SCHAFER CULLEN

CAPITAL MANAGEMENT

June 30, 2015

Jim Cullen
Chairman & CEO

Mid-Year Comments:

Abandoning the Safety Net

The melt-up market, now the third longest recovery without a 10% correction in the last 70 years, continues to roll along. **Dangerously, we have now reached a point in the market where risk is being increasingly ignored by many investors.** Evidence for what is going on can be seen in the P/E multiples of some popular stocks: Facebook at 80x earnings, Netflix at 170x, Twitter at 100x, and Amazon at 120x, to name a few. More evidence of an extended market lies in what happened in the first quarter of this year when the most speculative stocks with no dividends dramatically outperformed the more conservative dividend-paying stocks.

S&P 500 1st Quarter 2015

S&P 500 Dividend Yield	Q1 Return
No Dividend	+5.3%
Dividend over 2%	-1.7%

Schafer Cullen Research, 2015

Unless this is a new way to manage money, the first quarter tells us more about where we are in the melt-up cycle than it does about investing. So we think this is a good time to make the case again for the long term advantage of investing with a discipline (P/E, price-to-book, dividend yield).

The table below dates back almost 90 years to when Standard and Poor's started the S&P 500 index. The study compares investing in the S&P 500 versus the highest 20% of dividend yielding stocks within the index and the 20% lowest dividend yielding stocks. The results are remarkable. **What they show is that because the highest dividend-yielding stocks go down only half as much as the market when it corrects, there is a huge impact on performance over time.**

S&P 500: 1927 – 2012 w/$100,000 invested

Top 20% of Stocks by Yield	**$64.9M**
S&P 500 Index	$20.2M
Bottom 20% of Stocks by Yield	$11.1M

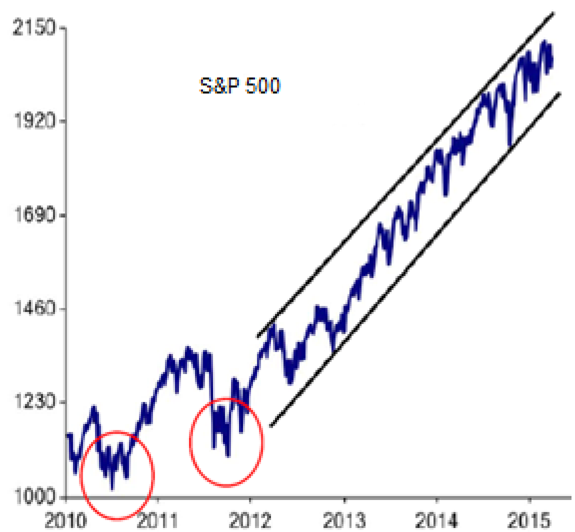
Cumulative Returns 1957 through 2012. Assumes annual rebalancing and reinvested dividends
Source: Standard & Poor's / Schafer Cullen Research, 2012

Additional Reasons for Caution

There are some areas of the market that are especially extended – the biotech stocks being the most extreme. The below chart of the biotech index shows that it is up approximately 500% over the past five years. As you can see, this mirrors the NASDAQ's 500% appreciation over the five years leading to the 2000 top.

The Melt-Up Continues

We would like to make two points about the chart below. The first is to show you how narrow and extended the melt-up market has been, and second, to highlight how dramatically performance changes when the market changes direction. We have circled the last two periods when we experienced corrections – 3Q 2011 and 2Q 2012. **The table below the chart shows how our high-dividend strategy dramatically outperformed in both down quarters.**



	6/2011-9/2011	3/2012-6/2012
Schafer Cullen HDV	-6.80	3.78
Standard & Poor's 500	-13.87	-2.75
	+7.0	+6.4

Schafer Cullen Research, 2015

<u>Where are we in the cycle?</u>

One thing I've learned after 50 years in the investment business is to NEVER – I emphasize NEVER – try to pick a market top. Examining valuation levels has been very helpful to us in identifying market bottoms; however, using these metrics to try to pick a market top is futile, since markets that are over-priced from a fundamental perspective can stay that way for a long time.

Accordingly, our strategy for dealing with a melt-up market is no different than it is for dealing with investing in general: (1) to be a long-term investor with a time horizon of five years; and (2) to invest with a discipline (P/E, price/book, dividend yield). History shows that following these two principles tends to smooth performance over even the most volatile periods. Just below is a table which tracks two of these disciplines – performance of the top 20% by yield and the bottom 20% by P/E.

The Case for Disciplined Value Funds

Rolling 5-Year Performance: Bottom 20% of the S&P 500 by P/E & Top 20% by Yield

Period	S&P 500 Bottom 20% by P/E	S&P 500 Top 20% by Yield	Period	S&P 500 Bottom 20% by P/E	S&P 500 Top 20% by Yield
1968-1972	9.7%	10.7%	1989-1993	14.5%	15.5%
1969-1973	0.0%	2.2%	1990-1994	10.1%	9.2%
1970-1974	1.1%	0.0%	1991-1995	23.2%	19.1%
1971-1975	12.4%	8.3%	1992-1996	17.9%	16.5%
1972-1976	17.8%	13.3%	1993-1997	22.0%	21.3%
1973-1977	17.0%	10.3%	1994-1998	17.8%	22.0%
1974-1978	24.7%	14.1%	1995-1999	18.2%	20.7%
1975-1979	34.3%	22.0%	1996-2000	13.9%	16.8%
1976-1980	24.7%	12.5%	1997-2001	13.3%	14.9%
1977-1981	18.2%	8.2%	1998-2002	4.7%	6.1%
1978-1982	22.2%	12.1%	1999-2003	12.1%	7.4%
1979-1983	24.5%	17.1%	2000-2004	16.0%	12.4%
1980-1984	26.1%	18.5%	2001-2005	15.4%	8.4%
1981-1985	26.5%	20.9%	2002-2006	16.0%	10.7%
1982-1986	27.6%	23.2%	2003-2007	17.3%	12.1%
1983-1987	18.9%	19.1%	2004-2008	-2.3%	-3.0%
1984-1988	18.2%	18.4%	2005-2009	2.0%	-3.6%
1985-1989	16.3%	21.4%	2006-2010	2.1%	-1.1%
1986-1990	6.1%	13.5%	2007-2011	-1.5%	-2.5%
1987-1991	10.5%	14.9%	2008-2012	2.0%	0.8%
1988-1992	15.4%	16.4%	2009-2013	24.7%	16.7%

Past performance is no guarantee of future results. The Standard & Poor's 500 Stock Index (the S&P 500) is a commonly used measure of the broad U.S. stock market. Indices are unmanaged and their returns assume reinvestment of dividends and, unlike mutual fund returns, do not reflect any fees or expenses associated with a mutual fund. It is not possible to invest directly in an index.

Source: S&P at 12/31/13

The Tough Five-Year Periods

Looking at the table, you can see that even the long-term value investor with a five-year time horizon can run up against periods in which markets are flat or down slightly. But there is also good news here – earnings tend to double irregularly every ten years; so if there is a five-year period where performance is flat, chances are good that value stocks will most likely catch up to earnings in the next five years.

With this in mind, we looked at all five-year periods going back to 1968, when value was either flat, down or up only in single digits. We then tracked the next five years starting with the year following the difficult five-year period. **What the table demonstrates is that difficult five-year periods have been followed by extremely good five-year periods.** The table tracks the high-dividend discipline, but what you see is equally applicable to the P/E discipline.

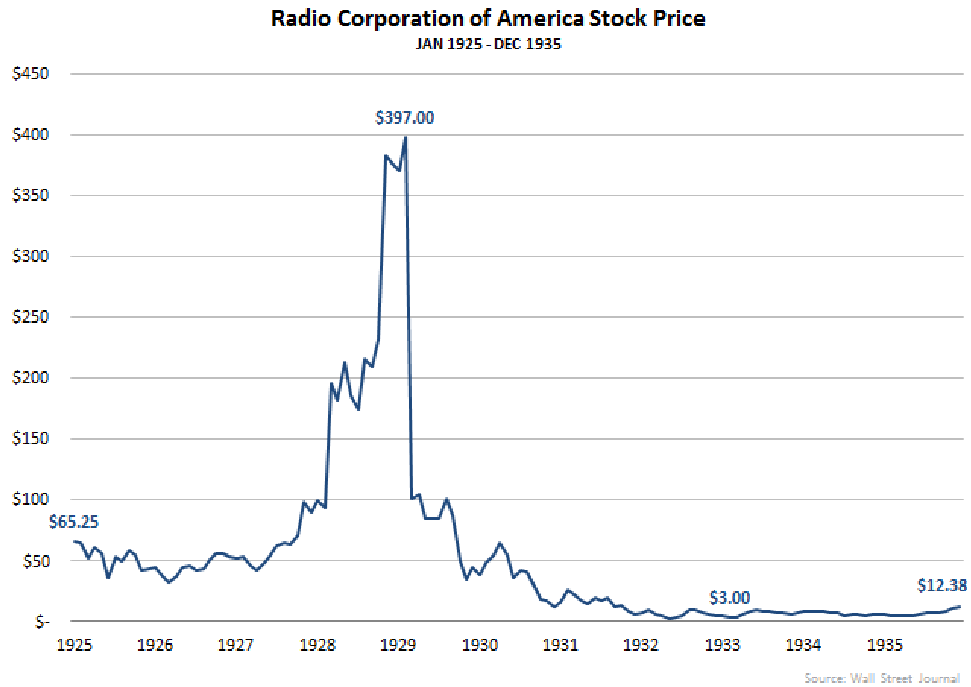
Poor 5-Year Periods	Top 20% by Yield Return	Next 5 Years	Top 20% by Yield Return
1969 – 1973	0.0%	1974 – 1978	24.7%
1970 – 1974	1.1%	1975 – 1979	34.3%
1986 – 1990	6.1%	1991 – 1995	23.2%
1998 – 2002	4.7%	2003 – 2007	17.3%
2004 – 2008	-2.3%	2009 – 2013	16.7%

Source: SCCM Research, January 2013

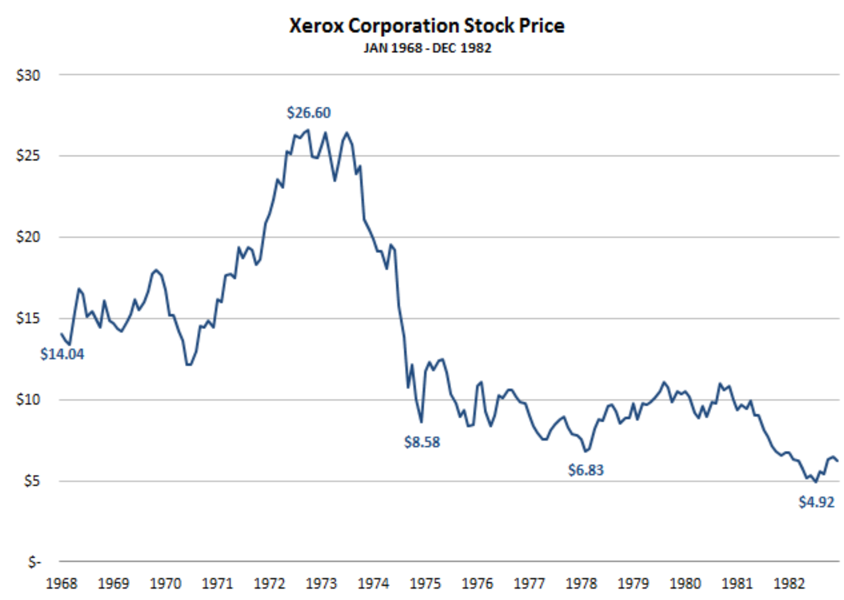
In a Melt-up Market, Don't Forget the Discipline

Melt-up markets eventually reach a point where investors get caught paying up for stocks. **While the five-year time period of investing combined with a discipline reduces the risk of investing, such is not the case if the investor simply ignores any investment discipline.** To illustrate this point you will find below three of the other most extended melt-up markets showing how the over-priced stocks were, in every case, much lower five-to-ten years later.

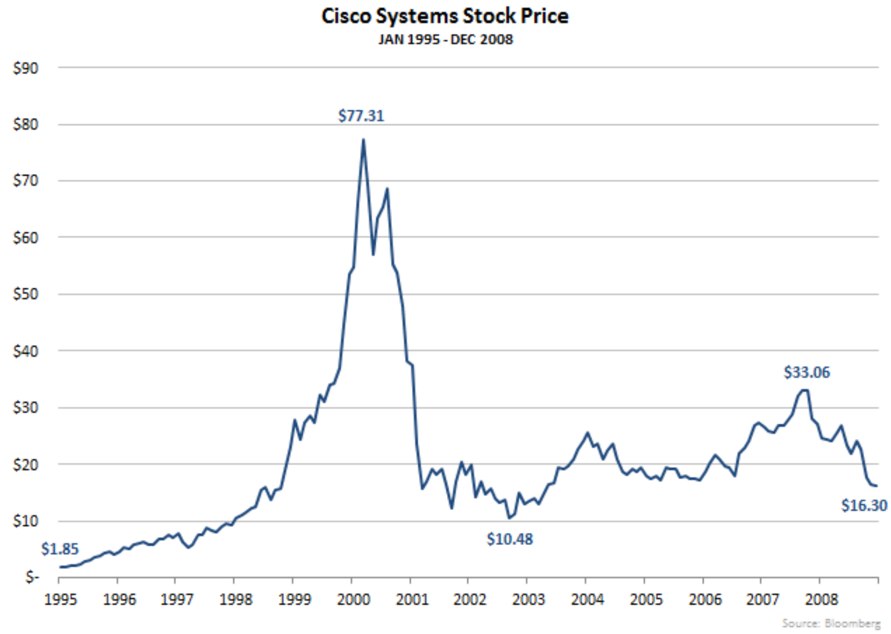
1929: This was the melt-up market famously known as "The Roaring 20's." Speculation ran high and the most popular stock of the day – RCA – seemed to have the greatest prospects. The company was the leader in manufacturing radios, which seemed to have unlimited consumer demand in the U.S. and all over the world. People thought the stock looked over-priced at $250 and even more over-priced at $300 and $400, and sure enough, the market corrected and the stock was down to $3 five years later even though RCA's earnings continued to go up during this entire five-year period.



1973: The most popular stocks of the market period were the "Nifty Fifty." The most notable companies of the day – IBM, Xerox, Polaroid and American Home Products among them – sported P/E multiples that went to extreme levels because they seemed to possess unbelievable prospects. But ten years after the correction, these stocks were still down, on average, more than 50% from their highs, even though, as was the case with RCA, their earnings continued to go up during the entire period.

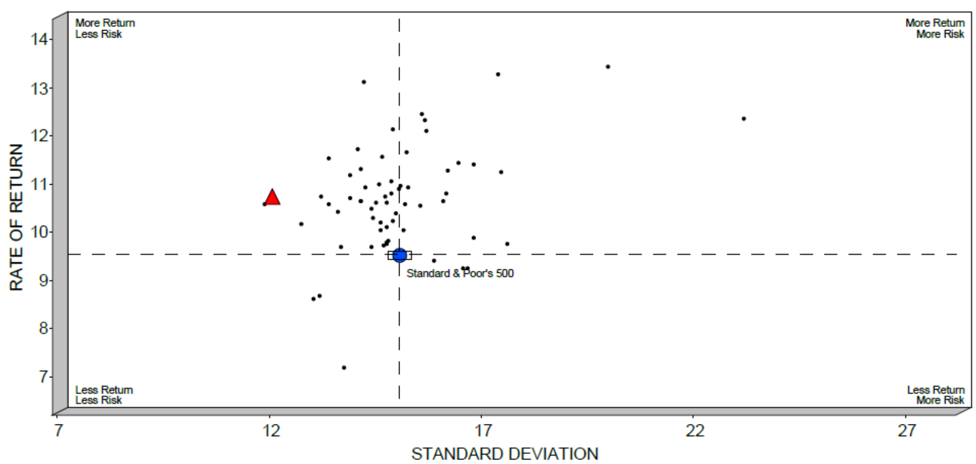


2000: Most of us remember the recent "Tech Bubble," and that ten years after its peak, the NASDAQ was still down more than 50%. And, as before, earnings of the top companies – Cisco, Intel, Microsoft – continued to go up during the decline.



<u>Risk-Adjusted Performance</u>

While absolute performance for the high dividend strategy tends to be strong in a melt-up market, a long period with no correction, like we are currently experiencing, penalizes relative performance. **But looking at long-term performance on a risk-adjusted basis gives the investor a much different picture.** The comparison below covers two full market cycles over the last 22 years that we have been employing the strategy.



	ROR	Std Dev	Alpha	Beta	R-Squared	Sharpe Ratio	Info Ratio Pop	Tracking Error Pop	Dnside Cap Ratio	Upside Cap Ratio
▲ Schafer Cullen HDV	10.58	11.90	3.32	0.66	0.68	0.66	0.14	8.50	63.39	73.50
● Standard & Poor's 500	9.36	14.91	0.00	1.00	1.00	0.45	0.00	0.00	100.00	100.00

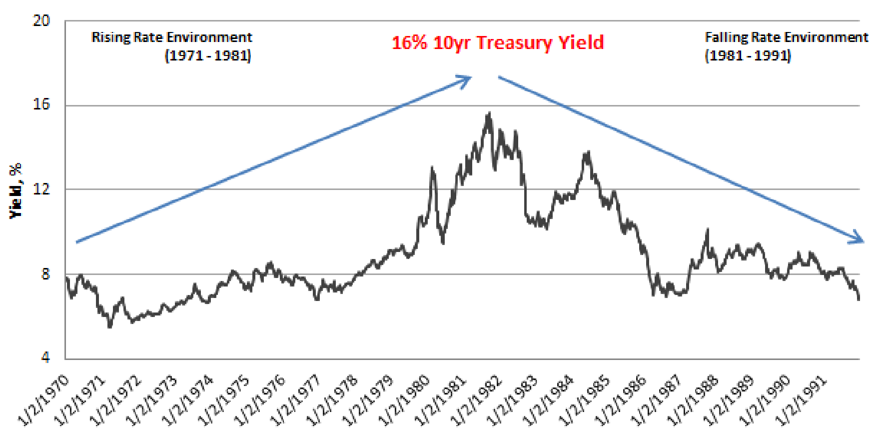
Schafer Cullen Research, 2015

Rising Interest Rates

The question remains about what happens to a high dividend strategy if interest rates go sharply higher. To answer the question, we look again at a study we reference in previous market letters showing what occurred the last time rates made a major move. We know that interest rate-sensitive stocks tend to sell off when rates start to go up, but those sell-offs tend to be short lived. **For the longer term, the rolling five-year performance of the value disciplines does surprisingly well in a rising interest rate environment.**

We want to emphasize that our High Dividend strategy has three main features: 1) P/E discipline, 2) dividend yield and 3) dividend growth. The chart below covers two of these disciplines – the P/E and yield, and shows that **the market went up less when rates were going higher; however, the relative performance of the dividend and P/E disciplines was dramatically better when rates were going up.** When rates were going down, the disciplines performed better than the market, though less well on a relative basis.

10-Year U.S. Treasury Yield



The performance data quoted represents past performance, which is no guarantee of future results.

Source: SCCM Research

RISING RATES		
5-Year Periods	Top 20% by Yield	Bottom 20% by P/E
1971 - 1975	8.30%	12.44%
1972 - 1976	13.30%	17.81%
1973 - 1977	10.30%	17.02%
1974 - 1978	14.10%	24.71%
1975 - 1979	22.00%	34.30%
1976 - 1980	12.50%	25.67%
1977 - 1981	8.20%	18.20%
Average Return	**12.67%**	**21.31%**
S&P Avg. Return	**6.92%**	

FALLING RATES		
5-Year Periods	Top 20% by Yield	Bottom 20% by P/E
1981 - 1985	21.00%	26.46%
1982 - 1986	23.20%	27.63%
1983 - 1987	19.10%	18.82%
1984 - 1988	18.40%	18.22%
1985 - 1989	21.40%	16.29%
1986 - 1990	13.50%	6.14%
1987 - 1991	14.90%	10.53%
Average Return	**18.79%**	**17.73%**
S&P Avg. Return	**15.96%**	

<u>The Dividend Cushion</u>

We believe it is important to mention two of the advantages of a dividend discipline that we have highlighted in recent market letters.

<u>1) Dividends in Recessions</u>: History shows that dividends on the S&P 500 have generally gone up during almost all of the recessions of the last 70 years even though earnings in these down markets have dropped, on average, between 25-50%.

<u>2) Dividends at Cost</u>: The dividend growth for our High Dividend strategy has averaged over 10% for the past four years. **Consider this: if the yield on a portfolio is 3.5% and dividend growth is 10%, in ten years the dividend yield on the portfolio will be 9.1% on a cost basis.**

<u>Conclusion</u>

History shows that it doesn't pay to try to time the stock market, but there are times, like the present, when risk levels have increased to a point where it is wise to have a safety net – like dividends.

Jim Cullen