



July 2013 – Psychology of Volatility

Time is the friend of the wonderful company, the enemy of the mediocre –Warren Buffett

Jeff Sommer has written recently on financial strategies in the Sunday New York Times about what he calls the Million-Dollar Illusion. Simply put he states that standards of living may not be maintained during a prolonged period of low interest rates. He further states that a 65-year-old couple with \$1 million in a typical tax-free bond portfolio and then supplementing their social security by taking 4% of their investments out a year has a greater than 70% probability of exhausting their financial assets during their lifetime because of these low rates.

Such statements do not reduce our stress. In fact, his articles have generated many comments expressing great concern. Being told to live more simply is usually not well received by people who believe they have sacrificed and have always lived within their means so that they may have a comfortable retirement and, possibly, leave something for their children.

The aggregate value of our financial holdings is one of the ways we all measure how we are doing on the economic front. Most of us live on what we earn by being compensated for the work we do. We save and invest so that we can maintain a lifestyle we are satisfied with when our work is interrupted or when we retire. We all wonder whether we have enough, and sudden, precipitous drops in value create stress. This can lead to poor investment decisions which can impede financial planning to achieve sufficient financial assets.

The fundamental issue for all of us is to think about investments in a more objective manner. One of the first things a student of investing learns is that there are only two ways to make money from a financial investment:

- Sell the investment at a price higher than your cost; and
- Be paid through dividends or interest.

We have emphasized in these letters investing in dividend-paying stocks during this period of low interest rates. But how does this play out in reality?

To illustrate this, we took a \$1 million dollar portfolio made up primarily of dividend-paying stocks in which we invest regularly. We then looked at what would have happened if we had hypothetically invested \$25,000 in each of forty such stocks at the start of 2003 for a ten-year period ending December 31, 2012. We thought this was a good time frame since it included the severe correction in 2008. Attachment A shows these stocks and their results during this period. (Dividends were not re-invested and we also included data from 2008 so we could include results for a very bad period).



The following table summarizes this data:

	2003	2012
Value of the Total Portfolio	\$1,000,000	\$2,427,946
Dividend Income	\$27,266	\$67,079
Dividend Yield	2.73%	2.76%
Annualized Returns:		
S&P 500		4.95%
S&P 500 w/ Dividends		7.10%
Portfolio Return		9.28%
Portfolio Return w/ Dividends		11.19%
Annualized Growth Rate of Dividends		9.42%

Some interesting observations are:

- Dividend income went up every year except 2009 when five of the companies (three were because of the bail out of the financial institutions) cut their dividend dramatically;
- Only two companies, General Electric and Pfizer, are valued at a lower price in 2012 than in 2003;
- The aggregate current dividend yield is about the same because the dividend growth rate approximated the portfolio's annual return even though dividends increased absolutely from \$27,266 to \$67,079; and
- The companies with the greatest dividend growth generally had the greatest increase in their stock value.

An important lesson to be learned here is there is a strong correlation in the long run regarding the relationship of the dividend and the value of the stock, and, while values can fluctuate dramatically, dividends are much more stable and are constantly increasing for well-managed companies.

Another Warren Buffett quote is: "Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years." This doesn't mean you shouldn't carefully follow the news and the financial information of your investments. Analysis, dividends, and the market will tell you whether management is competent. If we do our job, your capital will be preserved and your financial planning goals will not be an illusion but realized.

As always we are grateful to have you as a client. Please call us with any questions or comments.

Attachment A

Hypothetical \$1M Dividend Portfolio Performance 2003-2012

	Company	Ticker	Historical Prices (Adjusted for Splits)			Returns		Portfolio Value		
			12/31/2002	12/31/2008	12/31/2012	2003 - 2008	2003 - 2012	12/31/2002	12/31/2008	12/31/2012
1	Abbott	ABT	40.00	53.37	65.50	33.4%	63.8%	\$ 25,000	\$ 33,356	\$ 40,938
2	ACE Limited	ACE	29.34	52.92	79.80	80.4%	172.0%	\$ 25,000	\$ 45,092	\$ 67,996
3	American Express	AXP	35.35	18.55	57.48	-47.5%	62.6%	\$ 25,000	\$ 13,119	\$ 40,651
4	AT&T	T	27.11	28.50	33.71	5.1%	24.3%	\$ 25,000	\$ 26,282	\$ 31,086
5	BHP Billiton	BHP	11.50	42.90	78.42	273.0%	581.9%	\$ 25,000	\$ 93,261	\$ 170,478
6	Bunge	BG	24.06	51.77	72.69	115.2%	202.1%	\$ 25,000	\$ 53,793	\$ 75,530
7	Canadian Natl. Railway	CNI	13.85	36.76	91.01	165.4%	557.0%	\$ 25,000	\$ 66,338	\$ 164,238
8	Caterpillar	CAT	22.86	44.67	89.61	95.4%	292.0%	\$ 25,000	\$ 48,852	\$ 97,999
9	Chevron	CVX	33.24	73.97	108.14	122.5%	225.3%	\$ 25,000	\$ 55,633	\$ 81,333
10	Cullen/Frost Bankers	CFR	32.70	50.68	54.27	55.0%	66.0%	\$ 25,000	\$ 38,746	\$ 41,491
11	Diageo	DEO	43.80	56.74	116.58	29.5%	166.2%	\$ 25,000	\$ 32,386	\$ 66,541
12	Disney	DIS	16.08	22.69	49.79	41.1%	209.5%	\$ 25,000	\$ 35,266	\$ 77,387
13	Dominion Resources	D	27.45	35.84	51.80	30.6%	88.7%	\$ 25,000	\$ 32,641	\$ 47,177
14	DuPont	DD	42.40	25.30	44.98	-40.3%	6.1%	\$ 25,000	\$ 14,917	\$ 26,521
15	Emerson	EMR	25.43	36.61	52.96	44.0%	108.3%	\$ 25,000	\$ 35,998	\$ 52,075
16	Exxon Mobil	XOM	34.94	79.83	86.55	128.5%	147.7%	\$ 25,000	\$ 57,119	\$ 61,928
17	General Electric	GE	24.35	16.20	20.99	-33.5%	-13.8%	\$ 25,000	\$ 16,632	\$ 21,550
18	General Mills	GIS	23.48	30.38	40.42	29.4%	72.2%	\$ 25,000	\$ 32,348	\$ 43,046
19	IBM	IBM	77.50	84.16	191.55	8.6%	147.2%	\$ 25,000	\$ 27,148	\$ 61,790
20	Intel	INTC	15.57	14.66	20.62	-5.8%	32.4%	\$ 25,000	\$ 23,539	\$ 33,109
21	Johnson & Johnson	JNJ	53.71	59.83	70.10	11.4%	30.5%	\$ 25,000	\$ 27,849	\$ 32,629
22	JP Morgan	JPM	24.00	31.53	43.97	31.4%	83.2%	\$ 25,000	\$ 32,844	\$ 45,802
23	Kinder Morgan Partners	KMP	35.00	45.75	79.79	30.7%	128.0%	\$ 25,000	\$ 32,679	\$ 56,993
24	Lowe's	LOW	18.75	21.52	35.52	14.8%	89.4%	\$ 25,000	\$ 28,693	\$ 47,360
25	McDonalds	MCD	16.08	62.19	88.21	286.8%	448.6%	\$ 25,000	\$ 96,688	\$ 137,142
26	Microsoft	MSFT	25.85	19.44	26.71	-24.8%	3.3%	\$ 25,000	\$ 18,801	\$ 25,832
27	MMM	MMM	61.65	57.54	92.85	-6.7%	50.6%	\$ 25,000	\$ 23,333	\$ 37,652
28	NextEra Energy	NEE	30.07	50.33	69.19	67.4%	130.1%	\$ 25,000	\$ 41,851	\$ 57,534
29	Nike	NKE	11.12	25.50	51.60	129.4%	364.1%	\$ 25,000	\$ 57,342	\$ 116,033
30	Paychex	PAYX	27.90	26.28	31.10	-5.8%	11.5%	\$ 25,000	\$ 23,548	\$ 27,867
31	Pepsico	PEP	42.22	54.77	68.43	29.7%	62.1%	\$ 25,000	\$ 32,431	\$ 40,520
32	Pfizer	PFE	30.57	17.71	25.08	-42.1%	-18.0%	\$ 25,000	\$ 14,483	\$ 20,510
33	Procter & Gamble	PG	42.97	61.82	67.89	43.9%	58.0%	\$ 25,000	\$ 35,967	\$ 39,498
34	SCANA Corp	SCG	30.96	35.60	45.64	15.0%	47.4%	\$ 25,000	\$ 28,747	\$ 36,854
35	Schlumberger	SLB	21.05	42.33	69.30	101.1%	229.3%	\$ 25,000	\$ 50,285	\$ 82,324
36	Telus	TU	10.30	28.42	65.14	175.9%	532.4%	\$ 25,000	\$ 68,981	\$ 158,107
37	UnitedHealth Group	UNH	20.88	26.60	54.24	27.4%	159.8%	\$ 25,000	\$ 31,856	\$ 64,958
38	Wal-Mart	WMT	50.51	56.06	68.23	11.0%	35.1%	\$ 25,000	\$ 27,747	\$ 33,771
39	Weingarten	WRI	24.57	20.69	26.77	-15.8%	8.9%	\$ 25,000	\$ 21,049	\$ 27,235
40	Wells Fargo	WFC	23.44	29.48	34.18	25.8%	45.9%	\$ 25,000	\$ 31,449	\$ 36,463

Total Portfolio Value	\$ 1,000,000	\$ 1,509,091	\$ 2,427,946
Cumulative Dividend Income	-	\$ 229,520	\$ 460,297
Total Portfolio Value w/ Dividends	\$ 1,000,000	\$ 1,738,610	\$ 2,888,242
Total Return (%)	-	73.9%	188.8%
Portfolio Annualized Return (%)	-	9.7%	11.2%
S&P 500 w/ Div. Annualized Return (%)	-	2.4%	7.1%
Difference	-	7.3%	4.1%

Annual Dividend Income and Yield Growth 2003-2012

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Dividend Income (\$)	27,266	32,866	33,830	38,913	45,346	51,299	50,499	53,110	60,089	67,079
Dividend Change YoY (%)	-	20.54%	2.93%	15.02%	16.53%	13.13%	-1.56%	5.17%	13.14%	11.63%
Current Yield	2.73%									2.76%
Yield on Original \$1M	2.73%	3.29%	3.38%	3.89%	4.53%	5.13%	5.05%	5.31%	6.01%	6.71%
Annual CPI	1.90%	3.30%	3.40%	2.50%	4.10%	0.10%	2.70%	1.50%	3.00%	1.70%
Real Yield	0.83%	-0.01%	-0.02%	1.39%	0.43%	5.03%	2.35%	3.81%	3.01%	5.01%