main drawbacks as it relates to taxes. The first is that during the first few months of the year the unit-holder receives a Schedule K-1 from the partnership that describes his or her prorated share of partnership income, deductions, gains, losses, and tax credits. This can make for a more complex tax return and cause a filing delay if not received on a timely basis. The second drawback is that MLPs are not generally suitable for IRAs (or other nontaxable accounts) because certain partnership income greater than $1,000 can trigger a tax liability for the unit-holder, despite the tax-deferred nature of the account. This tax liability is known as Unrelated Business Taxable Income. Third, cost basis can only be tracked via the Schedule K-1 and the taxpayer’s records.

Foreign Stock (ADR and ADS) Dividends

Distributions from certain foreign stocks meeting the above requirements for qualified dividend income are taxed at the lower qualified dividend income (QDI) rates, with one catch. Many foreign companies will withhold local country taxes on dividends paid. The IRS provides relief in the form of a credit but only up to the U.S. tax rate. Therefore, generally if total foreign withholding on foreign source income exceeds U.S. tax rates, investors may end up paying the difference. Tax-deferred accounts like IRAs do not receive the tax credit and are out the full amount of the tax withheld and therefore foreign stock and ADRs from some countries may not be appropriate for IRAs. On the positive side, many countries across the Eurozone and the rest of Europe, and also Asia, have tax treaties with the U.S. that may reduce or eliminate tax withholding in certain situations.

Fixed Income Funds and Preferred Securities

It is important to note that some investment income that may often be referred to as “dividends” may not be taxed as a qualified dividend and thus does not qualify for the lower tax rates. Fixed income funds (especially closed-ends) pay dividends which are not qualified dividends and do not qualify for the reduced tax rate because the fund’s underlying income is interest from bonds, for example. They will be taxed at ordinary income rates. Although commonly referred to as “preferred stock,” many preferred securities currently outstanding are structured as debt instruments (trust preferreds, for example). As such, distributions associated with these securities would NOT be QDI-eligible. Check with your financial advisor and the offering documents to verify the structure of individual preferred issues.
The Enduring Qualities of Dividends

November 26, 2014

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International investing involves increased risk and volatility due to political and economic instability, currency fluctuations, and differences in financial reporting and accounting standards and oversight. Risks are particularly significant in emerging markets.

Dividend payments are not guaranteed. The amount of a dividend payment, if any, can vary over time and issuers may reduce or eliminate dividends paid on securities in the event of a recession or adverse event affecting a specific industry or issuer.

In addition to risks which generally pertain to equity investments, including market volatility and the potential loss of principal, investors in publicly-traded REITs, MLPs and BDCs should be aware of the following additional risks. REITs: risks include real estate specific uncertainties such as interest rate/refinancing risk, property value changes, and management skill. Overall economic conditions can impact property values and cash flows, which in turn may negatively impact share prices. MLPs: risks include commodity (energy) price and demand volatility; regulatory changes; taxation changes at the company level or the investor level; and accidents and associated environmental impacts. MLPs are concentrated in energy-related investments, and thus, would be expected to react to macro risks impacting the sector. BDCs: risks include interest rate/refinancing risks; accounting treatment and valuation of loans or securities held; and liquidity risks, such as financial market dislocation or other volatility. Additionally, for each of these investments, please be sure to consult with a tax expert to help assess your unique situation and constraints when it comes to taxation.

Standard & Poor's 500® Index (S&P 500®) is comprised of 500 stocks representing major U.S. industrial sectors. Performance figures are inclusive of dividends reinvested. S&P 500 is a registered service mark of The McGraw-Hill Companies, Inc. It is not possible to invest directly in an index.

The Dow Jones U.S. Select Dividend Index measures 100 leading U.S. dividend-paying companies. The index includes 100 companies. To be eligible for selection to the indexes, stocks must pass screens for dividend quality and for liquidity.

The S&P 500 Dividend Aristocrats index measures the performance of large cap, blue chip companies within the S&P 500 that have followed a policy of increasing dividends every year for at least 25 consecutive years.

The Bloomberg Real Estate Investment Trust (REIT) Index is a capitalization-weighted index of REITs having a market capitalization of $15 million or greater. The Index excludes Mortgage-related REITs and was developed with a base of 100 as of 12/31/1993. The index is rebalanced semi-annually in February and August.

The MSCI EAFE Index is a total return index, reported in U.S. dollars, based on share prices and reinvested gross dividends of approximately 1100 companies (only those securities deemed sufficiently liquid for trading by investors) from the following 20 countries: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Italy, Japan, Malaysia, Netherlands, New Zealand, Norway, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

The NASDAQ-100 Index includes 100 of the largest domestic and international non-financial securities listed on The Nasdaq Stock Market based on market capitalization. The Index reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology. It does not contain securities of financial companies including investment companies.

The Wells Fargo Business Development Company Index is a float adjusted, capitalization-weighted Index that is intended to measure the performance of all Business Development Companies that are listed on the New York Stock Exchange or NASDAQ and satisfy specified market capitalization and other eligibility requirements. To qualify as a BDC, the company must be registered with the Securities and Exchange Commission and have elected to be regulated as a BDC under the Investment Company Act of 1940.

The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs). The index is calculated using a float-adjusted, capitalization-weighted methodology.

The Barclays Capital U.S. Aggregate Index is an index comprised of approximately 6,000 publicly traded bonds including U.S. government, mortgage-backed, corporate and Yankee bonds with an average maturity of approximately 10 years. The index is weighted by the market value of the bonds included in the index. This index represents asset types which are subject to risk, including loss of principal.
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Except for the historical information contained herein, certain matters in this report are forward-looking statements or projections that are dependent upon certain risks and uncertainties, including but not limited to, such factors and considerations as general market volatility, global economic and geopolitical impacts, fiscal and monetary policy, liquidity, the level of interest rates, and historical sector performance relationships as they relate to the business and economic cycle.

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