James P. Cullen
Chairman & CEO

Mid-Year Comments

High Dividend Strategy
-- Revisited --

July 1, 2013

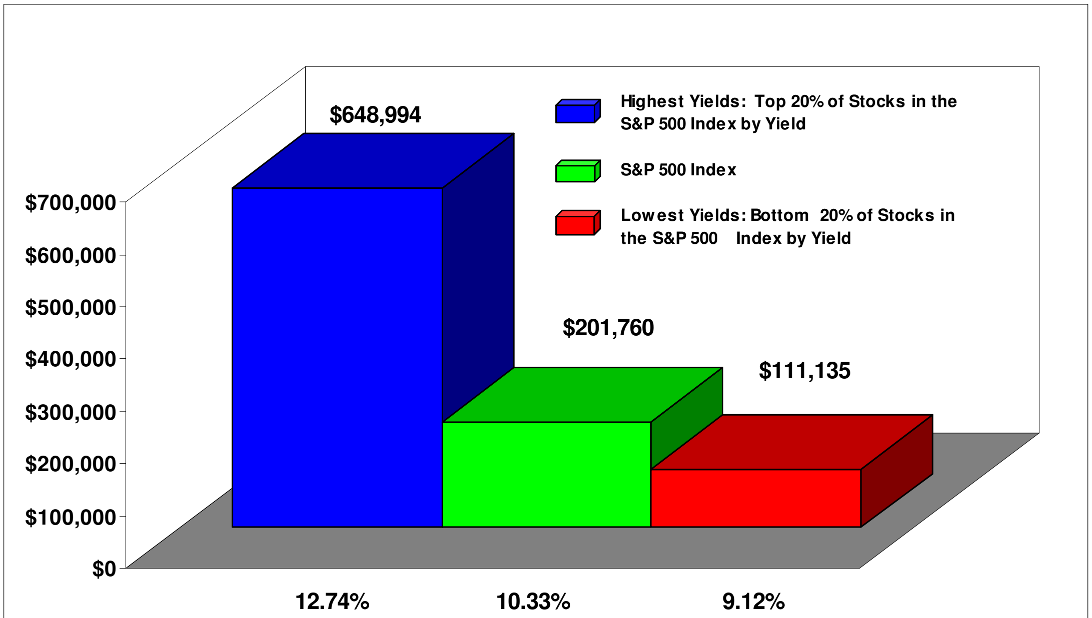
Recently market commentators have questioned whether the "dividend trade" is too crowded and overdone. **We believe that the guessing and worry are misplaced because The High Dividend Strategy is a long term investment approach and not about trading**. Granted, the chase for yield has driven up the price of many high dividend stocks. **However, one of the main features of the strategy is applying a price/earnings (P/E) discipline, and not simply focusing on dividend yield and dividend growth.** But because of the worry over the "dividend trade," we think this is a good time to review our investment approach.

<u>The Strategy</u>

Twenty years ago, when we developed this investment strategy, we decided that it should be comprised of three equally important components: **(1) P/E discipline, (2) Dividend Yield, and (3) Dividend Growth.** The rationale for employing each of these is as follows:

> **<u>P/E Discipline</u>** – **It is easy to forget in a market where investors are chasing yield that it is also easy to overpay**. And overpaying is often the Achilles' heel of ETF's, which purchase securities based on yield with no attention paid to price. The danger, as with any ETF, is that if the strategy becomes popular, the investor ends up with a portfolio of popular, but very overpriced stocks. This nearly always ends badly. The biggest challenge for us today is to keep our portfolio's valuation down to an attractive level relative to the overall market.

<u>Dividend Yield</u> – Before starting the strategy, our research showed that when the market went down the highest yielding stocks dropped half as much as the S&P. Our actual experience over the last 20 years shows that this has worked as well in practice as in theory. The table below shows how the dividend discipline has a powerful impact over time.



Cumulative Returns 1957 through 2012. Assumes annual rebalancing and reinvested dividends.
Highest is top 20%: Lowest is bottom 20%.
Source: Standard & Poors/Schafer Cullen, 2012

Schafer Cullen, 2013

<u>Dividend Growth</u> – Initially, our biggest concern was how the strategy would perform in strong bull markets. **But we decided that by buying high yielding stocks with the potential to grow their dividends, we would be competitive in such markets. And we were.** During the first three years after we put our strategy in place, the S&P 500 had an explosive upturn (1995, +37%; 1996, +23%; and 1997, +33%). Surprisingly, we kept up (1995, +31%; 1996, +20%; 1997, +30%), mainly as a result of dividend growth.

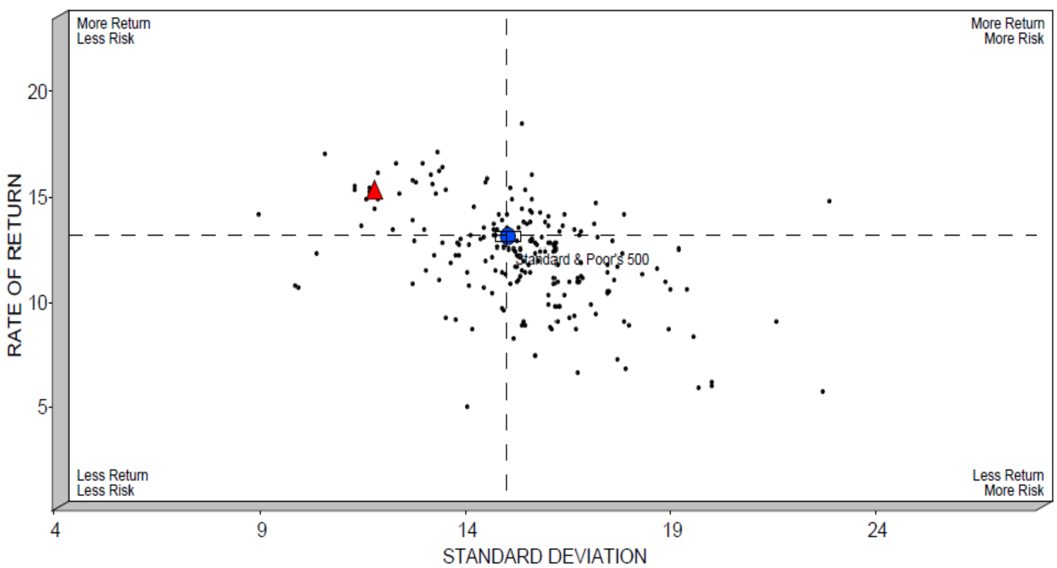
More evidence of the power of dividend growth is the strategy's performance during the so-called dead decade of 2000 – 2010. During this ten year span, the S&P 500 was -9.3% but because of dividend growth, the return on our portfolio was +75.8%.

Risk-Adjusted Performance

One of the great advantages of our High-Dividend Strategy lies in its risk-adjusted performance. In the current volatile investment environment, experienced investors have learned the dangers of chasing performance, which results in the hottest stocks in one market tending to be the worst performing in the next. We have seen over the last three years how our strategy has produced relative performance that has ranged from best to worst, quarter to quarter. **One way of dealing with the volatility, and not over-reacting, is to look at performance on a risk-adjusted basis.**

The scattergram below, covering the last three years, shows risk on the horizontal axis and performance on the vertical axis, and compares our strategy (represented by red triangle) with other value managers. The objective is to be in the upper left hand quadrant – more return, less risk.

SCHAFER CULLEN CAPITAL MANAGEMENT
HIGH DIVIDEND VALUE EQUITY
PSN LARGE CAP VALUE
MARCH 31, 2010 TO MARCH 31, 2013



	ROR	Std Dev	Alpha	Beta	R-Squared	Info Ratio	Sharpe Ratio	Tracking Error	Dnside Cap Ratio	Upside Cap Ratio
Schafer Cullen HDV	14.88	11.60	5.59	0.70	0.79	0.32	1.27	6.92	54.17	75.03
Standard & Poor's 500	12.67	14.80	0.00	1.00	1.00	0.00	0.85	0.00	100.00	100.00

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Dividend Investing Today

For most of the last 50 years, investors have ignored dividends, even though half of all returns during the same period have come from dividends. **The world is different today – investors have begun to appreciate dividends for their safety and downside protection.** Additionally, many corporations have come to understand that a strong dividend policy may be better for stock performance than buying back stock. **In fact, a major 10-year study demonstrates that companies that increase their dividends outperform the companies that buy back stock by 50%.**

The number of companies that have increased their dividends has risen dramatically during the last few years for two reasons. First, because companies have more cash on their balance sheets than at any time in the last half century, and second, because dividends as a percent of earnings (payout ratio) is the lowest in the last half century. Moreover, historically most companies boosted dividends payouts at single-digit rates, but recently more of them have reported double digit increases, knowing that investors now look for dividend growth as well as dividend yield.

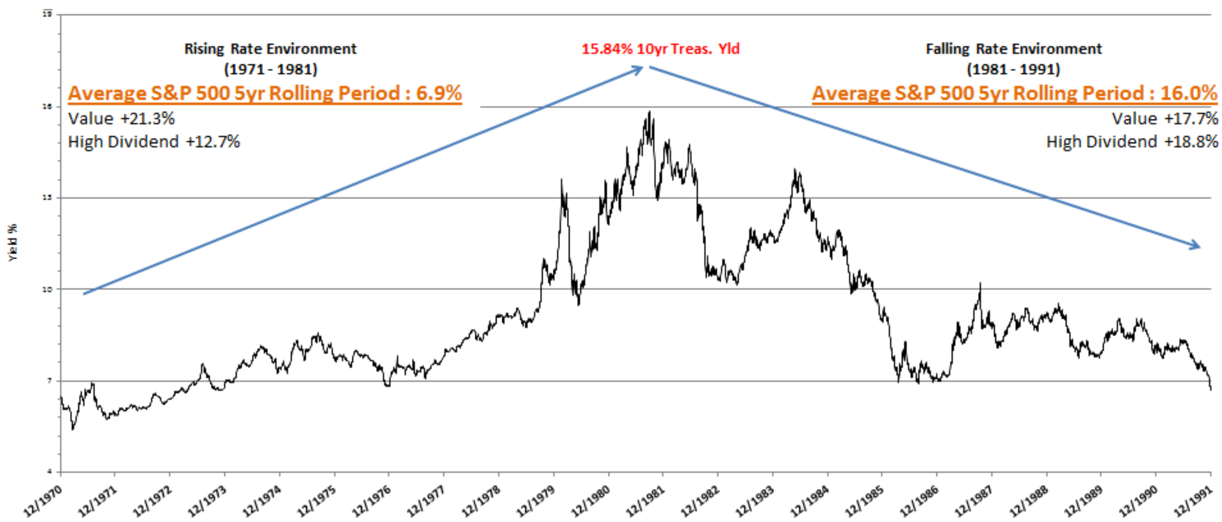
Double digit growth is what we as investment advisors are looking for. **Mathematically, if a company has a 4% dividend yield and increases its dividend at a 10% rate, the dividend on a cost basis will grow to 8% in seven years. If that happens, the stock price should go higher.**

What If – Higher Interest Rates

Some investors worry that if the rally in interest rates continues and takes them significantly higher, a portfolio of high dividend stocks will be negatively affected. For this reason we thought it would be a good time to revisit one of our old reports, written the last time investors were concerned about rising rates. The report covers the period from 1971 to 1980, a time of rising rates, and then the period from1981 to 1991, a time of falling rates. Over the course of the 20 years, the yield on the 10-year bond went from 4% to 16% and then back down to 4%.

In the short term, high-yielding stocks and the market reacted negatively to an increase in rates; but over the long term, the story was different. In our study we averaged the rolling 5-year returns for both the up and down rate environments for the low P/E and high dividend stocks in the S&P 500.

We see that in the rising rate environment the P/E and dividend disciplines doubled the performance of the S&P 500. However, the S&P performed only half as well as in an environment of falling rates. While the low P/E and high dividend stocks also did better in the falling rate environment, their relative performance was not as dramatic. **The message is that if rates start to move higher, sticking with a P/E and dividend discipline is something the investor would be well advised to do.**



RISING RATES **5-Year Periods**	**Top 20% by Yield**	**Bottom 20% by P/E**	**FALLING RATES** **5-Year Periods**	**Top 20% by Yield**	**Bottom 20% by P/E**
1971 – 1975	8.30%	12.44%	**1981 – 1985**	21.00%	26.46%
1972 - 1976	13.30%	17.81%	**1982 – 1986**	23.20%	27.63%
1973 – 1977	10.30%	17.02%	**1983 – 1987**	19.10%	18.82%
1974 – 1978	14.10%	24.71%	**1984 – 1988**	18.40%	18.22%
1975 – 1979	22.00%	34.30%	**1985 – 1989**	21.40%	16.29%
1976 – 1980	12.50%	25.67%	**1986 – 1990**	13.50%	6.14%
1977 - 1981	8.20%	18.20%	**1997 – 1991**	14.90%	10.53%
Average Return	**12.67%**	**21.31%**	**Average Return**	**18.79%**	**17.73%**
S&P Avg. Return	**6.92%**		**S&P Avg. Return**	**15.96%**	

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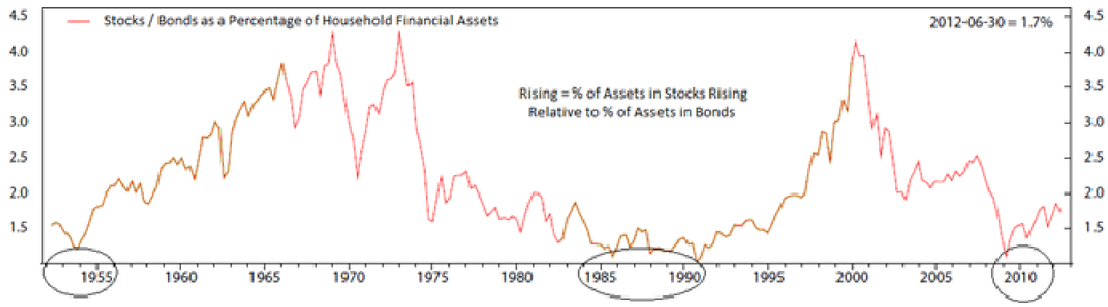
<u>The Market – Update</u>

One of the most powerful forces in the market is when investors come back into stocks after a prolonged period of being on the sidelines. To demonstrate the effects of this phenomenon, we revisit two charts from our "2013 Market Outlook" letter.

There we pointed out that since the 2008 recession, money had shifted out of equities and into bonds at an unprecedented rate, but that maybe flows had started to reverse.

Then we introduced the chart below, which showed that we had reached a point where stock ownership relative to bonds was at one of the three lowest levels in the last 60 years.



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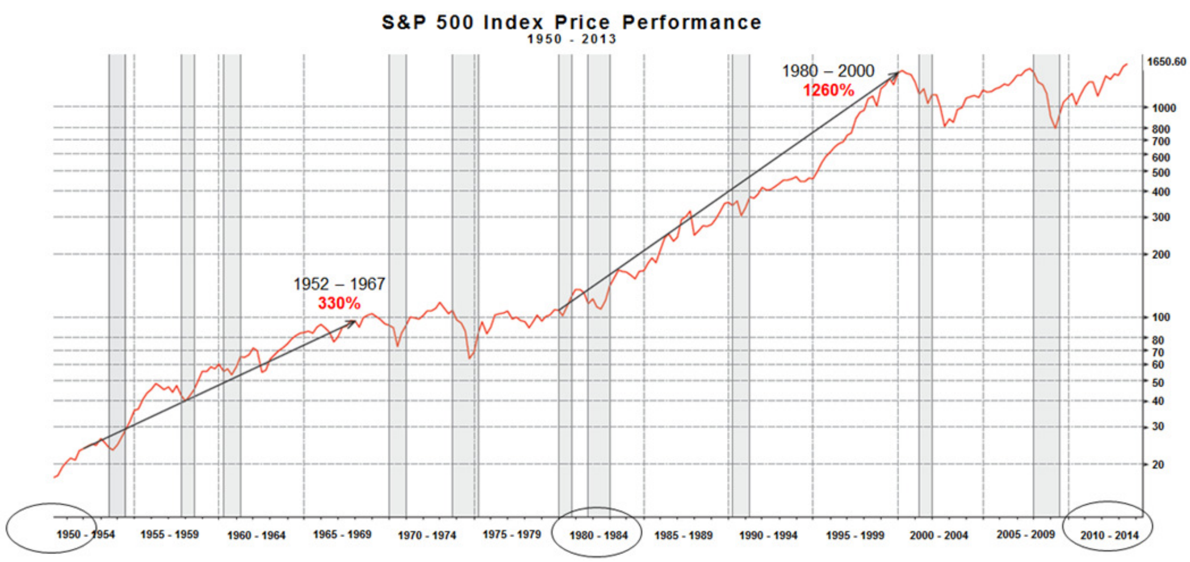
In the second chart, we went on to show how explosive the market became when momentum returned to stocks following those previously low periods. **Because of worries about the economy, in this letter we are adding all of the recessions for the entire period.** We can see that in both periods of strong market recovery, there were three recessions. **But, as it pertains to the long term investor, the study shows that the power of money flowing back into stocks was not seriously impacted by the recessions.**



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Conclusion

Investing with a dividend and P/E discipline is always important, but it is especially important in the challenging market we face today. In the current market, a phenomenal amount of time and money is spent devising various investment strategies that are not correlated with equities. **Perhaps it would be better to heed the advice of Ben Graham, who recommended simply buying equities for the long term and to be disciplined as to price.**

Jim Cullen