SCHAFER | CULLEN
CAPITAL MANAGEMENT

High Dividend Value
Q4 2019 Commentary

Market Review:

US equities advanced sharply in the 4th quarter of 2019, with the S&P 500 finishing up +9.1% and the Russell 1000 Value up +7.4%. The quarter capped off a remarkable year for stocks, as the S&P 500 returned 31.5% for the year, the best performance for the market since 2013. Two key themes that propelled stocks higher throughout the year continued in the 4th quarter, including accommodative policy by the Federal Reserve ("Fed") and progress in the US-China trade war. After the Fed cut interest rates in October for a third time in 2019, the Trump and Xi administrations in December agreed to a phase one trade deal.

Information Technology and Healthcare were the best-performing sectors, both finishing the quarter up +14.4%. While the strong quarter merely extended the banner year for Technology, which finished up 50.3% for 2019, Healthcare had been significantly lagging the broad market coming into October. The rally in Healthcare stocks appeared to be driven in part by the political landscape, as candidates advocating for sweeping changes in the healthcare system dipped in polls for the Democratic Presidential primary. Financials (+10.5%), and particularly bank stocks, benefitted from the risk-on sentiment and a slight steepening in the Treasury yield curve. The Communication Services sector was up +9.0%, as the internet and technology-heavy Media & Entertainment industry advanced +10.5%, while the Telecom industry gained only +3.7%. Defensive, higher-yielding sectors lagged in the quarter. Real Estate (-0.5%) was the only sector with negative returns, while Utilities were up only +0.8% and Consumer Staples returned +3.5%.

Given that the 4th quarter marked the end of the 2010's, it is worth noting the market's performance over the decade. Still recovering from the 2008 financial crisis at the beginning of 2010, the S&P 500's performance benefitted from a relatively low starting point. It further benefitted from a recession-free decade, now in unchartered territory as the longest economic expansion in US history. Over the decade, the S&P 500 returned 256%, or 13.5% on an annualized basis. Following roughly a decade of Value outperformance in the 2000's, the 2010's were marked by Growth's outperformance over Value, as the Russell 1000 Growth index returned 15.2% annualized versus 11.8% for the Russell 1000 Value. The outperformance of Growth can be further narrowed to a handful of stocks, as the acronym "FAANG[*]" was coined and those stocks returned approximately 21% annualized. Information Technology returned 17.5% annualized over the decade, while Healthcare was the second-best performing sector at 14.8% annualized, and Energy suffered from a rout in the WTI oil benchmark, from above $110 in 2014 to below $40 in 2016 and the sector returned only 3.3% annualized. Finally, it is worth noting that S&P 500 EPS growth averaged 10.2% over the decade, while revenue growth averaged only 4.4%, reflecting the increase in profit margins and the impact of share repurchases.

With widespread concerns about a potential slowdown in the economy earlier in the year, the Fed responded with its third rate cut in the 4th quarter, bringing interest rates to a range of between 1.5% and 1.75%. Following the announcement, Fed Chair Jerome Powell said "the current stance of policy is likely to remain appropriate," as long as the economy expands moderately and the labor market stays strong. In addition to the rate cuts, the Fed injected further liquidity into financial markets through overnight repurchase agreements, following significant dislocation in the repo market in September. The accommodative policies from the Fed come at a time when the US economy appears to be strong. The Commerce Department reported US GDP growth of 2.1% for the 3rd quarter, compared with 2.0% in the 2nd quarter.

It was a historic quarter on the geopolitical front. The US-China phase one trade deal rolled back certain US tariffs and cancelled new tariffs on roughly $156 billion in Chinese imports that were set to take effect on December 15th. Chinese concessions included increased purchases of farm goods and other US exports. The US, Mexico and Canada signed an amended USMCA trade deal to replace NAFTA, which included provisions aimed at creating manufacturing jobs in the US. Amidst all the trade developments, the House of Representatives voted to impeach President Trump for abuse of power and obstruction of Congress, only the third impeachment in US history. Senate Majority Leader Mitch McConnell is thus far insisting on a quick Senate trial, while Democrats in the House and Senate have demanded witnesses and further documents. Finally, the UK's Boris Johnson secured a historic general election victory as his Conservative Party won 364 of 650 seats in the House of Commons. The win sets the stage for the long-awaited Brexit on January 31st.

Performance Analysis:

The High Dividend Value Equity strategy composite returned 5.73% (gross) and 5.64% (net) for the fourth quarter of 2019 and 21.14% (gross) and 20.70% (net) for the full year 2019.

Figure 1: High Dividend Value Equity Returns vs. Benchmark

	Q4	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Since Incept*
High Dividend Value Equity (gross)	5.7	21.1	21.1	11.2	9.0	11.9	10.5
High Dividend Value Equity (net)	5.6	20.7	20.7	10.8	8.6	11.4	9.9
Russell 1000 Value Index	7.4	26.6	26.6	9.7	8.3	11.8	9.6
S&P 500 Index	9.1	31.5	31.5	15.3	11.7	13.6	9.9

12/31/1993. Performance for periods greater than 1 year is annualized.* ***Past performance is no guarantee of future results.*

US equities decisively broke out in the fourth quarter from the range-bound territory it had traded in since early 2018. Renewed balance sheet expansion by the Fed and increasing certainty on a US-China phase one trade deal fueled markets higher. The reflationary narrative that global growth will strengthen drove yield curve steepening and market rotation further into Growth and increasingly into Cyclicals.

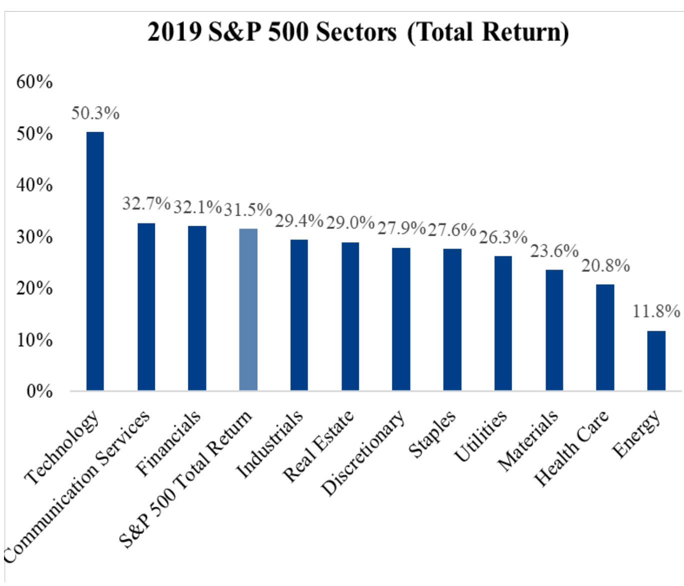
Figure 2: Federal Reserve Balance Sheet and S&P 500 Returns

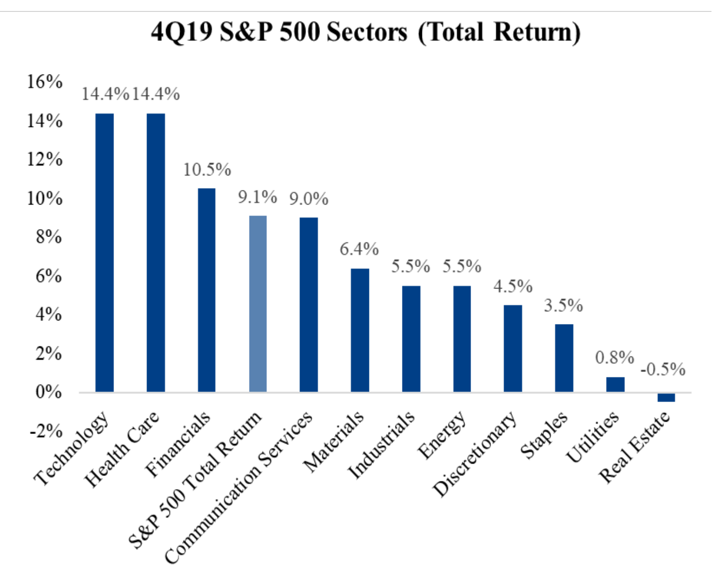
Source: Bloomberg, Morgan Stanley Research, US Weekly Warm Up, 1/6/2020.

Of the S&P 500 total return of 31.5% for 2019, Price/Earnings multiple expansion contributed 84% and was the primary driver of returns, followed by dividends, which contributed 8% for the year. S&P 500 earnings growth, which had been expected to be at 10% at the start of the year, is now projected to be flat year-over-year. One illustration of the beta-driven rally is the strength of the Philadelphia Semiconductor Index (SOX) which soared 60% in 2019 despite global semiconductor sales declining almost 10% – the biggest decline in a decade.

In the fourth quarter, the S&P 500 returned 9.1%; however, sector performance varied considerably as the market rotation into Growth and Cyclicals came at the expense of Defensives and Bond Proxies. Technology, the best performing sector for the quarter, outperformed Real Estate, the worst performing sector, by 1,500 basis points. Similarly, the highest dividend yielding quintile underperformed the market in the quarter and for the year.

Figure 3: S&P 500 Total Return by Sector





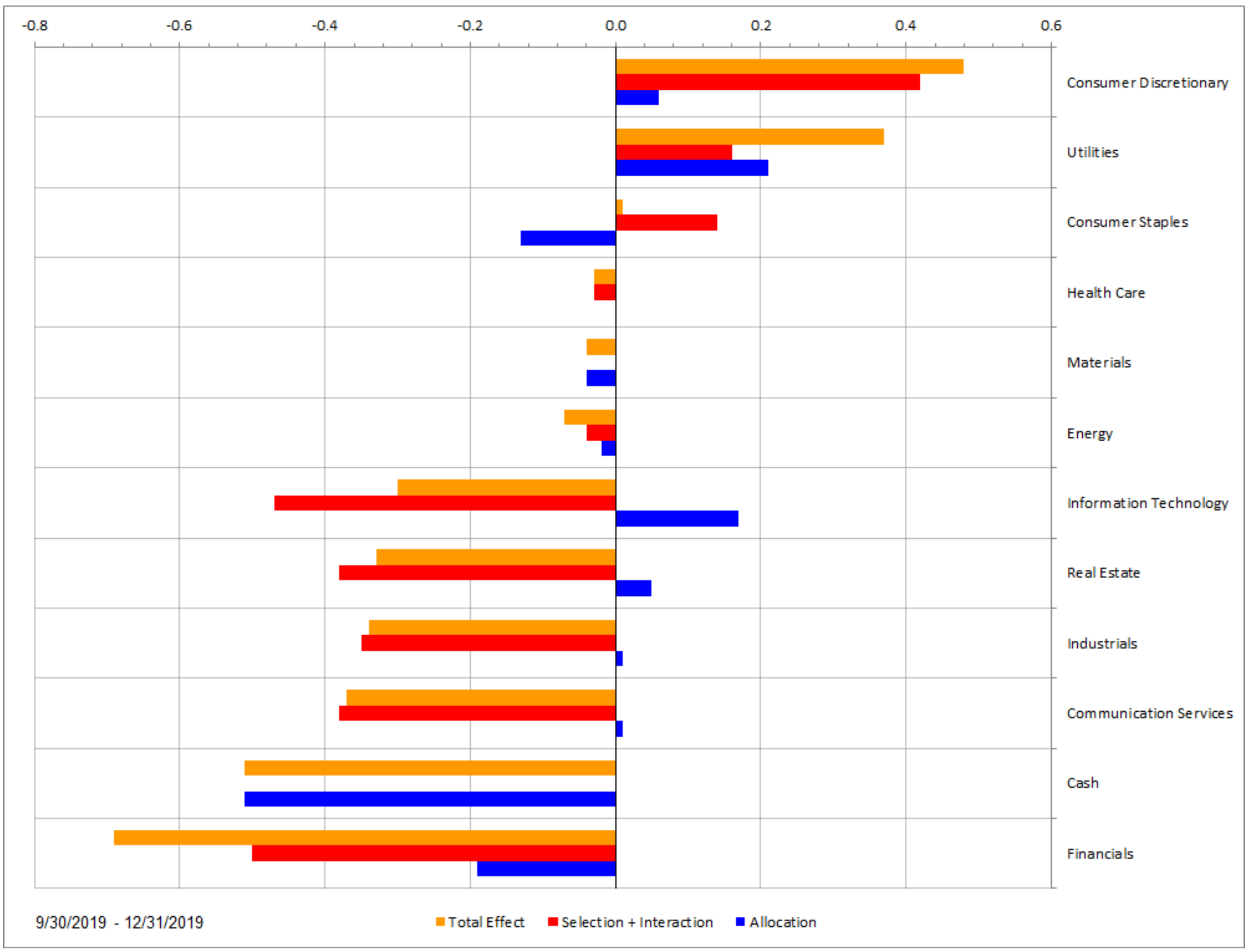
Source: BofA/ML, US Performance Monitor, 01/03/2020. **Past performance is no guarantee of future results.**

The investment discipline core to the High Dividend Value Equity strategy focuses on the long-term factors that drive superior risk-adjusted returns – investments in high quality companies with attractive relative valuations, sustainable and growing dividends and catalysts to drive earnings growth and improving sentiment. At quarter-end:

- **Low P/E Valuation Discipline**: The strategy's P/E was 16.2x 2020 earnings versus 17.8x for the Russell 1000 Value and 19.8x for the S&P 500 (Q4).
- **High Absolute Dividend Yield**: The strategy's dividend yield was 3.4% versus 2.5% for the Russell 1000 Value and 2.2% for the S&P 500 (Q4).
- **Strong Dividend Growth**: In Q4, three out of 39 portfolio companies raised their dividends with an average increase of 17.1%. For the full year 2019, 33 out of 39 portfolio companies raised their dividends with an average increase of 8.7%.

Portfolio Attribution:

Attribution Effects – High Dividend Value vs. Russell 1000 Value 9/30/2019 – 12/31/2019



Source: SCCM/Bloomberg, 12/31/2019.

The following attribution analysis of the High Dividend Value Equity portfolio utilizes the Russell 1000 Value Index as the benchmark of comparison for the fourth quarter of 2019.

Our underweight allocation to ***Consumer Discretionary*** combined with strong stock selection in the sector made it the largest contributor to relative performance for the quarter. While many cyclical Discretionary companies benefitted from the risk-on sentiment in the quarter, the sector was weighed down by auto manufacturers, several retailers and restaurant companies. Target (+20.6%) reported another stellar quarter of results, with comparable sales growth of 4.5% year-over-year, digital sales up 31%, in-store traffic up 3.1%, and an increasing gross margin. Target was the 4th best performing stock in the S&P 500 in 2019 and up 100.1% for the year. Genuine Parts (+4.5%) reported strong sales growth for its US automotive and industrial parts groups, while its European automotive sales improved sequentially after a challenging 2nd quarter. Our underweight allocation and strong stock selection within ***Utilities*** also aided relative performance. Utilities was the second-worst performing sector in the quarter as defensive, higher-yielding sectors lagged. NextEra (+4.5%) outperformed in the sector after it beat consensus estimates and several analysts raised full-year earnings estimates and price targets. Stock selection within ***Consumer Staples*** also benefitted relative performance. Altria (+24.1%) outperformed after the FDA appeared to delay a pursuit of regulation limiting nicotine levels in cigarettes. Cigarette manufacturers also appeared to benefit from the FDA's crackdown on vaping and flavors in e-cigarettes, which could alleviate pressure on core combustible volumes. Philip Morris Int'l (+13.6%) and Altria also rose on continued strong demand for their leading reduced risk product, IQOS, which began selling at stores in Atlanta and Richmond.

Our underweight allocation and stock selection within ***Financials*** detracted from relative performance in the quarter. Financials, and particularly bank stocks, benefitted from the risk-on sentiment and a slight steepening in the Treasury yield curve. Travelers (-7.3%) declined after the company reported adverse reserve development largely stemming from an increasingly difficult tort environment in its commercial auto and general liability lines. As it works through this period of elevated losses, the company is responding with substantial price increases in these lines of business, which should improve underwriting performance longer term. The difficult tort environment weighed on most property and casualty insurers, including Chubb (-3.1%); however, Chubb beat consensus EPS estimates on accelerating price increases across many of its lines. Stock selection within ***Communication Services*** detracted from performance, as BCE (-3.0%) declined on industrywide concerns in Canada that the rapid shift to unlimited wireless data plans will result in less revenue from overage fees generated when customers surpass monthly limits. Yet all three of BCE's divisions posted solid results in the 3rd quarter, with strong wireless subscriber and service revenue growth, and customer churn down year-over-year. Finally, stock selection within ***Industrials*** also impacted relative performance. Boeing (-13.9%) continues to work through the grounding and production halt of its 737 MAX, and replaced CEO Dennis Muilenburg with Chairman David Calhoun, who has served on Boeing's board for ten years. In its statement announcing the leadership change, Boeing said it looks to operate with full transparency with the aim of repairing relationships with the FAA and global regulators. Johnson Controls (-6.7%) underperformed in the quarter but finished the full year up 40.9%. In a transformative year for the company, following the sale of its automotive battery business, the firm met or exceeded management's expectations for growth, profitability and free cash flow conversion.

Portfolio Changes:

Purchases / Additions

The following positions were added to in the quarter: Bank of America (BAC), Chevron (CVX), Dow Chemical (DOW), Intel (INTC), Johnson Controls (JCI), Pfizer (PFE), Phillip Morris International (PM) and Wells Fargo (WFC).

Sales / Reductions

DuPont de Nemours (DD) – The position in DuPont de Nemours (DuPont) was sold in the quarter. Following the 2017 merger of Dow Chemical and DuPont and the subsequent spin of their combined agriculture business, DuPont's portfolio became centered on four core divisions: Electronics & Imaging, Nutrition & Biosciences, Transportation & Industrial and Safety & Construction. Based on Ed Breen's track record of driving value creation through mergers & acquisitions and spin-offs and DuPont's recent commentary, we believe that additional spin-offs / splits are likely to materialize over the coming months. With the recent announcement that its Nutrition & Biosciences division will be divested, we find the remaining businesses to be less compelling, with a lower and likely more cyclical revenue and earnings stream. Moreover, with a dividend yield that is already below our stated minimum threshold, we believe that dividend growth will likely be challenged going forward, especially as the spin-offs translate into a lower earnings and free cash flow generation profile at the group level. Lastly, DuPont remains partially exposed to the financial liabilities that may arise from the PFOA (perfluorooctanoic acid) litigation, in the event that Chemours, which currently indemnifies DuPont for these liabilities, becomes insolvent. Shares of DuPont are valued at 16.6x forward earnings and offer a 1.8% dividend yield.

The following positions were reduced in the quarter: Corning (GLW), Eli Lilly (LLY), Merck (MRK), Royal Dutch Shell (RDSB) and Travelers (TRV).

Dividend Summary:

In the fourth quarter of 2019, three out of 39 portfolio companies raised their dividend payments with an average increase of 17.1%:

- ConocoPhillips (COP) raised its dividend payment by +37.7%
- Merck (MRK) raised its dividend payment by +10.9%
- Siemens (SIEGY) raised its dividend payment by +2.6%

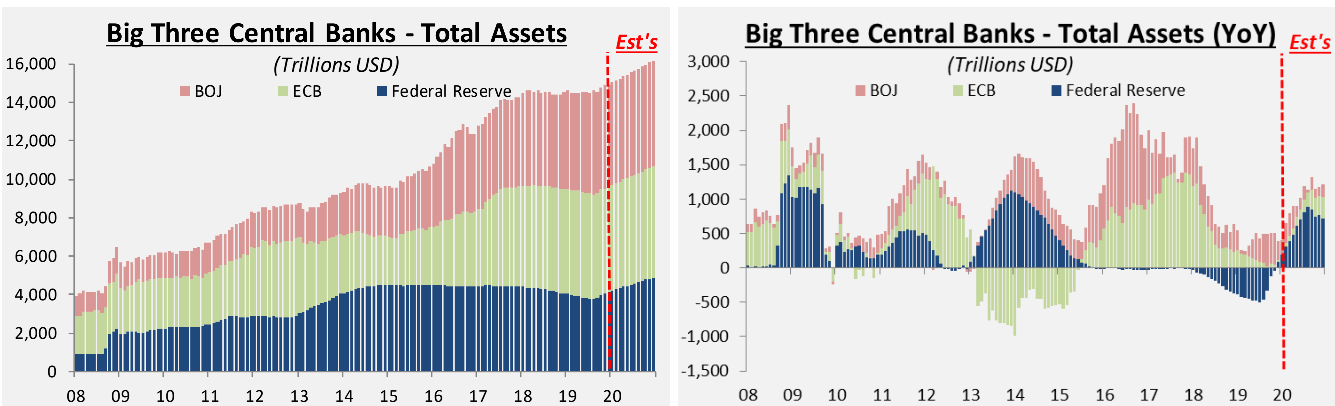
For the full year 2019, 33 out of 39 portfolio companies raised their dividends with an average increase of 8.7%.

Market Outlook:

US equity markets posted their second best year of returns in 2019 since the financial crisis as markets began to price in an economic rebound in 2020. Wall Street consensus expects further gains as global central banks collectively continue to expand their balance sheets, the US-China phase one trade deal serves to reduce the economic impact of tariffs and improve business confidence, and election years have historically delivered above-average market returns. In addition, analysts are optimistic, with corporate earnings expected to rise 10% year-over-year in 2020. Bullish views are also supported by the shift in Fed communication stating the committee is willing to let inflation run above target levels, reducing the risk of rate hikes and tighter liquidity.

The late 2019 market rally was in part driven by the resumption of global central bank balance sheet expansion which began in earnest in October 2019. The three largest central banks (Federal Reserve, ECB, and BOJ) continue to expand their balance sheets at the rate of $100B per month, which has served to suppress volatility with the 30-day realized volatility for the S&P 500 reaching one of the lowest readings on record. The low volatility environment has driven quantitative and systematic strategies to rebalance out of fixed income and into riskier assets, driving equity prices higher. The impact of renewed Fed balance sheet expansion can be seen in the significant acceleration in money supply growth with US M2 growth accelerating from 3.8% year-over-year in April 2019 to 7.6% in December 2019.

Figure 4: Central Bank Balance Sheets



Source: Wolfe Research, 2020 Outlook, 12/16/2019.

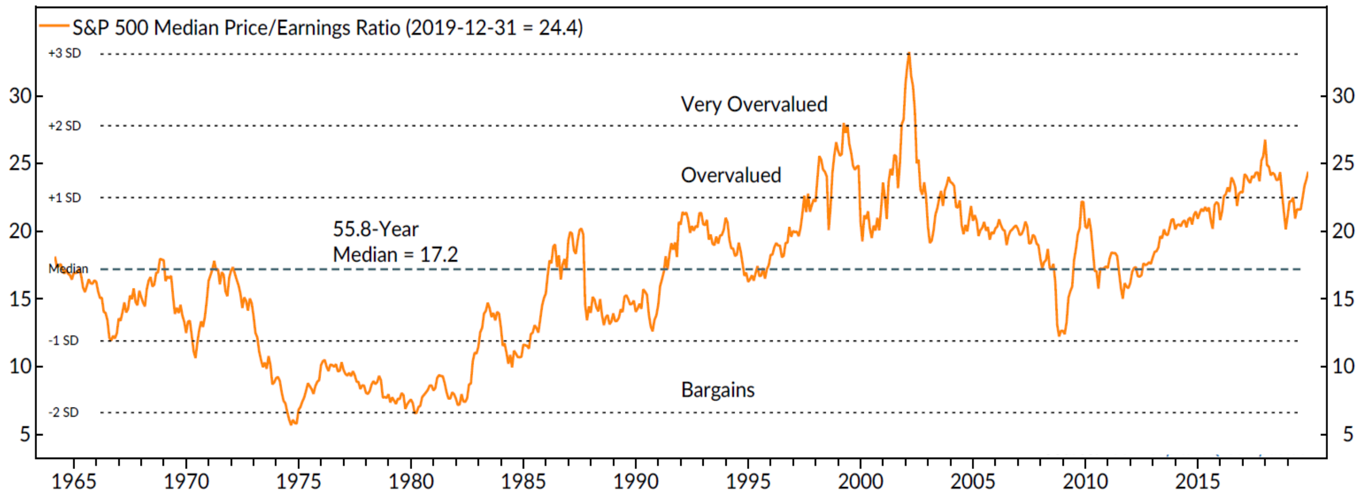
The continued rise of passive investing and momentum have driven the S&P 500 to be further concentrated, with the 10 largest companies now representing 25% of the index, similar to record levels reached during the Tech Bubble. While this in and of itself does not signal risk, it does highlight the concentration and crowding in trillion-dollar market capitalization companies that will eventually face growth challenges.

Figure 5: Market Cap of 10 Largest S&P 500 Companies as % of Total S&P 500 Market Cap

Source: BofA/ML, Strategy Snippet: Liquidity Concerns, 12/11/2019. Dates in study 1/1986-10/2019.

Elevated market valuation and bullish investor sentiment are challenges for the equity markets ahead. The S&P 500 median Price/Earnings ratio is 24.4x while the Price/Sales ratio is 2.4x, higher than the peak of the dot-com bubble. These heightened levels have been partially justified by low inflation, low rates and global monetary stimulus. While valuation levels can remain elevated and can further expand, earnings will likely be an increasingly important factor for returns. Interestingly, during periods of EPS acceleration, P/E multiples have typically fallen at a 9.1% rate (Ned Davis Research, The Case for P/E Contraction in 2020, 12/17/19).

Figure 6: S&P 500 Median Price/Earnings Ratio



Source: Ned Davis Research, 12/31/2019.

Thank you for your continued support. Feel free to reach out to us if you have any questions.

Best Regards,
Schafer Cullen Capital Management, Inc.

*FAANG is an acronym for the market's five most popular stocks: Facebook, Apple, Amazon, Netflix and Google.

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