S C H A F E R C U L L E N

C A P I T A L M A N A G E M E N T

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Dividends Revisited
A New Era

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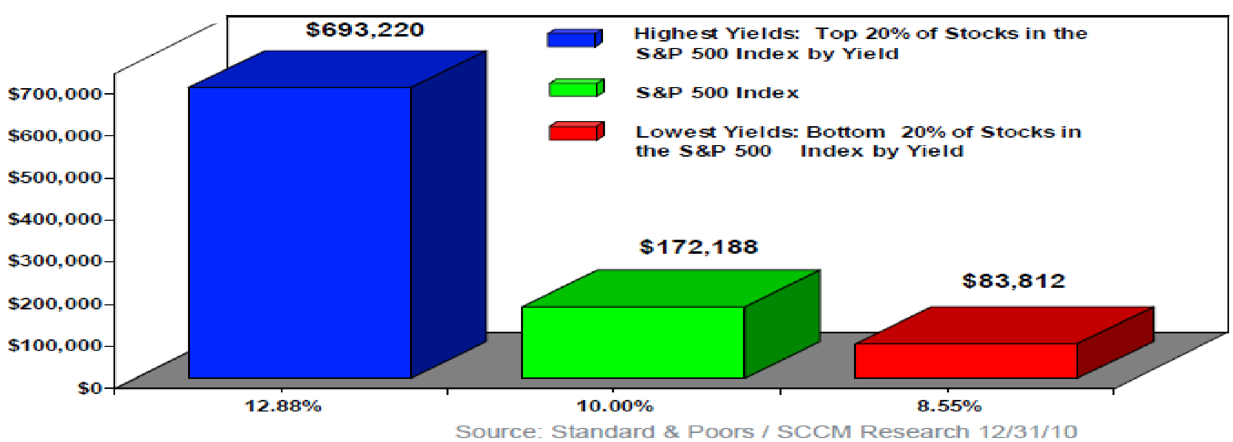
After being ignored for years, an investment strategy focused on high dividends was the market's best performer in 2011. This attracted a lot of attention, as many brokers and advisors scrambled to set up high dividend ETF's and mutual funds using the strategy. So many of them, that some began to say that the strategy had become "crowded."

We disagree. For the long term investor, we believe that for the first time since the 1930's and 1940's, dividends are becoming an important investment consideration. What makes the strategy so powerful is not only that investors are starting to realize the advantages, but importantly, so are the corporations that pay the dividends. What they both realize is that dividend yield and dividend growth has an impact on stock price. In addition, the slow growth, low interest rate and deleveraging environment that probably will be with us for a while acts as a perfect macro backdrop for the strategy.

We believe the change in the way investors look at dividends makes it worth looking at market history captured in a chart below, one that has appeared in a previous market letter. The bar graphs show that since 1957, the highest dividend yielding stocks of the S&P 500 dramatically outperformed both the S&P and the lowest yielding stocks in the index.



Cumulative Returns 1957 through 2010.
Assumes annual rebalancing and reinvested dividends.
Highest is top 20%: Lowest is bottom 20%.

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Why It Happens

A major reason for the dramatic outperformance is simple math. When the market goes down, the stocks with the highest dividends tend to go down half as much. The chart shows how over time this has a dramatic impact on performance.

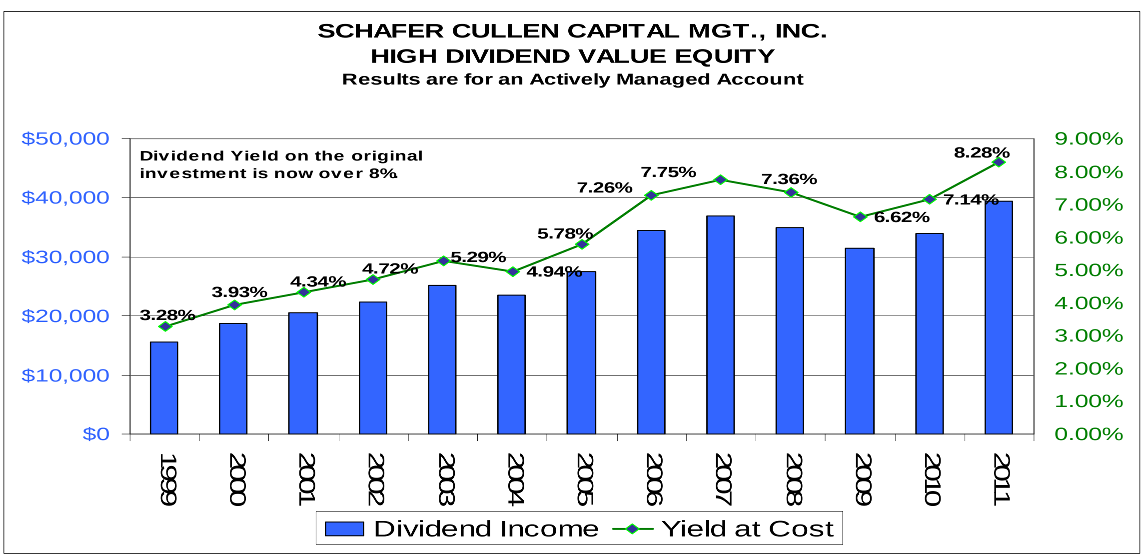
Two other studies look at approaches that have competed with dividends for surplus corporate cash:

- Share Buy Backs: A Smith Barney study that covered a 10-year period compared the performance of companies that announced buy-backs versus those that increased their dividends. **The result was that the dividend increasers outperformed those doing buy-backs by 50%.**

- Acquisitions: A Morgan Stanley study that covered a 15-year period looked at 3,500 acquisitions made by public companies. **The results showed that the majority of acquisitions had a negative impact on the stock price**. The study also showed that the larger the acquisition the worse the results.

Easy to Understand

The chart below shows the growth in the dividend yield for a Schafer-Cullen portfolio since 1999, with the dividend yield computed annually on the original cost basis. The time span, incidentally, includes the so-called "dead decade" for stocks. For the entire period, the market was up only +6.8%, whereas the high dividend portfolio was up +118.8%. Meanwhile, the yield on cost grew from 3.28% to 8.28%.



CUMULATIVE TOTAL RETURN

High Dividend Value Equity:	**118.83%**
S&P 500:	**6.80%**
Russell 1000 Value:	**48.04%**

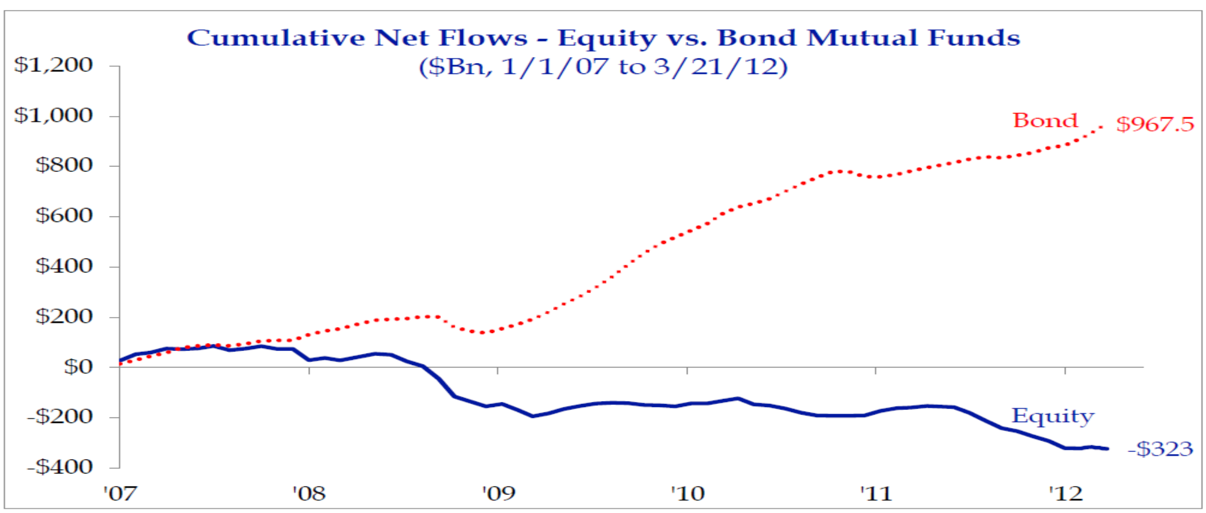
Results net of fees for periods 12/31/99-12/31/11

Once in a Generation Change

For the 45 years I've been in the investment business, dividends have never been popular among investors. In the mid 1960's, the only people who got excited about dividends were the brokers who had been around since the 1940's. Most of us new to the business (like the new market participants in every generation) were only interested in growth. And the 1960's were an era of "go-go" growth when the two most glamorous growth industries were color TVs and airlines. For these two lines of business, perceived to have unlimited growth potential, dividends were not given a moment's consideration. While the color TV and airline industries in fact experienced phenomenal growth, the stocks themselves were investment disasters, and most of the companies were out of business by the end of the decade -- so much for growth. **On the other hand, during the same time, from the mid 1960's to the early 1980's, the Dow Jones had no return, while the unloved highest dividend paying stocks were up over 1,000%.**

Fuel for the Future

The chart below reminds us of what we saw at the peak of the tech bubble when all the money going into the market went into high-tech stocks at the highest multiple levels in history. Today we see that money is flowing into bonds at a time when bond yields are at one of their lowest levels in history. With bond yields so low relative to stock yields, the stage would seem to be set for some flow back into equities.



Source: Strategas 04/02/12

Taxes and Dividends

For taxable accounts, it looks like taxes on dividends may be higher in the future. We will go into this in more detail later but surprisingly, a higher tax rate on dividends doesn't necessarily have a negative impact on the performance of high dividend stocks.

Dividends and Our Strategies

Dividends have always been an important part of all of our strategies, all of them inspired by Ben Graham's three disciplines: price to earnings, price to book, and dividend yield. Let's take a look at how dividends affect all our investment strategies:

Value This is our original strategy, implemented in 1984, with the focus on P/E and P/B, where earnings were expected to be better than average. Dividends were always an important secondary consideration, as were debt/equity ratio, return on capital, and price to cash flow. **Today we are taking dividends much more seriously, but our primary focus for the strategy is still low P/E stocks with strong earnings outlooks.** Good examples are the four most recent stocks purchased in the strategy which have an average multiple of under 10x earnings with good earnings outlooks. In addition, they have dividend yields averaging over 3% and recent dividend increases over 20%.

High Dividend This strategy was first employed in 1994 with an equal emphasis on P/E, dividend yield and dividend growth potential. As the academic studies have indicated, our experience has been in down markets, the high dividend accounts have generally gone down half as much as the market.

International High Dividend Begun in 2004 as an extension of the domestic high dividend strategy. The strategic emphasis is put the same three factors -- low P/E, dividend yield and dividend growth.

US Small Cap First employed in 1992, this strategy is more like Value, with emphasis on the disciplines of P/E, P/B, and potential catalysts for growth. Generally, US small cap companies do not pay dividends, but we have found it a plus when they do.

Global Small Cap LP While US small cap companies usually don't have a dividend policy, surprisingly, the international and especially the emerging market companies tend to have high dividend yields.

Summary

We believe there is a major change taking place in the way the market looks at dividends. Investors, corporations and the current unsettled global economic environment are all helping to drive the change.

-Jim Cullen