ThomasPartners
INVESTMENT MANAGEMENT®

Quarterly Observations

July 1, 2018

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ThomasPartners income strategies seek to provide: Income Every Month | Income Growth | Competitive Total Returns Over Time

Building Plans that Work

"A goal without a plan is nothing more than a dream."
–Hank Haney, renowned PGA golf coach

Clients ask us…

Since the start of the year, the stock market has seen a return to volatility and the share-price gains mostly non-rewarding. While such short-term circumstances should never be a surprise to any equity investor, the prevailing volatility and lower returns are in direct contrast to the low volatility and steady quarterly gains enjoyed over the past few years.

It is no surprise, therefore, that today's market conditions have inspired a number of client questions, which most generally center on asking if the prevailing circumstances are of sufficient concern to us to warrant a change in strategy.

The answer, of course, depends largely on what an investor's specific objectives are and how their current investment plan is designed to address such circumstances.

Pots or sources…

Wharton Professor Jeremy Siegel has long observed that he sees only two kinds of investors: those who view their portfolios as "pots of money" and those who view them as "sources of income." The former group seeks growth ***over time*** while the latter group seeks income *all the time*.[1]

It is our opinion that this performance time-frame differential—*over time* versus *all the time*—is a critical variable in any investor's plan; especially with respect to the role of volatile capital gains. If the plan needs capital gains only *over time*, price volatility and/or lower returns in any short-term period are not enduring problems. But, if the plan calls for regular capital gains to fund regular cash distributions *all the time*, share price volatility and/or lower returns can cause significant and permanent damage.

(Continues)

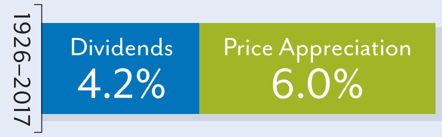
Did you know?

We often highlight that the market capitalizes earnings and collects dividends. While these dividends are meaningful over time, accounting for over 40% of the S&P 500's total return historically[2], collecting them requires patience.

According to Ned Davis[3], the average holding period for a common stock traded on the New York Stock Exchange is just 10 months. Such a short holding period allows few dividend payments to be collected and increases an investor's reliance on the more volatile component of a stock's return: price movement.

Perhaps this near sightedness has made investors more susceptible to market volatility. At the same time however, the more patient, long-term investors, can continue to collect dividends that are not fully valued by those with a shorter time horizon.

Perhaps said better by Warren Buffett, "The stock market serves as a relocation center at which money is moved from the active to the patient."[4]



Source: 2017 Stocks, Bonds, Bills & Inflation® (SBBI®) Yearbook. Bloomberg. The above graphic represents the compounded annual return of the S&P 500® Total Return Index and assumes the reinvestment of dividends, includes capital gains, and does not reflect the effect of taxes and fees. Indexes are unmanaged and not available for direct investment.

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Logically, the "plans" for each type of investor should be quite different. Growth objectives with no need to fund regular cash distributions can enjoy a lot of investment selection freedom. Steady income objectives, however, require more cash flow discipline. Less-volatile sources of investment return—rents, dividends, and interest—should therefore play a larger and more continuous role.

ThomasPartners approach...

In the ThomasPartners strategies, we have embraced investors who view their savings as "sources of income," either today, because they are already retired and need to fund their retirement lifestyles, or tomorrow, because they will eventually be retired and need to replace their employment paychecks.

This embrace was not only largely based on our understanding of that group's objectives (our founder was retired for years), but also on our perception that investment strategies that meet income objectives *all the time* can be accomplished without necessarily diminishing capital gains potential *over time*.

The principal tools we use are dividend-paying common stocks, or more specifically, dividend-growing common stocks.

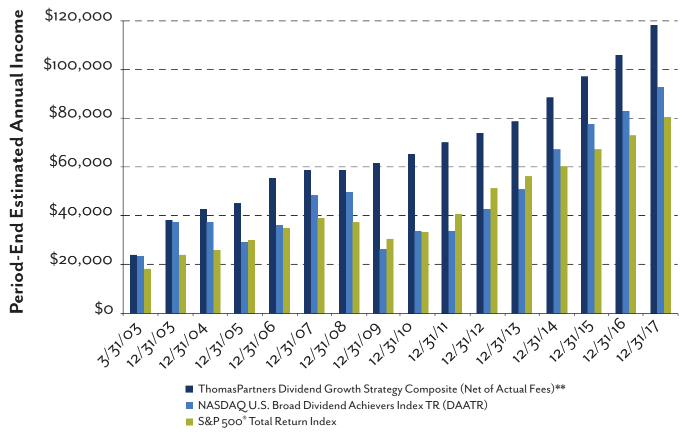
Our process involves screening all stocks for quality, for dividend-growth history/potential, and for attractive valuations in relation to their free cash flows. The results of our screens yield a robust pool of stocks from which we attempt to build portfolios designed to deliver monthly dividend income *all the* time; generate whole portfolio dividend income growth; and create attractive total returns (capital gains + dividends) *over time*...in that order of priority.

Historical evidence...

Seeking to protect clients' retirement lifestyles in this manner might seem like a tall order, but, it's not. Dividends are not vulnerable to stock market volatility; they are paid directly by companies when stock prices are rising and when they are falling. Portfolio dividend income streams can be made to grow even when stock prices do not; all that's needed are finding stocks that grow their dividends and portfolio management that maintains a consistent focus on that growth objective. And, as demonstrated in Figure 1, it can be done.

The dark columns reveal the estimated income that could have been generated in the ThomasPartners Strategy Composite with a hypothetical investment of $1 million since inception of the strategy. Obviously, the objective of income *all the time* was well met, despite experiencing a number of periods with high stock market volatility and low or no capital gain returns. It is worth noting the income *all the time* experience of this composite; during the so-called Great

Figure 1: **ThomasPartners Dividend Growth Estimated Income Growth Since Inception**



****The ThomasPartners Dividend Growth Strategy Composite as shown is for illustrative purposes only and not available for direct investment.**
The Estimated Income Growth Since Inception chart assumes that a client invested $1 million in the ThomasPartners Dividend Growth Strategy on March 31, 2003 (the strategy's inception date). Each period's estimated annual income shown is the product of that initial $1 million investment and the accumulation of capital appreciation plus reinvestment of all distributions of income since the inception date, multiplied by the annualized current strategy yield. Please see additional explanatory notes and disclosures at the end of this document for information regarding the strategy, benchmark and portfolio information. **Past performance does not guarantee future results.**

Recession (later 2007 through early 2009) when major stock indexes were down over 30% incomes were maintained, and therefore, retirement lifestyles may have been maintained too.

Total returns...

The incomes indicated in the above chart are after fees, and do not account for taxes or include capital gains, however, the composite's capital gains have been quite attractive as well. Over the 15 years shown in the chart, the ThomasPartners Strategy Composite not only delivered a steady and growing dividend income stream*, but also delivered total returns, on average, of 9.47%, net of fees; 1.10% ahead of its benchmark and only 0.70% less than that of the S&P 500 over the same period. Said differently, the hypothetical $1,000,000 initial investment on March 31st, 2003 would be worth $3,974,242 as of June 30th, 2018.

To answer our clients' questions, we do not need to predict future volatility and stock market capital appreciation in order to achieve "source of income" portfolio objectives, largely because our clients' plans fund regular withdrawals mostly with less-volatile dividend income, not with more volatile capital gains. And, as noted, if a client spends dividends during market downturns and is not forced to distribute principal, the portfolio's *over time* growth potential is maintained.

*2008's estimated income did not grow relative to 2007's estimated income.

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Thank you…

Once again, we want to thank you for trusting ThomasPartners Investment Management to build an investment strategy for you. We always welcome your questions and comments, so please feel free to contact your dedicated Investment Professional if you have any. We would be very pleased to address your questions and look forward to speaking with you, as well.

Research Insights

"It's waiting that helps you as an investor, and a lot of people just can't stand to wait. If you didn't get the deferred-gratification gene, you've got to work very hard to overcome that.[5]" –Charlie Munger

The quote above, from Berkshire Hathaway's Vice Chairman and long-time partner of Warren Buffett, reminds us that patience is an underrated attribute of successful investors. With an ever-increasing torrent of news flow, investors could be forgiven for increasing their trading activity to react to the latest news about the economy, interest rate policy, or actions to restrict global trade. Our approach at ThomasPartners has not wavered, however, as we have continued to focus on those factors that drive long-term results: delivering income, growing that income, and earning competitive returns. We take the approach of assessing return potential based on a company's growth in sales, earnings, free cash flow, and of course, dividends.

Dividends not only drive value over time, but they also provide a dependable income stream that you can spend or reinvest. Increasing trading activity can undermine this income stream as you need to hold the shares in order to receive the cash disbursement. Value can also be slow to evolve. A company's stock price is likely to be far more volatile than its underlying business, presenting opportunities to buy a company below its intrinsic value and sell when it trades meaningfully above. These deviations from a business' underlying value may unnerve investors if they focus solely on the share price and not on how the underlying business is performing. We have long used dividend growth as a proxy for company fundamentals. If a stock meaningfully increases its dividend over time, we posit that the stock price will ultimately catch up (i.e., a higher dividend yield—dividend/price—will attract more buyers). Conversely, if a company disappoints our own expectations for dividend increases, it may signal that its business results are not as robust as previously indicated.

The investment industry is in many ways geared towards increasing activity. Brokerage analysts' upgrades or downgrades of a stock or sector can generate commissions for the brokerage firm by creating buy and sell tickets. Product innovations created new ways for investors to not only invest in an economic sector, but also in stock characteristics (think low volatility, momentum, value, etc.) or exposures (regions or countries). These "innovations" can also spur activity as investors chase one hot sector, factor, or exposure and roll into another with a better near term outlook.

Our approach at ThomasPartners remains steadfast as we look to provide a consistent and growing income stream while also pursuing competitive total returns over time. No one will confuse us with an active trader as we have consistently maintained a low turnover strategy focused on the value drivers of each business and how they interact as a portfolio. Using Mr. Munger's parlance at the top of this essay, we rely on our deferred-gratification genes to manage your portfolio in accordance with its objectives while remaining patient to collect our dividends and seek to realize attractive total returns over time.

Dividend Increases

Fifteen U.S.-based companies in the ThomasPartners portfolio increased their cash dividend payments in the second quarter of 2018.

Declared increases:

Company	Ticker	Increase Declaration Date	Annual Dividend	Percent Increase
JPMorgan Chase & Co.	JPM	6/28/18	$3.20	**42.86%**
TJX Cos, Inc.	TJX	4/4/18	$1.56	**24.80%**
Starbucks Corp.	SBUX	6/19/18	$1.44	**20.00%**
Lowe's Cos, Inc.	LOW	6/1/18	$1.92	**17.07%**
Watsco, Inc.	WSO	4/2/18	$5.80	**16.00%**
Apple, Inc.	AAPL	5/1/18	$2.92	**15.87%**
Parker-Hannifin Corp.	PH	4/19/18	$3.04	**15.15%**
Deere & Co.	DE	5/30/18	$2.76	**15.00%**
BB&T Corp.	BBT	4/24/18	$1.50	**13.64%**
Johnson & Johnson	JNJ	4/26/18	$3.60	**7.14%**
Philip Morris International, Inc.	PM	6/8/18	$4.56	**6.54%**
Exxon Mobil Corp.	XOM	4/25/18	$3.28	**6.49%**
Leggett & Platt, Inc.	LEG	5/15/18	$1.52	**5.56%**
International Business Machines	IBM	4/24/18	$6.28	**4.67%**
Procter & Gamble Co.	PG	4/10/18	$2.87	**4.00%**

We appreciate your investment in the ThomasPartners Strategies. Please contact your Investment Professional if your investment objectives or circumstances have changed such that a review of your ThomasPartners strategy account(s) might be necessary, or if you have any specific questions about how your account is managed.

[1] Financial Analysts Journal: *Q Group Panel Discussion: Looking to the Future* https://www.cfapubs.org/doi/pdf/10.2469/faj.v72.n4.5
[2] Source: 2017 Stocks, Bonds, Bills & Inflation® (SBBI®) Yearbook. Bloomberg.
[3] Source: Ned Davis Research, Inc. New York Stock Exchange.
[4] 1991 Berkshire Hathaway Chairman's Letter to shareholders.
[5] *Wall Street Journal: A Fireside Chat with Charlie Munger* https://blogs.wsj.com/moneybeat/2014/09/12/a-fireside-chat-with-charlie-munger/

Past performance is no guarantee of future results; the value of investments and the income derived from them can go down as well as up. Future returns and the achievement of stated goals are not guaranteed, and a loss of principal may occur.

Portfolio Management for the ThomasPartners Strategies is provided by ThomasPartners Investment Management, a division of Charles Schwab Investment Advisory, Inc. ("CSIA"). CSIA is a registered investment adviser and an affiliate of Charles Schwab & Co., Inc. ("Schwab"). Both CSIA and Schwab are separate entities and subsidiaries of The Charles Schwab Corporation. Please refer to the ThomasPartners Strategies Disclosure Brochure for additional information.

All expressions of opinion are subject to change without notice in reaction to shifting market conditions. Information provided herein is for informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decisions.

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Indexes are unmanaged, do not include fees, and cannot be invested in directly.

The Estimated Income Growth Since Inception chart assumes that a client invested $1 million in the ThomasPartners Dividend Growth Strategy on March 31, 2003 (the strategy's inception date). Each period's estimated annual income shown is the product of that initial $1 million investment times the composite strategy's cumulative total return (net of actual fees) since the inception date, times the strategy's annualized dividend yield. The strategy's annualized dividend yield at each indicated point in time is derived by taking the last dividend paid for each stock in the portfolio, dividing that dollar amount by the price of the stock on that measurement date, and then annualizing the resulting amount. The dividend yield for the S&P 500 Index and the NASDAQ U.S. Broad Dividend Achievers Total Return Index is obtained from Bloomberg for 2014–2017. The dividend yield is calculated using the gross dividend receipts over the prior year divided by the ending index value. This calculation is different than in prior years. The dividend yield for the DAATR was previously calculated by ThomasPartners and based on the methodology recommended by the index provider. Please note that the strategy's yield calculation methodology may result in a higher yield than the index yield methodology because generally the dividend paying equities in the strategy will increase their dividends over the course of a 12 month period, resulting in an annualized methodology based on the last dividend paid for each stock being higher than a methodology using the actual dividends paid over the trailing 12 months.

The period-end estimated annual income shown in the Estimated Income Growth Since Inception charts is hypothetical. Hypothetical performance results have inherent limitations. The estimated annual income and portfolio value shown for the ThomasPartners Strategies do not represent the results of any actual account. No representation is made that a client will achieve results similar to those shown. These charts should not be used as the sole basis in forming any investment decisions. Actual accounts have had performance that differs from the hypothetical performance shown in these charts during comparable periods due to the customization of advice to each client and other factors.