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HIGH YIELD DIVIDEND NEWSLETTER

ALWAYS PREPARE FOR THE WORST

And Don't Forget Warren Buffett's Two Rules

We are in unique times – you and me. For quite some time now, US equities have been in a bull market. Many men and women wiser than me will tell you, however, "never to confuse a bull market with brains," and as this bull market ages ever so gracefully, I want to continue to emphasize this reality. The wind has been at our backs, mostly for the better over the past 9 years since the March 2009 panic bottom, and please don't ever lose sight of this. Overconfidence has been the bane of many investors' process, and we won't ever fall prey to that folly.

> AS INTEREST RATES LOOK POISED TO RISE IN THE COMING YEARS (AND DECADES?) ON THE BACK OF WHAT WE BELIEVE TO BE HIGHER SOVEREIGN US CREDIT RISK ("INFLATION"), IT IS GROWING INCREMENTALLY MORE LIKELY THAT STOCK VALUES MAY LOSE (THE) INTEREST-RATE TAILWIND OF THE PAST FOUR DECADES.

My boss at a previous employer used to tell me that as much as 40% of an individual stock's return is determined by the market's return. That was almost 15 years ago now, when exchange traded funds (ETF's) weren't nearly as popular as they are today. With the rise of passive vehicles and exchange-traded products that group stocks together by theme, rules of thumb have certainly changed, and with most trading on the markets being of the passive or quantitative nature, the future may reveal stocks have become increasingly more

MORAL HAZARD AND FOLLY?

"The Financial Crisis has instilled within investors a degree of entitlement and moral hazard. There are throngs of savers, for example, that are putting money in the market in anything at any price in their 401(k)s with the view that the long term will be better than today. But is this folly? Is this prudent? You wouldn't pay anything for groceries, so why would one just pay anything for stocks? As it relates to strong stock market performance, have the past four decades been more about falling interest rates than about the success of passive index investing and "buying anything at any price and holding for the long term?" Interest rates pose one of the last few challenges to the idea that stocks always go up, and frankly, we won't know if this challenge is victorious or not until many years hence."

correlated.

The Financial Crisis during 2008/2009 was brief, and the market snapped back so rapidly from the doldrums of that "Great Recession," that it has become merely a blip in the recollection of many. What the rapid rebound from the Financial Crisis to all-time highs has taught "the market," in my view, is that it may now believe that nothing may matter in the ever-march higher for stocks "over the long run." We know this is not true, as fundamentals and value will always matter (as it is what differentiates a $100 billion entity from a $100 million one), but one has to think about what the markets might have learned from the credit crunch of last decade--and it might not be risk aversion, but quite the opposite.

For those that were glued to the television and news outlets at all hours of the night during those troubling days of 2008/2009 (like me), it's hard to imagine that we're where we are today, how far we've come. To remember the news of Lehman Brothers' bankruptcy, AIG and GM's troubles, Fannie and Freddie needing tax-payer support and the list goes on and on, how did we ever make it back to here, let alone avoid the next Great Depression. It's an incredible story, one that was orchestrated by the Fed and not by natural market forces. The lessons of the past will always tell bank officials to flood the markets with liquidity whenever a crisis is threatening. It's "Depression Economics" in a nutshell.

Unfortunately, what this has taught investors is that the Fed will always be there for them. It has created something of a moral hazard, where market participants always believe everything is going to be okay "over the long run." During the Financial Crisis, it was only when Lehman Brothers' toppled when the markets truly sold off aggressively because it spoke clearly that the Fed wasn't going to step in to bail out anybody and everybody. But the Fed eventually came to the rescue during those troubling months of the Great Recession, and now the markets, nearly a decade later, are almost entirely dependent on its next moves. The Fed has become like a parent watching over its children. They let them play, but he or she will always be there when they get into trouble.

But why are we talking about things that happened almost a decade ago now? Why are they relevant to today's markets? Well, it should be well known that even small changes in interest rates can have implications on long-term equity values. Stocks are long-duration financial instruments, where most of their value composition is derived from their long-term free cash flow generation. When interest rates move higher, stock values tend to fall, all else equal. When interest rates move lower, stock values tend to rise, all else equal. To a large degree, the Fed is not only setting interest rates, but it is also influencing equity values (and therefore prices).

Many of you may remember the interest rate on your first home mortgage. For many of you, this was likely a double-digit figure. If you recall, during the 1980s, the federal funds rate was nearly 20%, and since then, it has fallen to practically 0% today, a decline that has coincided with one of the biggest bull markets in US history. However, as interest rates look poised to rise in the coming years (and decades?) on the back of what we believe to be higher sovereign US credit risk ("inflation"), it is growing incrementally more likely that stock values may lose this interest-rate tailwind of the past four decades. Certainly, there have been periods of monetary expansion and contraction since the 1980s, but the trend in interest rates has been ever-downward, and while stocks have had boom and bust periods during this time period, they have coincidentally moved ever-upward, carving out a robust inverse correlation.

Meanwhile, the Financial Crisis has instilled within investors a degree of entitlement and moral hazard. There are throngs of savers, for example, that are putting money in the market in anything at any price in their 401(k)s with the view that the long term will be better than today. But is this folly? Is this prudent? You wouldn't pay anything for groceries, so why would one just pay anything for stocks? As it relates to strong stock market performance, have the past four decades been more about falling interest rates than about the success of passive index investing and "buying anything at any price and holding for the long term?" Interest rates pose one of the last few challenges to the idea that stocks

always go up, and frankly, we won't know if this challenge is victorious or not until many years hence.

But you are aware of this, and that's all that matters to me. That's all a lowly newsletter publisher can do is to tell you how it is through our eyes. The financial industry may appeal to your optimistic view that things will always work out in the end, but it seems more reasonable and certainly more logical that things in the past have worked out for a variety of reasons (one of them: declining interest rates). If so, it means it is more important than ever that one pays attention to his or her investments during the coming rising interest rate environment. It may be folly to believe that things just "work out" and that all one has to do is pursue long-term indexing as either a strategy for wealth generation or wealth preservation. As Warren Buffett put in his 2017 letter to Berkshire shareholders, released last weekend:

> "The less the prudence with which others conduct their affairs, the greater the prudence with which we must conduct our own."

Personally, I don't believe that everyone can get rich by doing the same thing as everyone else, and this very view just doesn't sit well when it comes to my opinion on indexing. The market seems to always find a way to disappoint the most investors, and most investors these days are going passive! Nobody truly knows what the future may hold, but it could end badly for the great many of investors that are simply not paying attention to what they are paying for their investments. Investors should be watching the rise in interest rates very closely, and while there are confounding variables (economic growth and the like) that can offset the headwind of higher borrowing costs, higher interest rates damage equity values, all else equal.

With each passing year, there are fewer and fewer market participants that may remember the dot-com bubble and bust, too, and it seems that the cryptocurrency "revolution" has become but an outgrowth of history rhyming. Time may tell, however, as even Amazon (AMZN) was written off as a bust following the dot-com crash in the early 2000s--but look at what it has done since! There may be some long-term winners in cryptocurrencies, but still, it is very likely that many will fail as many dot-coms did. The scarcity argument for crypto-assets doesn't hold up either, in our view, as more and more initial coin offerings (ICOs) hit the markets.

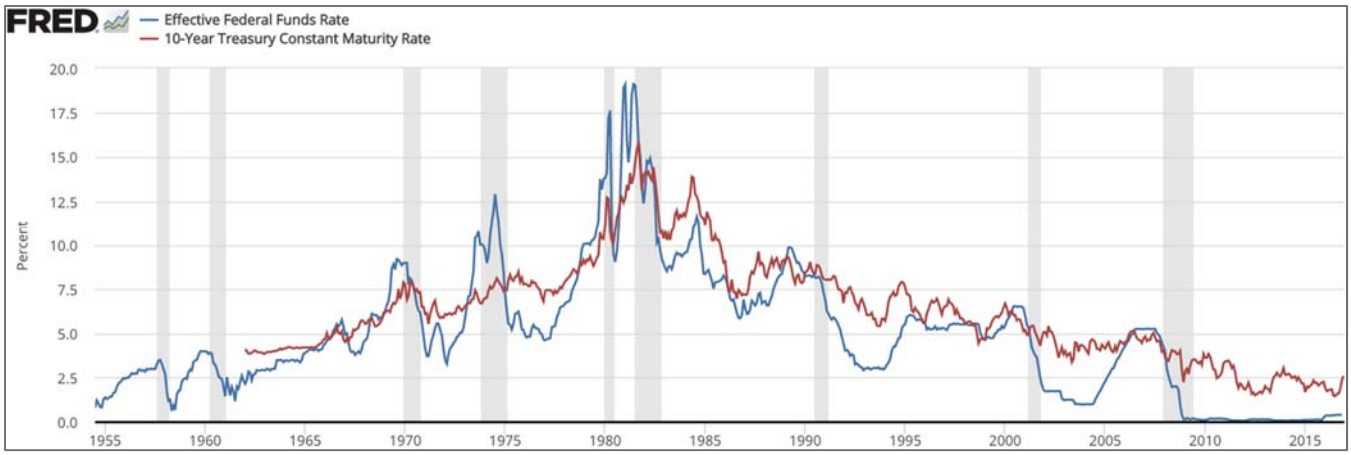
For many that experienced the dot-com bubble and crash first hand, it's hard to imagine how companies could be getting trading gains of 10%, 20%, 30%, or more by just adding "Blockchain" to their names, or how investors can eagerly be buying up cryptocurrencies at any price, regardless of any intrinsic value calculation, which remains elusive for any currency. Currencies are all relative, priced in other currencies, and even items like gold and fine wine, don't have "intrinsic value" in the traditional sense. They operate under the "greater fool" framework, where generating a return is exclusively a function of what you sell the asset for, not what that asset can generate as cash internally.

But why bring up cryptocurrencies in a High Yield Dividend Newsletter? We think the combination of a US stock market that has tremendous moral hazard, as in the case of dependence on the Fed and long-term thinking, coupled with the risk appetite similar to that of the dot-com bubble, as in cryptocurrencies, is making for a very unique time. Throw in the Trump presidency, the fact that corporate tax reform passed with such ease, and a general optimistic feeling about unemployment and consumer confidence, it may not be any surprise that stocks still rest near all-time highs, even after the recent pullback. Many point to frothy measures such as the market-cap-to-GDP or the cyclically-adjusted price-to-earnings ratio (CAPE or Shiller P/E) as reasons for why things are way out of whack at the moment.

But I think we need to "keep it real," too. Though we are very concerned about the rising interest rate environment and implications on stock values over the long run, shares of stocks in the S&P 500 aren't "insanely priced" as calendar-year 2019 bottom-up earnings implies they are currently trading at a price-to-earnings multiple of ~16 times, according to Factset. Granted, this reflects earnings a couple years forward that are bolstered by stock buybacks and rising debt

loads, but revenue performance hasn't been poor by any stretch of the imagination. This earnings estimate for 2019 includes the full impact of tax reform, but again, it remains debatable what multiple is the "right" one to put on equities, especially in the event of rising interest rates.

Bloomberg reported recently that "Goldman Says Stocks May Dive 25% If 10-Year Yield Hits 4.5%." Others, including Bank of America Merrill Lynch, say that S&P fair value could fall more than 20% if a normalized risk-free rate advances 150 basis points, and nearly 30% if it advances 200 basis points, as reported by ZeroHedge. The reality is not if interest rates impact stock values, but by how much, and whether other factors such as revenue growth (and core operating earnings expansion) will more than offset the rise, to keep the market moving in the right direction.



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For those reading this High Yield Dividend Newsletter, interest rates should be foremost on your mind, always. We've emphasized time and time again that high yield dividend investing is fraught with both dividend-sustainability and interest-rate risk. All readers of this publication should be thinking about their risk profiles and if risk-free rates advance to 4% or 5% or higher whether certificates of deposit may be a better vehicle than risky dividend-paying equities. For example, it wasn't 15 years ago when one could get a one-year certificate of deposit at the local bank for an annual percentage yield of 7%. A risk-free, government-backed yield for 7% sounds unheard of today, but it could happen again, and maybe not in the too-distant future.

Please be mindful of these innate risks because dividend and high-yield investing could fall deeply out of favor if interest rates take on an even more aggressive move higher. Anyone that tells you otherwise is just trying to sell you something. With investing, please always remember the concept of opportunity cost and trade-offs, and these dynamics have a market impact on prices, especially in the high-yield space, where many equities act more bond-like than anything else. In the event many high yield investors seek "riskless" government-backed securities (if interest rates continue their ascent), for example, a sell-off in the high yield space might ensue, and this could punish security prices regardless of what happens to any one individual security's firm-specific fundamentals.

The high yield arena ("no man's land") is full of land mines with respect to the dividend ("dividend sustainability"), but also with respect to the big risk that is rising interest rates ("capital preservation"). Know your goals and risk tolerances, and work with a personal financial advisor that can best match them for you. Whenever you think interest rates can't keep marching higher, think about what your mortgage rate was on your first house, and how that may differ from where rates are today. If Goldman Sachs and BofA Merrill Lynch are saying stocks could take a big tumble if risk-free rates move just a few hundred basis points higher, think about what might happen to equity prices in the high yield space.

We may no longer have the interest-rate tailwind at our backs, and this may have profound implications on equity values but also those entities paying out lofty

dividend/distribution yields. Always prepare for the worst, and don't forget Warren Buffett's two main rules:

1) Never lose money
2) Never forget rule No. 1.

SIMULATED PORTFOLIO IDEA OMEGA HEALTHCARE (OHI) -- DIVIDEND CUT COMING?

Image shown: The performance of Omega Healthcare (OHI) since the beginning of 2016.

The value of any newsletter publication will rest in the quality of information it provides and the ability to explain risks in easy-to-understand ways. There are others that may hype the magnitude of dividend yields as a reason to get excited about owning an equity, but there comes a point in the level of that dividend yield, where it says more about the risks of the sustainability of the payout at current levels than finding an unpolished gem. Many portfolio managers start to become worried when the market-price yield on an instrument approaches the 6%-7% mark, as realized yields (what you actually receive) often end up below that of expected yields (what you are expecting to receive).

What we're trying to explain is that for a company that may be yielding 10%+ (its expected yield), it is likely that a dividend cut may be around the corner (given the magnitude of the yield and the risk that it implies), and its true yield may be closer to 5%-6% (its probable realized yield). Typically speaking, the market is not hugely inefficient, where double-digit yields imply fantastic opportunity more than increasing risk of a cut. When thinking about ideas for the simulated High Yield Dividend Newsletter, we're looking for considerations that offer both diversification benefits, but also what we consider to be high potential realized yields, regardless of their expected yields.

For example, a company may have an expected yield of 10% (what its current forward annualized yield is today), but after a dividend cut, its realized yield may be 5%-6% (what investors may eventually receive). If we believe that a 5%-6% yield may be still acceptable level for a simulated High Yield Dividend Newsletter idea, we may still like the entity, even as we expect it to eventually cut its dividend. Said differently, whereas a dividend cut may send dividend growth investors running for cover, a cut in the payout may not be an automatic removal in the land of high yield investing, particularly if the entity continues to post an above-average yield following the cut. Remember, this newsletter is about high yield content and idea generation, not dividend growth or capital appreciation.

Let's now talk about what we are seeing with respect to simulated High Yield Dividend Newsletter portfolio idea Omega Healthcare (OHI), and why understanding the difference between expected yield and realized yield is important, especially if the healthcare REIT eventually cuts its payout. Right now, Omega is yielding about 10%, and the red flag warning about a dividend cut is up. The healthcare REIT has faced a heightened degree of uncertainty of late as a result of placing one of its top operators, Orianna Healthcare, on a "cash basis," meaning it only accounts for rent received from the operator as it receives cash payments. Given the operational struggles Orianna has experienced of late, the risk is heightened these cash payments may come up short.

Omega's 2018 guidance brought the risk of a potential dividend cut to the fore as its guidance range for funds available for distribution (FAD) of $2.64-$2.74 is roughly in line with its current annualized dividend of $2.64. Management does not expect to raise its payout in 2018 after 22 consecutive quarterly increases heading into the year, and it may have to sell non-core assets to cover the payout. The REIT is adamant that the tight coverage is a result of having a number of assets

currently being reviewed for potential sales and believes that its long-term dividend coverage is much more sufficient that it appears heading into 2018.

We're not so sure, and that it has to sell assets (some of its best) will only put greater pressure on organic FAD generation. Put bluntly, the healthcare REIT's dividend coverage could weaken further in the near term as its recovery is in part dependent on the struggling Orianna as well as the timing of asset sales. The latter of those two factors highlights material execution risk as management will not only need to make prudent asset sales but also efficiently recycle the capital gained on those sales into more productive assets capable of sustaining the payout over the long run. Asset sales as a source of cash to be used in covering annual dividend obligations is not a sustainable strategy. General Electric (GE) is a good case study about the hazards of selling core earnings assets and implications on dividend health (GE has cut its dividend twice during the past 10 years).

All things considered, we're not saying a dividend cut at Omega Healthcare is going to happen tomorrow, but we would certainly not be surprised to see the payout reduced as it battles some near-term headwinds. Unfortunately, the risk of a dividend cut is a fact of life in the high-yield arena, and portfolios that may not be able to handle reduced income should take notice. Even after any dividend cut by the healthcare REIT, we still would expect it to fetch an attractive yield. How the market reacts to the reduced distribution is something we will have to watch very closely.

SIMULATED PORTFOLIO IDEA TALLGRASS ENERGY PARTNERS (TEP) – EVALUATING STRUCTURAL REORGANIZATION

Tallgrass Energy Partners (TEP) delivered another quarter of robust income generation for shareholders in its fourth quarter of 2017, results released February 13. After raising its quarterly payout by more than 18% over fourth quarter 2016 levels, the MLP was able to maintain solid distribution coverage as measured by the industry-specific metric of distributable cash flow. Distribution coverage came in at 1.28x in the quarter, an improvement from 1.24x in the year-ago period. In 2018 Tallgrass expects to raise the payout 7%-10% on an annual basis in 2018, assuming the Tallgrass Energy family remains under its current structure.

Adjusted EBITDA for Tallgrass grew nearly 43% on a year-over-year basis to ~$173 million in the fourth quarter of 2017 thanks to growth related to drop-down transactions, organic projects, and acquisitions. The MLP maintained conservative financial leverage relative to peers with a debt-to-adjusted EBITDA ratio of 3.0x, but its credit rating remains below investment grade due to its dependence on the Pony Express Pipeline and Rockies Express Pipeline LLC as well as limited visibility in cash flows beyond 2020, when a material amount of transportation contracts for its Pony Express Pipeline expire.

The Tallgrass Energy family is also evaluating a potential structural reorganization, something that is not new to the MLP universe. An ideal transaction, or transactions, would reduce Tallgrass' cost of capital and streamline and simplify its organizational structure, and the evaluation process and any resulting transaction could be completed by the end of 2018.

SIMULATED PORTFOLIO IDEA GOVERNMENT PROPERTIES INCOME TRUST (GOV) – LEASE EXPLORATION WORTH MONITORING

Government Properties Income Trust (GOV) came under pressure following its fourth-quarter earnings report, results released February 26. Occupancy in the quarter fell to 94.2% on a consolidated basis from 95.1% in the year-ago period, while normalized funds from operation per share fell to $0.50 from $0.58. Same properties net operating income edged slightly higher, growing 0.9% on a year-over-year basis, and the REIT retained 88% of its tenants in the full-year 2017.

Perhaps most concerning for Government Properties is the fact that leases accounting for ~11.3% of its annualized rent are subject to exploration in 2018. From this, management expects at least 4.9% of annualized rent to be vacated, which includes 3.6% of annualized rent from government tenants and 1.3% from the private sector. The most significant vacating tenant is

expected to be the Bureau of Prisons, a full building user in Washington DC that accounts for ~1.9% of annualized rent; its lease expires at the end of March 2018.

The loss of the Bureau of Prisons lease highlights a trend of declining demand in Washington DC from the US Government and affiliated parties. Government Properties Income Trust generates more than 43% of its annualized revenue from the metropolitan Washington DC area as of the end of 2017, exposing it in a meaningful way to the health of the local economy. The decline in demand from government agencies in leasing properties in the Washington DC area could play a role in lower realized rents moving forward.

As of February 23, tenants leasing 630,788 rentable square feet (~38% of potential non-renewals by square footage) have notified the REIT of plans to not renew their leases. As a result of weak current market conditions, management expects the replacement leases to be at rates below current levels if they are successful in refilling the vacated properties. We're keeping an eye on Government Properties' tenant retention and re-leasing performance moving forward in 2018, but the added scale that resulted from the recent acquisition of First Potomac Realty Trust should help its portfolio absorb the losses, should they remain reasonable.

However, its annualized yield, too, at 11%+, is at levels that speak to increased risk of a dividend cut. Investors should tread lightly when yields start to get in the double digits.

MACQUARIE INFRASTRUCTURE (MIC)

A Cautionary Tale

Image shown: Macquarie Infrastructure's equity price has been devastated by the recent dividend cut February 22.

The low-interest rate environment following the Financial Crisis nearly a decade ago has lured income investors to seek out alternative avenues to generate an acceptable dividend payout to fund a lifestyle in or near retirement. Macquarie Infrastructure Corp is a cautionary tale that we'd like to highlight, as its elevated dividend yield had masked the underlying, fundamental challenges the business continues to face. We want to continue to emphasize the hazards of the high yield space, and why one has to tread lightly, particularly in the context of capital preservation.

Macquarie Infrastructure (MIC) is a cautionary tale, in our view, of what can happen to a high-yielder when its dividend is cut, and the company's story gives all-the-more reason why we continue to pay close attention to simulated High Yield Dividend Newsletter portfolio idea Omega Healthcare (OHI). An entity's shareholder base has a lot to say with respect to how a stock price might respond in the event of a dividend cut. For Macquarie, the market was blindsided by its outlook for the dividend in 2018, released February 22, and investors decided to sell in mass, as the chart to the left shows. Let's walk through the story and explain what happened.

Breaking Down Macquarie Infrastructure Into Its Components

One of the main advantages that Macquarie Infrastructure Corp (MIC) has over MLPs is the corporation structure, where the income-flow is treated as a dividend and a capital return on form 1099, thus eliminating the burdensome K-1's that tend to bedevil accountants during tax season. Macquarie's underlying business can be broken down into four key segments, with Tank Terminals and Aviation Services comprising nearly three fourths of the overall parent's EBITDA.

As a rule, MIC is looking to deploy capital into long-lived capital-intensive industries that spin off a great deal of predictable cash flow over a long period of time. The business profile of the various divisions, such as Tank terminals with numerous environmental and construction challenges, naturally limits the competitive environment. Thus, over time, the company had believed it would be able to ensure a return above its cost of capital, helping to support the dividend. *It didn't exactly happen as planned, unfortunately.*

International-Matex Tank Terminals

International-Matex Tank Terminals (IMTT) is a wholly owned division of MIC that is headquartered in New Orleans, Louisiana. The operation consists of twelve bulk liquid storage terminals located in the US and Canada. The composition of products stored is as follows: roughly half of the products come from refined petroleum products with nearly a quarter coming from chemicals and the rest from agriculture products. IMTT has wisely shielded itself from the vagaries of the commodity cycle as the bulk of its contracts are based on a "take or pay" basis where IMTT generates revenue from renting out space in the tank. IMTT receives payment irrespective of if the product is stored in the tank (provided customers don't go belly-up); it has even included inflation kickers in the contracts.

A new, unexpected headwind developed, however, that is threatening the cash flow profile of the business. The handling of the "Big 6" petroleum products entered into a sustained decline with management mentioning numerous times the complex is now in "backwardation." Backwardation is a term utilized in the commodity industry to indicate shorter-term contracts are more expensive than longer-dated ones. The challenge for MIC is a host of customers that have utilized space have now closed shop and have exited the industry. Utilization rates, which averaged 93.3%, have steadily declined to an expected mid-80's rate this year.

The decline is dramatic and has had widespread repercussions on the health of the dividend. MIC's dividend is now expected to decline from $1.44 per share for the fourth quarter of 2017 to $1 per share each quarter in 2018. MIC is looking to pivot away from the decline in the business with strategic alternatives that would be considered, but the damage to its equity price has been severe.

Atlantic Aviation

Atlantic Aviation is a network of 70 fixed based operations that service the needs of private aircraft. The business provides a wide range of services from catering, hangar cleaning, providing a terminal and fuel sales. Notably absent from the business is the maintenance of the aircraft. This is by design as maintenance is very costly and highly unpredictable. Atlantic is generally shielded from commodity exposure as it directly passes on the price of jet fuel to the customer. Atlantic's main revenue driver is the sheer number of flights as volume expands profits rise accordingly. The business does have some cyclicality as flight revenue may tail off in a recession, though the business has remained remarkably stable following the financial crisis. In some ways, the industry may be ripe for further consolidation as the field remains highly fragmented with over 3,500 fixed based operations in the US.

Contracted Power

MIC's contracted power division consists of 8 thermal and two wind facilities that generate 350 megawatts of power. The division has long-dated contracts (ranging from 20-25 years) with local entities such as regional utilities to purchase 100% of the power that is produced. The management team has stated on numerous events it would like to grow capacity to over 1 gigawatt of power as it finds the dynamics of the industry favorable.

Hawaiian Gas

The smallest division is Hawaii Gas, the only regulated gas utility on the Hawaiian Islands. The segment also sells propane into the unregulated market as well. We view the pricing dynamics of the Hawaiian Gas division as favorable, but we do not expect a large amount of additional capital to be invested in this division as the industry dynamics of the contracted power division remain more favorable.

Lessons from the Macquarie Infrastructure Story

The equity price of MIC certainly did not respond well to the change in the underlying business fundamentals of its tank division, IMTT. At the newly lowered $1 per share quarterly dividend rate for 2018 (from $1.44 per share previously), MIC is still yielding over 10%, tempting more investors, but we want you to be aware of three things.

First, MIC's dividend yield was already very elevated before it announced the dividend cut, and as we continue to explain, a high yield in today's ultra-low interest rate environment says more about the elevated risk of a dividend cut than it being a tremendous opportunity/mispricing the market is overlooking. Income levels for Macquarie investors were cut.

Second, MIC's shareholders took its equity to the wood shed and sold it aggressively. That its shares still yield 10% implies that another dividend cut and another leg down in the share price can't be ruled out either. This is what we call a double whammy—where both income levels and reduced and capital is impaired, perhaps permanently, if Macquarie never recovers.

Third, we wanted to make you aware of the Dividend Cushion construct for Macquarie. The Dividend Cushion ratio is a forward-looking, cash-flow based coverage ratio that considers future free cash flow relative to cash dividends paid, and the net balance sheet impact, to help assess the sustainability of a company's dividend. Macquarie continues to be buried under a mountain of net debt (~$3.5 billion), and its free cash flow for 2017 of ~$188.5 million was far less than that needed to pay out the $450+ million in cash dividends during the year. The risk of a dividend cut was considerably elevated, as its Dividend Cushion ratio would have been meaningfully negative.

The high yield dividend-paying space, in general, has come under intense selling pressure during the first quarter of 2018, as the interest rate backdrop in the US has become less favorable for equities. We continue to monitor broad-based headwinds, but you must be aware of instances like Macquarie Infrastructure that unfortunately happen all-too-frequently in the "no-man's land" of the high-yield arena. To a very large degree, ideas in the high yield dividend-paying space will have concerning Dividend Cushion ratios, and successful investing in the space is more about avoiding land mines than anything else.

- Brian Nelson, CFA President, Investment Research

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Disclosure: Brian Nelson and Kris Rosemann do not own any shares of any securities mentioned in this newsletter. Alexander J. Poulos holds no shares of Macquarie Infrastructure (MIC), the article in this newsletter he has authored. Please contact info@valuentum.com for more information regarding Valuentum's editorial policies.

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We continue to be excited about the launch of the simulated High Yield Dividend Newsletter portfolio, the inaugural edition released January, 1, 2018. This is now third edition of the newsletter! We've learned a lot in recent months about what works and what doesn't work for our members. Thank you for the feedback.

Many of our members continue to prefer the list-versus-weighting perspective across our simulated newsletter portfolios. It may also be true that a lot of new members won't feel like they have missed out on anything under a list-versus-weighting format, too, which has been a concern when brand new members see a simulated portfolio that has been around for half a decade or longer.

Though we may calculate simulated performance of the High Yield Dividend Newsletter periodically, we don't think it is necessary to do so on a monthly basis. It also runs counter to our long-term perspective, and not having to do the monthly calculations will help free up our analyst resources, so we can even deliver more top quality within each newsletter edition.

The list-and-weighting format facilitates a level of consistency across our newsletter products, and we may consider migrating the simulated High Yield Dividend Newsletter portfolio to a range-of-percentage-weightings, too, as we have with respect to both the simulated Best Ideas Newsletter portfolio and simulated Dividend Growth Newsletter portfolio.

The simulated High Yield Dividend Newsletter portfolio is presented in similar fashion as that of the first edition. If you have any questions, comments, or concerns, please be sure to let us know at info@valuentum.com.

Idea	Symbol	Weighting	Est Annual Div's/Share ($)	Est Div Yield
CORE				
Global X SuperDividend ETF	SDIV	5.0%	1.46	6.52%
Global X SuperIncome Preferred ETF	SPFF	10.0%	0.89	7.23%
iShares International Select Dividend ETF	IDV	5.0%	1.53	4.33%
iShares MSCI Australia ETF	EWA	5.0%	1.03	4.30%
iShares U.S. Preferred Stock ETF	PFF	5.0%	2.13	5.66%
PowerShares Senior Loan Portfolio	BKLN	5.0%	0.81	3.46%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	3.76	5.45%
EQUITY				
AmeriGas Partners	APU	5.0%	3.80	8.79%
BP PLC	BP	5.0%	2.40	5.96%
Digital Realty Trust	DLR	5.0%	3.72	3.66%
Enterprise Products Partners	EPD	5.0%	1.70	6.59%
Government Properties Income Trust	GOV	5.0%	1.72	11.60%
Landmark Infrastructure Partners	LMRK	5.0%	1.47	8.33%
Magellan Midstream Partners	MMP	5.0%	3.68	5.75%
Omega Healthcare Investors	OHI	5.0%	2.64	10.32%
Public Storage	PSA	5.0%	8.00	4.15%
Realty Income Corporation	O	5.0%	2.63	5.24%
Senior Housing Properties	SNH	5.0%	1.56	9.86%
Tallgrass Energy Partners	TEP	5.0%	3.86	9.80%
		100.0%		**6.71%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 2/28/2018.

Note: There was a correction to the yield in the iShares MSCI Australia ETF during the release of the inaugural edition.

SCREEN OF THE MONTH – HIGH YIELDING EQUITIES FROM OUR COVERAGE UNIVERSE

Company Name	Symbol	Industry	Dividend Yield	Div Growth	Div Safety	Div Cushion	Leverage
Stonemor	STON	Personal Services	21.5%	VERY POOR	POOR	-0.6	HIGH
NuStar	NS	Oil & Gas Pipelines	18.6%	VERY POOR	POOR	0.8	HIGH
Frontline	FRO	Shipping	14.4%	NMF	NMF	NMF	HIGH
Energy Transfer Partners	ETP	Oil & Gas Pipelines	11.8%	VERY POOR	VERY POOR	1.8	HIGH
Centurylink	CTL	Telecom Services - divers	11.7%	VERY POOR	VERY POOR	-2.7	HIGH
Buckeye Partners	BPL	Oil & Gas Pipelines	11.0%	GOOD	GOOD	1.3	HIGH
Alliance Resource Partners	ARLP	Industrial Minerals	10.9%	POOR	GOOD	1.3	LOW
Omega Healthcare	OHI	REIT - Healthcare	10.3%	EXCELLENT	GOOD	1.3	HIGH
DDR	DDR	REIT - Retail	10.0%	VERY POOR	VERY POOR	0.4	HIGH
Spirit Realty	SRC	REIT - Retail	9.3%	NMF	NMF	NMF	HIGH
AmeriGas Partners	APU	Utilities	8.8%	VERY POOR	POOR	0.6	HIGH
DCP Midstream	DCP	Oil & Gas Pipelines	8.6%	GOOD	GOOD	2.2	HIGH
Holly Energy	HEP	Oil & Gas Pipelines	8.5%	VERY POOR	POOR	1.2	HIGH
CoreCivic	CXW	Management Services	7.9%	VERY POOR	POOR	0.9	HIGH
Vector Group	VGR	Tobacco	7.8%	VERY POOR	VERY POOR	0.1	HIGH
Western Gas	WES	Oil & Gas Pipelines	7.7%	VERY POOR	VERY POOR	0.5	HIGH
Seaspan	SSW	Shipping	7.4%	NMF	NMF	NMF	HIGH
Iron Mountain	IRM	Commercial Services	7.4%	VERY POOR	VERY POOR	0.5	HIGH
Spectra Energy Partners	SEP	Oil & Gas Pipelines	7.2%	EXCELLENT	GOOD	1.7	HIGH
Terra Nitrogen Company	TNH	Chemicals - agriculture	7.1%	NMF	NMF	NMF	LOW

Note: The Dividend Cushion ratio and qualitative assessments in the table above may change following the date of this publication. Please be sure to access the website at www.valuentum.com for more information. Please also note that Valuentum publishes both an adjusted Dividend Cushion ratio and an unadjusted Dividend Cushion ratio. Many of the equities included in this table have substantial equity-price and dividend-payment risk.

SCREEN OF THE MONTH – AUSTRALIA ETF (EWA) TOP HOLDINGS

Company (ticker)	Asset Class	Weight (%)	Sector	FX Rate[1]	Dividend Yield[2]
COMMONWEALTH BANK OF AUSTRALIA (CBA)	Equity	9.88	Financials	1.28	6.81%
WESTPAC BANKING CORPORATION CORP (WBC)	Equity	7.85	Financials	1.28	5.99%
BHP BILLITON LTD (BHP)	Equity	7.42	Materials	1.28	3.53%
AUSTRALIA AND NEW ZEALAND BANKING (ANZ)	Equity	6.35	Financials	1.28	5.82%
NATIONAL AUSTRALIA BANK LTD (NAB)	Equity	6.07	Financials	1.28	6.61%
CSL LTD (CSL)	Equity	5.53	Health Care	1.28	1.33%
WESFARMERS LTD (WES)	Equity	3.44	Consumer Staples	1.28	6.42%
WOOLWORTHS GROUP LTD (WOW)	Equity	2.68	Consumer Staples	1.28	3.52%
RIO TINTO LTD (RIO)	Equity	2.57	Materials	1.28	6.45%
MACQUARIE GROUP LTD DEF (MQG)	Equity	2.49	Financials	1.28	4.00%
WOODSIDE PETROLEUM LTD (WPL)	Equity	2.01	Energy	1.28	4.92%
TRANSURBAN GROUP (TCL)	Equity	1.88	Industrials	1.28	4.72%
SCENTRE GROUP (SCG)	Equity	1.54	Real Estate	1.28	5.55%
INSURANCE AUSTRALIA GROUP LTD (IAG)	Equity	1.43	Financials	1.28	6.63%
SOUTH32 LTD (S32)	Equity	1.31	Materials	1.28	2.55%
SUNCORP GROUP LTD (SUN)	Equity	1.31	Financials	1.28	8.38%
WESTFIELD CORPORATION STAPLED SECU (WFD)	Equity	1.29	Real Estate	1.28	3.53%
NEWCREST MINING LTD (NCM)	Equity	1.24	Materials	1.28	0.82%
AMCOR LTD (AMC)	Equity	1.21	Materials	1.28	4.13%
ORIGIN ENERGY LTD (ORG)	Equity	1.2	Energy	1.28	3.60%

1) 1 USD = 1.28 AUD

2) Dividend yield as measured on Australian exchange

Note: The iShares MSCI Australia ETF (EWA) targets exposure to large and mid-sized companies in Australia. It is included in the simulated High Yield Dividend Newsletter portfolio.

DIVIDEND REPORT PAGE 2 – ENTERPRISE PRODUCT PARTNERS (EPD)

Enterprise Product Partners EPD FAIRLY VALUED

Buying Index™ 6 | Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$21.00 - $35.00	HEALTHY	GOOD / 1.9	EXCELLENT	5.79%

Assessment of Company Dividend Strategy

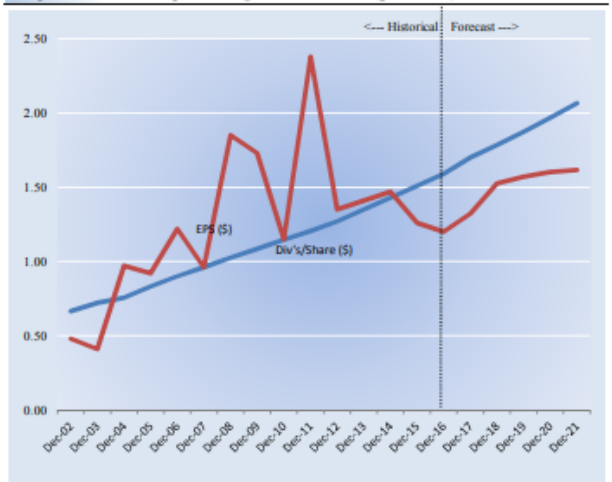
Key Strengths

The credit rating agencies are huge fans of Enterprise Product Partners' debt, giving the MLP high marks at Baa1/BBB+, one of the highest among its peers. This gives it great flexibility to raise capital, and we generally like its simplified structure with no GP IDRs. Since its IPO in 1998, the company has completed $64 billion in organic growth projects and major acquisitions. In this light, there's not much that will derail the MLP's distribution. Enterprise Product Partners' 'distribution coverage ratio' has been at least 1.2x over the past 5 years, but we must emphasize that we are not fond of industry-specific coverage metrics. Its worth noting that distributable cash flow took a hit in 2016 as energy resource pricing remained suppressed.

Potential Weaknesses

Though management has worked diligently to extend its debt maturities, it's hard to overlook the tens of billions of dollars raised via debt since 2009. The MLP has ~$5.2 billion of capital growth projects under construction with more to come through 2019, and spending related to such projects will continue to weigh on free cash flows. Total debt sat at ~$24.7 billion as of the third quarter of 2017. The past several years have been bolstered by non-core asset sales, and reinvestment risk remains a concern. Unrestricted cash on hand and borrowing capacity on its revolver mitigate risk to a degree. The firm's unadjusted Dividend Cushion ratio is the most appropriate measure of the risks of the payout, in our opinion, given its capital market dependence.

Graphical Relationship, Earnings and Dividends (per share)

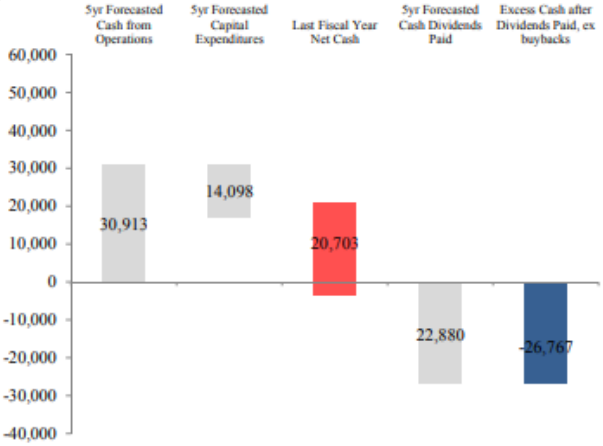


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. Enterprise Product Partners's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is less than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Raw, Unadjusted Dividend Cushion Cash Flow Bridge - Raw

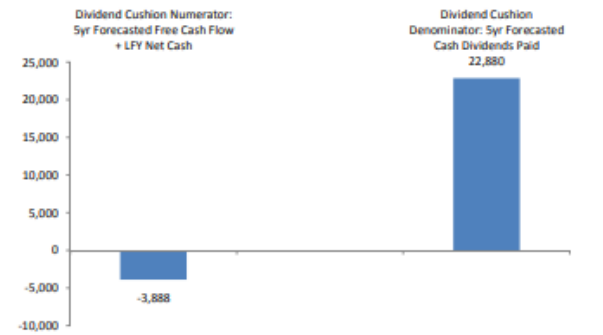


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

The Dividend Cushion Ratio Deconstruction, shown in the image to the right, reveals the numerator and denominator of the Dividend Cushion ratio. At the core, the larger the numerator, or the healthier a company's balance sheet and future free cash flow generation, relative to the denominator, or a company's cash dividend obligations, the more durable the dividend. In the context of the Dividend Cushion ratio, Enterprise Product Partners's numerator is smaller than its denominator suggesting weak dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.

Raw, Unadjusted Dividend Cushion Ratio Deconstruction - Raw



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DIVIDEND REPORT PAGE 2 – MAGELLAN MIDSTREAM (MMP)

Magellan Midstream MMP FAIRLY VALUED

Buying Index™ 5 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$52.00 - $82.00	HEALTHY	GOOD / 1.1	EXCELLENT	4.84%

Assessment of Company Dividend Strategy

Key Strengths

Magellan likes to point out that it is an investment-grade MLP with no incentive distribution rights, allowing it a lower cost of capital. Its portfolio is rather diversified between refined products (~57%), crude oil (~33%) and marine storage (~10%). As with many of its peers, the MLP notes that it expects future fee-based, low-risk activities to comprise a high percentage of its operating margin. Though economic returns on such investments should be watched closely, the company continues to evaluate more than $500 million of potential growth projects on top of the $1.15 billion projects in progress for 2018-2019. Magellan is targeting 8% distribution growth in 2017-2018 and distribution coverage of 1.1x on a long-term basis.

Potential Weaknesses

Magellan is committed to maintaining a solid investment-grade rating, and at BBB+/Baa1, the MLP is one of the highest-rated among its peers. Distribution growth ahead of core business expansion will drive lower coverage in coming periods, and the MLP is leveraged, albeit not as much as peers. We doubt management will mess with its proven history of distribution expansion, and the MLP has a revolver should near-term needs warrant. It has advanced the quarterly payout for 60+ consecutive quarters since its IPO, but total debt outstanding stood at roughly $4.1 billion as of the third quarter of 2017. Magellan's cost of capital may be lower than some peers' thanks to the lack of incentive distribution rights, but it is still dependent on the capital markets.

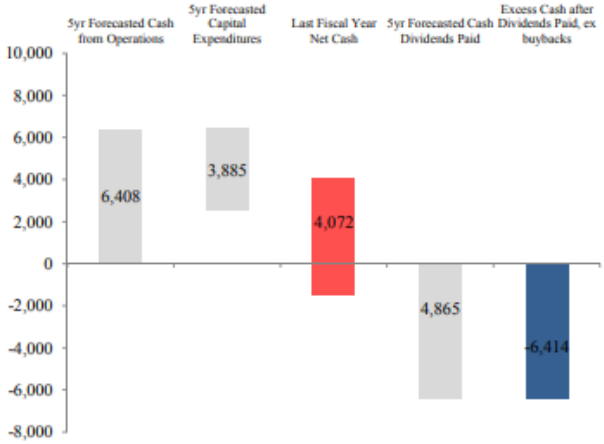
Graphical Relationship, Earnings and Dividends (per share)

The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. Magellan Midstream's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is less than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Raw, Unadjusted Dividend Cushion Cash Flow Bridge - Raw

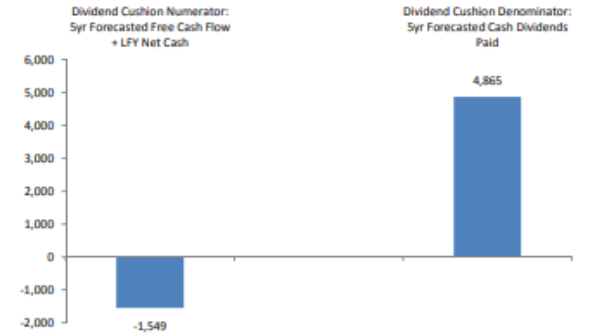


Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

The Dividend Cushion Ratio Deconstruction, shown in the image to the right, reveals the numerator and denominator of the Dividend Cushion ratio. At the core, the larger the numerator, or the healthier a company's balance sheet and future free cash flow generation, relative to the denominator, or a company's cash dividend obligations, the more durable the dividend. In the context of the Dividend Cushion ratio, Magellan Midstream's numerator is smaller than its denominator suggesting weak dividend coverage in the future. The Dividend Cushion Ratio Deconstruction image puts sources of free cash in the context of financial obligations next to expected cash dividend payments over the next 5 years on a side-by-side comparison. Because the Dividend Cushion ratio and many of its components are forward-looking, our dividend evaluation may change upon subsequent updates as future forecasts are altered to reflect new information.

Raw, Unadjusted Dividend Cushion Ratio Deconstruction - Raw



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DIVIDEND REPORT PAGE 2 – PUBLIC STORAGE (PSA)

Public Storage PSA FAIRLY VALUED

Buying Index™ 6 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$134.00 - $223.00	HEALTHY	GOOD / 1.4	EXCELLENT	3.76%

Assessment of Company Dividend Strategy

Key Strengths

Investors have come to love Public Storage, with the REIT trading at a very lofty multiple of its expected funds from operations. Revenue has been fantastic at Public Storage, and operating income has performed even better, the latter advancing to ~$1.4 billion in 2016 from ~$750 million in 2011; cash distributions per share have almost doubled over the same time. It has paid a quarterly dividend in each of the past 18+ years, and we love its A-rated corporate credit quality. Public Storage's dominance in major metro areas is a key competitive advantage in our view, especially given concentration/density benefits, and its brand is a key recognizable asset. Operating cash flow has averaged ~$1.8 billion during the past three years (2014-2016).

Potential Weaknesses

We have had no qualms with Public Storage's operating performance, as same store revenue and property NOI continue to grow nicely in its US self-storage operations. Oversupply is expected to provide headwinds to pricing in the near term. Growth outside the US may not be as easy, as self-storage tends to be a smaller market in Europe, which it targets through its Shurgard brand. We're somewhat disappointed that the firm will become more active in the corporate debt markets, as we tend to be relatively debt-averse when it comes to income holdings. The REIT remains capital-market dependent, and this could come back to haunt investors during weak times of credit availability. Dividend obligations are not minor: ~$1.5 billion per annum.

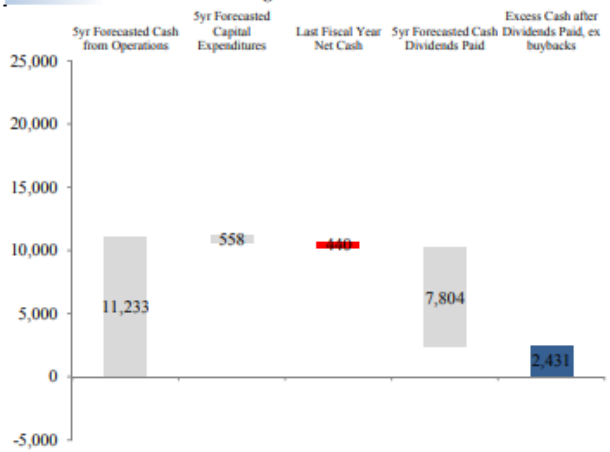
Graphical Relationship, Earnings and Dividends (per share)

The graph above shows the relationship between a firm's earnings per share and its dividends per share.

Dividend Cushion Cash Flow Bridge Evaluation

The Dividend Cushion Cash Flow Bridge, shown in the image to the right, illustrates the components of the Dividend Cushion ratio and highlights in detail the many drivers behind it. Public Storage's Dividend Cushion Cash Flow Bridge reveals that the sum of the company's 5-year cumulative free cash flow generation, as measured by cash flow from operations less all capital spending, plus its net cash/debt position on the balance sheet, as of the last fiscal year, is greater than the sum of the next 5 years of expected cash dividends paid. Because the Dividend Cushion ratio is forward-looking and captures the trajectory of the company's free cash flow generation and dividend growth, it reveals whether there will be a cash surplus or a cash shortfall at the end of the 5-year period, taking into consideration the leverage on the balance sheet, a key source of risk. On a fundamental basis, we believe companies that have a strong net cash position on the balance sheet and are generating a significant amount of free cash flow are better able to pay and grow their dividend over time. Firms that are buried under a mountain of debt and do not sufficiently cover their dividend with free cash flow are more at risk of a dividend cut or a suspension of growth, all else equal, in our opinion. Generally speaking, the greater the 'blue bar' to the right is in the positive, the more durable a company's dividend, and the greater the 'blue bar' to the right is in the negative, the less durable a company's dividend.

Dividend Cushion Cash Flow Bridge



Source: Company Filings, Valuentum Projections

Dividend Cushion Ratio Evaluation

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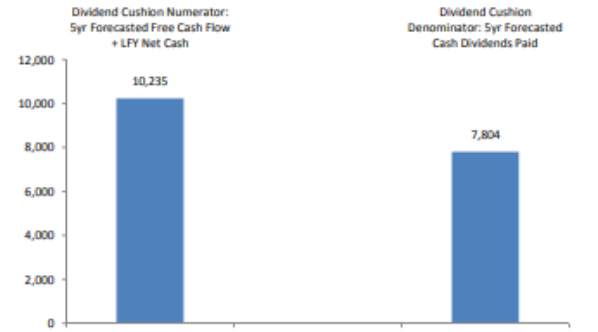
Dividend Cushion Ratio Deconstruction



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VALUENTUM

DEFINITIONS

ValueCreation. This is a proprietary Valuentum measure. ValueCreation indicates the firm's historical track record in creating economic value for shareholders, taking the average difference between ROIC (without goodwill) and the firm's estimated WACC during the past three years. The firm's performance is measured along the scale of EXCELLENT, GOOD, POOR, and VERY POOR. Those firms with EXCELLENT ratings have a demonstrated track record of creating economic value, while those that register a VERY POOR mark have been destroying economic value.

ValueRisk. This is a proprietary Valuentum measure. ValueRisk indicates the historical volatility of key valuation drivers, including revenue, gross margin, earnings before interest, and enterprise free cash flow. The standard deviation of each measure is calculated and scaled against last year's measure to arrive at a percentage deviation for each item. These percentage deviations are weighted equally to arrive at the corresponding fair value range for each stock, measured in percentage terms. The firm's performance is measured along the scale of LOW, MEDIUM, HIGH, and VERY HIGH. The ValueRisk™ rating for each firm also determines the fundamental beta of each firm along the following scale: LOW (0.85), MEDIUM (1), HIGH (1.15), VERY HIGH (1.3).

ValueTrend. This is a proprietary Valuentum measure. ValueTrend indicates the trajectory of the firm's return on invested capital (ROIC). Firms that earned an ROIC last year that was greater than the 3-year average of the measure earn a POSITIVE rating. Firms that earned an ROIC last year that was less than the 3-year average of the measure earn a NEGATIVE rating.

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