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HIGH YIELD DIVIDEND NEWSLETTER

THERE IS MILK AT THE STORE

"Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning." -- Winston Churchill

Very few of us could have imagined that we'd witness the bull market that began on that fateful day in March 2009 that might very well mark a generational low. In 2009, major investment banks around the globe were struggling to survive, and the fallout in the mortgage markets left the banks holding paper that nobody wanted to own, let alone buy. The global financial system was on the verge of collapse and gross domestic product was plummeting. Companies didn't want to invest, nor hire, and nobody wanted to lend to anybody. The market system had ground to a halt. Some say during the depths of the Financial Crisis that the US was about two weeks away from complete shutdown, to the point where there might not have been milk available at the local store.

Nothing may have been worse than the Great Depression that engulfed the US following the Crash of 1929, which sent markets down more than 80% over a brief 2.8-year period in the 1930s, but the Great Recession of late last decade was rather frightful. In studying past bear markets, they tend to be short and steep. According to information from First Trust, the average bear market lasts just 1.4 years, leading to an average cumulative loss of ~41% over such a short time. It is interesting how brief broad market declines have been in the context of the average bull market lasting more than 9 years. Based on data from First Trust, there have been 9 bull markets since 1926 and 8 bear markets over the same time, so history provides a good sample set. But why are bear markets so short in duration?

Human psychology. In layman's terms, bear markets cause considerable pain over short periods of time because everybody runs to the exits…at the same time. Bull markets, on the other hand, are built over years and years of savings, but once bad news hits impacting future expectations, investors want to get their money out as soon as possible. The broad selling with little buyers causes stocks to face considerable, immediate pressure, resetting market prices to reflect a downside scenario much more quickly than the steady build of wealth during bull markets. Regardless of one's opinion about Treasury or the Fed, the government oversight of the markets kept us from the brink of disaster during the credit crunch, even if certain regulatory policies and loose lending standards may have been the primary reasons why the US was staring down the abyss in 2009.

But there is milk at the store. Another Great Depression

> "IT'S QUITE POSSIBLE THAT JUST LIKE THE GREENSPAN YEARS, MANY INVESTORS WERE BETTER OFF AFTER THE DOT-COM CRASH AND IRRATIONAL EXUBERANCE BY HAVING BEEN A PART OF THE STOCK MARKET RUN THAN SITTING OUT OF IT ENTIRELY. QUITE FRANKLY, WE'RE HAVING A HARD TIME COMING UP WITH REASONS TO SAY THIS MARKET WON'T CONTINUE TO MOVE HIGHER, REGARDLESS OF THE CAPE RATIO OR MARKET-CAP-TO-GDP MEASURES." – BRIAN NELSON, CFA

didn't happen. In fact, the Fed's prolonged zero-interest rate policy (ZIRP) worked incredibly well to drive stock market prices higher, and the multiple rounds of quantitative easing have worked wonders on the global financial system. The US sovereign debt load has exploded higher during the past few years, but the US has always had a large national debt and deficits have never posed a problem, in part because the US continues to be the strongest nation on the planet. When it comes to sovereign credit health, almost everything is relative, particularly when it comes to the strength of currencies. Like it or not, the Fed did a marvelous job in saving the global financial system as we know it.

Many had the confidence to believe that the US would bounce back from the Great Recession, and we'd point to Warren Buffett's masterful op-ed that ran in the New York Times in October 2008 as one example: Buy American. I Am. Boy was Uncle Warren right. As the world around us was crumbling in 2008-2009, Mr. Buffett was loading up on American stocks…in his personal account. His reasoning came down to a simple rule: "Be fearful when others are greedy and be greedy when others are fearful." During the doldrums of late 2008, before things really fell out of bed in March 2009, people were quite fearful. Some may say, however, that they had good reason to fear.

US gross domestic product had fallen by 8.2% during the fourth quarter of 2008, and it fell by 5.4% during the first quarter of 2009. The economy was truly in shambles, and people were feeling it on the frontlines as US unemployment ratcheted up to nearly 10% by October 2009. There were good reasons to be scared. There were good reasons to pull one's money out of the stock market. There were sound arguments to be made that the decade following the credit crunch might be like that of the Great Depression. The future could not be predicted, and many tried and true companies were failing from General Motors to AIG and beyond. Even Washington Mutual experienced a modern-day run-on-the-bank. Many hardly even remember just how close to Armageddon we truly were.

But we'd posit that even Mr. Buffett could not have imagined the meteoric rise of the stock market since then through today. Where we may have believed the Oracle of Omaha that things would bounce back, and that not all would be lost, and that new highs would be had once again, if not next decade than in the decades ahead, not even he could have predicted the pace of the market's rise these past 9 years, at least in this humble author's opinion. What we're saying is that while eclipsing the prior highs of the Great Recession may have been expected by some of the more experienced investors, witnessing the subsequent surge in the stock market has been something of a spectacle. Nobody could have predicted a Trump Presidency and the passing of tax reform, in 2008, but my goodness, look at things now!

US unemployment is now at 3.9%, as of July 2018, the lowest it has been in as long as we can remember. The US economy has not been in recovery, but it has been in expansion since 2010. The economic weakness of 2009 was a mere blip in history, and US gross domestic product has advanced steadily, to now eclipse $19+ trillion, a far cry from the $14.7 trillion during 2008. We're talking real growth and real prosperity for Americans, and a stock market supported by strong earnings. FactSet is estimating that S&P 500 companies will earn $178.28 per share in calendar year 2019, as of their August 31 update, which is up from $73.70 in calendar year 2008, prior to the Great Recession, and $61.95 per share during calendar 2009 when the global financial system was a mess.

Even the expansion from calendar year 2016 levels of $119.29 per share in earnings per share is remarkable. Although a good portion of the S&P 500 earnings-per-share growth has been driven by significant buybacks, the bottom-line growth of S&P 500 companies has been and is expected to be robust, nonetheless. As of August 31, FactSet estimates that the 12-month forward P/E ratio for the S&P 500 is 16.8, and while this is above the 5-year average of 16.3 and the 10-year average of 14.4, it is certainly not bubbly, by any stretch of the imagination. The US economy may have been propped up by ultra-low rates, quantitative easing, and significantly increased sovereign (and corporate debt) during the past several years--and earnings growth may largely be driven by buybacks--but the stock market is operating on a firm foundation of valuation.

One of our major concerns regarding the threat to valuation has been interest rates. As Warren Buffett has often stated, interest rates are one of the most

important, if not the most important, drivers behind stock prices, and they have been (ultra) low in the US for some time (they've even been negative elsewhere in the world). Corporate tax reform may reduce the cash coffers of the US government creating an increased threat of US credit risk and inflation, and while the Fed is intent on raising the federal funds rate, President Trump is now attacking the issue of rising rates head on. Though we believe the Fed will act independently, it will become much more difficult for it to continue to raise rates in 2019, in our view, if the White House is breathing down the Fed's neck. The latest strong recovery in the equity markets during the past several months may be, in part, a function of expectations of a slower pace of rate hikes starting in 2019.

Still, nobody could have predicted the magnitude and duration of the current bull market, one that is now over 9 years in duration, driving compound annual returns of 17.5%+ since. Nobody could have predicted that Donald Trump would become President of the United States back when GDP was plummeting by high-single-igit rate during the fourth quarter of 2008. Following the Bush II administration, some may have believed that we wouldn't see another Republican President in a few decades, or at least not for some time. If you recall, even the election polls had put Hillary Clinton as the clear favorite to win the 2016 election over Donald Trump. Since election night, Democrats have been working around the clock to get Mr. Trump out of office, and with all the investigations, the US is starting to look a bit silly on the world stage--not because of Trump, but because of the rallying cry of its citizens against their elected President of the United States.

Lehman Brothers, Bear Stearns, Washington Mutual – these are just a few historic brand names that the new generation of investors may never have even heard of, as arguably the names of many companies that folded during the Great Depression may never have reached the ears of the baby-boomer generation. History may not repeat exactly, but it definitely seems to rhyme quite often. Uncle Warren was right. Look at how good things are today, and the stock market is *not* built on castles-in-the-air like that of the dot-com bubble of the 1990s. The market is supported by strong earnings and strong earnings growth, and it has technical support in the form of company buybacks--all the while the number of stocks is shrinking and indexing is proliferating, creating what we'd call a buy-at-any-price mentality against ever-diminishing supply. Prices tend to keep rising under such a scenario.

Though Mr. Buffett, today, may say that people are more greedy than fearful, and this may help explain why Berkshire Hathaway is holding on to a large cash balance, it's hard to bet against the stock market over the long haul. We'd love to be contrarians--and sound smart in saying that when things look the best, it's time to be the most cautious--but things have been looking great for years, and the market has moved ever higher…again and again. Things were looking the worst in March 2009, too, and the economy and stock market has expanded considerably since then. It's fair to even say that the stock market may be resilient under almost any conditions**. It may only be the case that today is just the end of the beginning of this bull-market run from the Great Recession, and that the next phase will be the creation of a real bubble, something that bears may finally be right about--but maybe not for years yet.**

Yet, even if the bears end up being correct and a bubble is created and it subsequently bursts, such a scenario means even better stock market returns in the years ahead. It's quite possible that just like the Greenspan years, many investors were better off after the dot-com crash and irrational exuberance by having been a part of the stock market run than sitting out of it entirely. Quite frankly, we're having a hard time coming up with reasons to say this market won't continue to move higher, regardless of the CAPE ratio or market-cap-to-GDP measures. The one thing that the Great Recession may have taught the newest generation of American earners and investors is not prudence or care, but rather the idea that the government will come to the rescue, and things will just "work out." Moral hazard may be running rampant today, but that may just mean greater stock market returns in the years ahead...until the next inevitable bear market (when, not if, it comes).

Until then, stay optimistic. This bull market may still have legs.

Brookfield Properties Increases Bargaining Power with GGP Purchase

Image shown: Brookfield Property's share-price performance since 2016

Commercial real estate giant Brookfield Property Partners (BPY) recently closed its acquisition of top mall owner GGP in a deal that carried an aggregate cash/equity ratio of roughly 61/39 and included a total cash consideration of $9.25 billion. The deal is expected to be immediately accretive to Brookfield's funds from operations per unit, and GGP shareholders should be pleased with the increasing income generation as Brookfield's per unit distribution was more than 40% higher than that of GGP at the time the deal closed.

The agreed-upon price tag wasn't Brookfield's first attempt at a takeover, and in order to get the deal done, it had to raise its per share cash consideration to $23.50 from $23.00 and its exchange ratio for the equity portion of the deal to 1 from 0.9656. Brookfield also created a new REIT titled BPY US REIT (BPR), shares of which are structured with the goal of providing economic returns equivalent to Brookfield units, and shareholders have the option to exchange one Brookfield unit for one BPY share or the cash equivalent of one Brookfield unit.

The combined company has an ownership interest in $90 billion in total assets and net operating income of $4+ billion, making it one of the largest players in the global commercial real estate market. Such scale enhances the potential to increase its bargaining power with tenants, specifically in the challenged retail space, where its presence has been materially enhanced with the now full-ownership of GGP. Brookfield boasts a solid BBB credit rating from S&P, thanks to its notable scale, diverse real estate portfolio, and the deep pockets of its sponsor, Brookfield Asset Management (BAM), which holds over $285 billion in assets under management as a leading global alternative asset manager. Brookfield Property's core assets are in premier office and retail real estate, but it also has interests in multi-family, triple net lease, industrial, hospitality, self-storage, student housing, and manufactured housing assets.

We think GGP shareholders got a fair deal when considering the option for $23.50 per share in cash, and those that chose to take the equity option in the deal should be mighty pleased to now collect an annual dividend that is more than 40% higher than that received as a GGP shareholder. Units of Brookfield Property Partners currently yield ~6.2%.

Stellar Keytruda Growth Powers Merck Higher

Image shown: Merck's share-price performance since 2016.

Shares of pharmaceutical giant Merck continue to accelerate thanks in large part to the growth of its key oncology asset Keytruda. Even though Merck is a well-established entity, future growth is highly correlated to the continued expansion of Keytruda as it continues to gain market share thanks in large part to superior clinical data and label expansion.

By Alexander J. Poulos

Key Takeaways

Keytruda remains a star performer powering Merck's quarterly performance.

We remain big fans of Keytruda's potential as the recent clinical data underscores the best in class potential of the molecule.

The performance of Keytruda is critical for Merck as sales deceleration in former growth properties begin to weigh on overall sales of the company.

Why are we profiling Merck in the High Yield Dividend Newsletter? For one, we're expecting big growth in the company's dividend in coming years, and the entity almost yields 3%. When it comes to pharma/biotech exposure in the High Yield Dividend Newsletter, we're pretty light.

Merck is a strong consideration, even if the magnitude of its dividend yield may be still one in the making. The high end of our fair value range for Merck is $74 per share. The company is trading at ~$68 per share at the time of this writing.

Merck's Keytruda

We would classify Merck (MRK) as an oncology growth story as future expansion is highly correlated with the performance of Keytruda. We are comfortable with the large degree of exposure tied directly to Keytruda as it is not uncommon for one or two compounds to fuel growth as witnessed throughout the pharma landscape. The large degree of concentration, however, carries an elevated degree of risk if a new entity disrupts market share, usually via an unexpected post-marketing side effect or through superior clinical data.

A recent example of this phenomena is the relatively poor performance of Bristol-Myers Squibb (BMY) since it topped out in the mid-$70s in July 2016, fueled in large part by the superior data that Keytruda continues to generate. Despite the broader stock market reaching new highs yet again, Bristol-Myers' share price has yet to recover from the steep sell off due in large part to its key compound Opdivo failure in a critical clinical trial in August of 2016. Shares of Bristol are trading at ~$60 per share at the time of this writing.

Merck's Keytruda continues to cement its dominance as the go-to immune-oncolytic agent as evidenced with an impressive string of data releases, culminating with simply stellar numbers following the recent ASCO conference in June of 2018. The data presented at ASCO, in our view, has cemented Merck's leadership position in Immuno-Oncology, thus paving the way for future revenue growth for Keytruda. The pace of expansion is evident in Merck's second-quarter numbers, released July 27, as the company reported Keytruda sales of $1.667 billion for the second quarter 2018 versus $881 million in the second quarter of 2017, an 89% year-over-year increase.

As impressive as Keytruda's second-quarter performance was, Merck may still be in the early stages of realizing the full commercial potential of Keytruda. Firstly, the data release in June of 2018 came at the tail end of the second quarter, meaning the sales force has not even begun the marketing push for Keytruda based on new data. In addition to the expected strong push from the sales force, the FDA has yet to grant first-line status to Keytruda in certain indications, thus an additional regulatory hurdle is impeding wider uptake.

On August 20, however, the FDA approved Keytruda for first-line metastatic Non-Small Cell Lung Cancer (NSCLC), but there are still opportunities. We were especially impressed with comments made by Merck during the July 27 conference call that the company is capturing roughly two thirds of all new patient starts for first line Non-Small Cell Lung Cancer (NSCLC), one of the largest areas of need. We view Merck's commentary as further validation of our thesis that Merck is now in the pole position with the key immuno-oncolytic agent.

The Oncology division remains the linchpin of Merck's growth as the division generated sales of $3,6 billion for the first six months of 2018. To add further context to the sales figures, Merck's pharmaceutical sales generated $18.2 billion for the comparable period. Oncology remains an area of notable growth, as Merck needs continued expansion in oncology to offset the loss of revenue from other divisions.

Diabetes Franchise

The Diabetes division spearheaded by Januvia and Janumet continue to feel the pressure form new entrants, along with a less-than-optimal reimbursement environment, which continues to weigh on margins.

Januvia posted sales of $949 million during the second quarter of 2018 versus sales of $947 million in the second quarter of 2017. The "flattish" nature of sales of Januvia, in our view, underscores the competitive nature of the diabetes market. Janumet fared somewhat better with sales of $585 million versus sales of $563 over the comparable year-over-year second-quarter periods.

We do not view Diabetes as an area of focus for Merck going forward as the company has one asset in phase 2 trials, which is currently under clinical hold. Typically, when a product is placed on a clinical hold, it is due to some underlying issue, either with the efficacy of the product or the side-effect profile. Instead, we believe Merck will look to maximize the profitability of the unit, which may include a lower sales level as funding for reps may be diverted into other more promising areas.

Vaccines

The vaccine market remains an area of growth for Merck, in spite of recent disruption via a new product introduction by GlaxoSmithKline (GSK). Merck's Zostavax vaccine for shingles has been disrupted by Shingrix, GSK's two-shot regiment for the prevention of shingles in adults.

Zostavax six-month sales in 2018 totaled $108 million versus the $308 million over the first half of 2017, despite the severe manufacturing constraints as GSK woefully underestimated demand for Shingrix. Going forward, we expect Zostavax sales to tail off further, however. Thankfully for Merck shareholders, the continued growth of Gardasil and Proquad continue to power growth higher.

Sales for Merck's entire Vaccine division totaled $2.9 billion in the first half of 2018 versus $2,744 in the comparable period of 2017. The Vaccine division remains an area of continued investment for Merck, as with three assets in phase III trials (though one is under clinical hold), along with one under review by the FDA. We view the Vaccine division as a steady growth engine for Merck, and though it lacks the explosive growth of a "Keytruda-like-drug," the business dynamics remain compelling, in our view, as Merck looks to continue to build on its leadership position in vaccines.

Animal Health

The pricing dynamics of Animal Health remain favorable, thus underscoring Merck's continued enthusiasm for the division. Unlike its smaller rival Eli Lilly (LLY), which plans to spin off to shareholders its Animal Health Division (Elanco), Merck continues to view Animal Health as an area ripe for additional business development deals. Sales for the first six months of 2018 totaled $2.16 billion versus $1.89 billion in the comparable period of 2017 for an overall year-over-year growth rate of 14%.

In our view, we favor Lilly's move to spin off Elanco as the impressive growth prospects of the division will no longer be masked by the much larger revenue stream of the parent. Let's keep in mind--the end users tend to be brand loyal with the relative absence of a robust generic market for branded animal feeds. Thus, the overall dynamics of Animal Health remain very favorable in our view.

Wrapping Things Up

Overall, for the second quarter, Merck reported sales of $10.5 billion versus $9.93 billion in the second quarter of 2017, an increase of 5%. The increase in sales allowed Merck to post earnings of $1.06 per share on a non-GAAP basis, well ahead of the consensus projection. The better-than-expected performance prompted management to raise its annual earnings guidance to $4.22-$4.30 versus the prior range of $4.16-$4.28 per share.

We remain bullish on the prospects of Keytruda, as we feel at this juncture the molecule remains best-in-class in the ultra-competitive field of Oncology. Our issue with Merck remains the deceleration in sales of other key franchises, however, which may hamper some of the upside revenue potential for Merck. We'll be monitoring this risk closely.

Our fair value estimate range for Merck is $50-$74 per share with the recent share price rally pushing Merck towards the higher end of our fair value range. We rank Merck's dividend as Good with a Dividend Cushion ratio of 2, underscoring the ability of Merck to raise its dividend over time. We like Merck's long-term prospects, and we're hoping that we may have a chance in the future to add the idea to either the simulated Dividend Growth Newsletter portfolio or the simulated High Yield Dividend Newsletter.

High Yield Dividend Newsletter Earnings Roundup

AmeriGas Partners Raises Adjusted EBITDA Guidance

AmeriGas Partners (APU), the country's largest retail propane marketer, turned in its best fiscal third quarter adjusted EBITDA performance since fiscal 2013 in the quarter ended June 30, 2018, results released August 1. Adjusted EBITDA advanced 15% from the year-ago period, and management subsequently raised its full-year fiscal 2018 EBITDA guidance to $625-$645 million from $610-$620 million.

Retail volumes sold grew 4% in the quarter thanks to colder weather in April, which was partially offset by warmer months in May and June compared to the same period of fiscal 2017. National Accounts, which consists of supply and delivery services for enterprises across the country, turned in another solid quarter as it grew volumes 11% on a year-over-year basis. AmeriGas reaffirmed its adjusted earnings per share guidance in a range of $2.70-$2.80, which represents ~20% growth over its record adjusted earnings per share realized in fiscal 2017 and an 11% 5-year CAGR from fiscal 2013.

AmeriGas points to natural gas infrastructure as a key growth driver. The company continues to develop new investments in areas adjacent to the Marcellus Shale Formation as demand for natural gas grows. It is also pouring capex into its UGI Utilities business to serve the growing demand for natural gas as a power source across its residential, commercial, and industrial segments. Liquefied petroleum gas (LPG) and international operations also present growth opportunities with a focus on European LPG distribution.

Units of AmeriGas currently yield ~9.7%, and we value units at $48 each.

Enterprise Product Partners Turns in Record-Setting Quarter; Hikes Distribution

Enterprise Product Partners (EPD) CEO Jim Teague pointed to fourteen financial and operational performance records set in the second quarter of 2018, results released August 1, as evidence on his company's strong performance, which has been boosted by $5.3 billion of assets being "placed in service" since the second quarter of 2017. Volume growth across its integrated asset base and higher NGL prices in its natural gas processing business were key growth drivers as well. The master limited partnership also raised its quarterly per unit distribution by 2.4% to $0.43 in the quarter as well, which marked its 56th consecutive quarter of distribution growth.

Distributable cash flow of $1.4 billion in the second quarter provided ample coverage (estimated to be 1.5x by management) of the payout when considering only the industry specific measurement of cash flow, but we must note that the distribution is dependent on access to the capital markets as free cash flow for in first half of the year came in at ~$777 million compared to cash distributions paid to limited partners of more than $1.8 billion. The MLP's adjusted Dividend Cushion ratio, which gives it credit for the aforementioned access to capital markets, currently sits at 1.9, and units yield ~6.1% as of this writing. Our fair value estimate for units is $28 each, and it holds solid investment grade credit ratings of Baa1/BBB+ thanks in part to its simplified structure that has no general partner incentive distribution rights, a recent trend we've seen take hold across the MLP of which it was well ahead of the curve.

Enterprise Product Partners continues to invest heavily in growth and current has $5.1 billion in major capital projects expected to come online by the end of 2019 with more to come, and it is targeting a 3.75x-4.0x debt-to-adjusted EBITDA ratio (currently 3.9x). Growing demand for US hydro carbons from international markets backs a portion of its growth plans, and export demand is expected to remain on an upward trajectory, thanks in large part to Asia. Roughly half of Asia's LPG is imported with ~40% of those imports coming from the US, and this demand is considered inelastic to a large degree as it is consumer-oriented and the continent boasts a burgeoning middle class.

Magellan Midstream Raises Distributable Cash Flow Guidance

Net income at Magellan Midstream Partners (MMP) rose only ~2% in the second quarter of 2018 from the year-ago period, but the industry-specific measure distributable cash flow grew ~6.5% on a year-over-year basis to nearly $267 million in the quarter thanks in part

to higher than expected refined products pipeline shipments and earlier than assumed recognition of commodity profits.

Magellan's operating margin in its 'Refined Products' segment fell by ~$23 million to ~$191 million as a result of lower commodity profits related to the impact of mark-to-market adjustments for futures contracts used in hedging. Within the segment, transportation and terminals revenue grew nicely thanks to strong demand for refined products and higher storage and service fees. Its 'Crude Oil' segment set a quarterly record for operating margin thanks to a condensate splitter that began operations in June of last year and higher spot shipments at favorable pricing. Lower utilization impacted its smaller 'Marine Storage' segment as a result of maintenance work on ongoing issues related to Hurricane Harvey.

The MLP remains committed to raising its annual distribution by ~8% in 2018, and it expects its $1.1 billion distributable cash flow guidance ($20 million higher than previous guidance) to result in 1.2x distribution coverage. Magellan expects annual distributable cash flow growth in the 5%-8% range in both 2019 and 2020, and it plans to maintain its coverage ratio at ~1.2x as it plans to grow the distribution in line with this guidance in coming years. It holds solid investment grade credit ratings of BBB+/Baa1, which is an important consideration given the capital market dependence of its distribution. Free cash flow through the first half of 2018 came in at ~$302 million compared to cash distributions paid of ~$394 million. Units yield ~5.6% as of this writing, and its adjusted Dividend Cushion ratio sits at 1.2. Our fair value estimate for units is $69 each.

Omega Healthcare Raises 2018 Guidance; Progresses on Asset Repositioning

Omega Healthcare (OHI) CEO Taylor Pickett referred to the second quarter of 2018, results released August 3, as "eventful yet productive" as the REIT sold the majority of the facilities associated with its strategic asset repositioning effort, restructured its struggling Signature portfolio, and transitioned its legacy Orianna facilities in Mississippi and Indiana to two of its existing operators. With the majority of dispositions behind it, management can now focus on redeploying the proceeds into growth opportunities.

Funds from operations (FFO) for the second quarter came in at $0.75 per share compared to $0.73 in the year-ago period, but adjusted funds from operations (AFFO) fell by $0.11 to $0.76 per share as a result of one-time refinancing costs included in FFO in the second quarter of 2017. Omega raised the bottom end of its 2018 AFFO per share guidance by $0.07 after the second quarter, putting its new guidance range at $3.03-$3.06, which still represents a meaningful step down from ~$3.30 in 2017. Management notes that the narrowed guidance range reflects the increased clarity related to resolving issues related to its Orianna-operated facilities and the timing of asset sales and proceed redeployment, the latter of which will have say in where in the guidance range it ultimately lands.

Shares of Omega have fared well since its largely positive second quarter report, and while we like the progress it is making, another material challenge exists in identifying the proper capital allocations with the proceeds of recent asset sales. We're keeping a close eye on this risky idea. Shares are trading roughly in line with our $33 per share fair value estimate, and the REIT's adjusted Dividend Cushion ratio sits at 0.8, highlighting the riskiness of the payout's dependence on the capital markets. Shares yield ~8% as of this writing.

Public Storage Continues Battling Oversupply Concerns

Self-storage giant Public Storage (PSA) continues to expect supply deliveries to be elevated in 2018 over 2017, mitigating its pricing power is to a degree despite its notable scale in an otherwise fragmented market. However, management sees some potential for a slowdown in deliveries as we head into 2019, but uncertainty persists as a result of the inherent unpredictability associated with development projects. Rising costs related to labor and materials, steel in particular, could help cause such delays in development and provide Public Storage with some short-term relief from incoming supply, but management did not appear confident in its ability to look ahead to the operating environment of 2019 at this juncture.

In its second quarter report, results released August 1, Public Storage turned net income per diluted share of $2.00 compared to $1.59 in the comparable period of 2017 thanks to growth in self-storage net operating income, its share of a gain on sale of assets by PS Business Parks, and positive currency impacts. An acceleration of share-based compensation expense accruals partially offset these positive factors. Same-store facilities revenue advanced 1.5% in the quarter on a year-over-year basis thanks to higher realized annual rent per occupied square foot, but higher property taxes drove cost of operations for same store facilities higher by 2.6% from the year-ago period.

We currently value shares of Public Storage at $183 each, but a return to a more favorable pricing environment could present upside to this estimate. The REIT's adjusted Dividend Cushion ratio sits at 1.4, but its unadjusted Dividend Cushion ratio is also relatively healthy for a REIT at 1.2. Shares yield nearly 3.8% as of this writing.

Realty Income Boosts FFO Guidance

Realty Income (O), aka "The Monthly Dividend Company" continues to be a model of consistency. The image below, which presents compound average annual total return data as of June 30, highlights its tremendous dividend track record and the diversification of its portfolio.

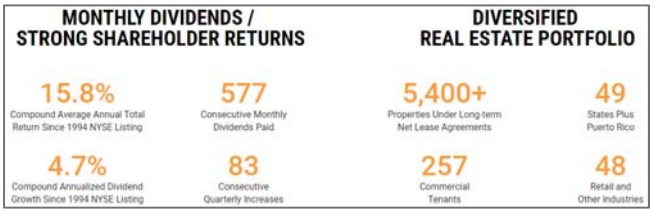


Image source: Realty Income IR website

In the second quarter of 2018, results released August 1, Realty Income raised its quarterly payout by more than 4% from the year-ago period, and AFFO per share grew 5.3% on a year-over-year basis to $0.80. Management raised its full-year AFFO guidance to a range of $3.16-$3.21 from $3.14-$3.20, now representing annual growth of 3%-5% over 2017. The REIT also raised its 2018 acquisitions guidance to ~$1.75 billion from previous guidance of $1.0-$1.5 billion.

The REIT's occupancy rate remains tremendous as it advanced to 98.7% as of the end of the second quarter of 2018, up from 98.6% a quarter earlier and $98.5% a year earlier. Its weighted average remaining lease term is a healthy 9.3 years, and its rent recapture rate (annual new rent on re-leases) came in at 107.6%, showcasing its ability to refill expiring leases at attractive rates.

We currently value shares of Realty Income at $58 each, and its adjusted Dividend Cushion ratio sits at 0.7. The REIT's dividend remains dependent on access to the capital markets, which we do not anticipate being an issue as it boasts some of the strongest credit ratings of any REIT on the market (A3/A-). Shares yield ~4.5% as of this writing.

Tallgrass Energy CEO Comments on Successful Merger

In its second quarter 2018 report, newly formed Tallgrass Energy (TGE) CEO had positive comments regarding the quarter and the completed merger.

"In the second quarter, our team successfully executed a smooth, seamless combination transaction while delivering outstanding financial, commercial and operational results. Excluding merger costs, Pro Forma Net Income and Adjusted EBITDA would have been approximately $56 million and $208 million respectively. Driving the quarter's results were our highest-ever quarterly average daily throughput on Pony Express and strong performance in our Natural Gas Transportation and Gathering, Processing and Terminalling segments. With the merger completed, a strong balance sheet, healthy dividend coverage and improved cost of capital, TGE is well-positioned as one of the country's leading core infrastructure companies." -- Source: Tallgrass Energy second quarter report

- Brian Nelson, CFA
President, Investment Research

- Kris Rosemann
Head of Data, Associate Investment Analyst

Disclosure: Brian Nelson and Kris Rosemann do not own any shares of any securities mentioned in this newsletter. Alexander J. Poulos does not own any securities mentioned in the article he authored in this edition. 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. 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 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. 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 each month in similar fashion (list and weightings) 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				
Alerian MLP ETF	AMLP	5.0%	0.83	7.60%
Global X SuperDividend ETF	SDIV	5.0%	1.51	7.28%
Global X SuperIncome Preferred ETF	SPFF	10.0%	0.86	7.14%
iShares International Select Dividend ETF	IDV	5.0%	1.55	4.75%
iShares MSCI Australia ETF	EWA	5.0%	0.99	4.40%
iShares U.S. Preferred Stock ETF	PFF	5.0%	2.09	5.50%
PowerShares Senior Loan Portfolio	BKLN	5.0%	0.88	3.81%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	3.93	5.82%
EQUITY				
AmeriGas Partners	APU	5.0%	3.80	9.71%
BP PLC	BP	5.0%	2.46	5.74%
Digital Realty Trust	DLR	5.0%	4.04	3.25%
Enterprise Products Partners	EPD	5.0%	1.72	6.01%
Magellan Midstream Partners	MMP	5.0%	3.75	5.49%
Omega Healthcare Investors	OHI	5.0%	2.64	7.99%
Public Storage	PSA	5.0%	8.00	3.76%
Realty Income Corporation	O	5.0%	2.64	4.51%
Tallgrass Energy LP	TGE	5.0%	1.99	8.09%
		90.0%		**5.40%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 8/31/2018.

We expect to increase our allocation to 100% soon, as we look to add to the Core component of the portfolio.

OIL & GAS PIPELINE COMPANIES IN OUR COVERAGE UNIVERSE

Company Name	Symbol	Est. Div. Yield	Div Cushion	Div Growth	Div Safety	Div Track Record	VBI	Fair Value Estimate	Economic Castle
DDR	DDR	11.2%	-1.2	VERY POOR	VERY POOR	RISKY	3	$15.00	Neutral
Omega Healthcare	OHI	8.8%	0.8	VERY POOR	POOR	HEALTHY	4	$33.00	Attractive
Spirit Realty	SRC	8.5%	-	-	-	HEALTHY	6	$7.00	Neutral
Kimco Realty	KIM	6.9%	0.8	VERY POOR	POOR	RISKY	4	$16.00	Neutral
WP Carey	WPC	6.3%	0.7	VERY POOR	POOR	HEALTHY	4	$70.00	Attractive
Tanger Factory	SKT	5.9%	0.6	POOR	POOR	HEALTHY	7	$22.00	Attractive
HCP	HCP	5.6%	0.9	VERY POOR	POOR	RISKY	6	$28.00	Attractive
Retail Properties of America	RPAI	5.5%	0.2	VERY POOR	VERY POOR	HEALTHY	3	$12.00	Neutral
Ventas	VTR	5.4%	1.4	GOOD	GOOD	HEALTHY	6	$56.00	Neutral
Welltower	WELL	5.4%	1.4	GOOD	GOOD	HEALTHY	6	$60.00	Neutral
LTC Properties	LTC	5.4%	0.7	VERY POOR	POOR	HEALTHY	6	$48.00	Attractive
Macerich	MAC	5.0%	-1.1	VERY POOR	VERY POOR	RISKY	7	$45.00	Neutral
Realty Income Corp	O	4.7%	0.7	EXCELLENT	GOOD	HEALTHY	6	$58.00	Neutral
Simon Property	SPG	4.5%	0.9	POOR	GOOD	RISKY	6	$171.00	Attractive
Taubman	TCO	4.2%	-0.1	VERY POOR	VERY POOR	HEALTHY	5	$67.00	Neutral
GGP	GGP	4.1%	0.3	POOR	VERY POOR	RISKY	6	$24.00	Attractive
Universal Health Realty	UHT	3.9%	1.2	VERY POOR	POOR	HEALTHY	6	$57.00	Neutral
Healthcare Realty Trust	HR	3.9%	1.1	VERY POOR	POOR	RISKY	6	$26.00	Neutral
CoreSite Realty	COR	3.7%	0.8	GOOD	GOOD	HEALTHY	6	$98.00	Neutral
Regency	REG	3.5%	0.3	VERY POOR	VERY POOR	RISKY	6	$62.00	Neutral
Digital Realty Trust	DLR	3.3%	1.6	EXCELLENT	GOOD	HEALTHY	6	$102.00	Neutral
Federal Realty	FRT	3.3%	0.1	VERY POOR	VERY POOR	HEALTHY	6	$102.00	Neutral
SL Green	SLG	3.1%	-0.4	VERY POOR	VERY POOR	RISKY	6	$85.00	Neutral
CyrusOne	CONE	2.8%	-0.5	POOR	POOR	HEALTHY	6	$56.00	Neutral

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 – TOP HOLDINGS OF THE ALERIAN MLP ETF (AMLP)

Company	Ticker	Weight	Credit Rating*	Dividend Yield
Enterprise Products Partners LP	EPD	10.11%	Baa1	6.00%
Magellan Midstream Partners LP	MMP	9.98%	Baa1	5.46%
Plains All American Pipeline LP	PAA	9.96%	Ba1	4.60%
Energy Transfer Partners LP	ETP	9.82%	Baa3	10.05%
MPLX LP	MPLX	9.20%	Baa2	6.73%
Buckeye Partners LP	BPL	4.64%	Baa3	14.19%
Western Gas Partners LP	WES	4.42%	Ba1	7.67%
EQT Midstream Partners LP	EQM	4.28%	Ba1	7.69%
Andeavor Logistics LP	ANDX	3.89%	Baa2 (UR)	8.34%
DCP Midstream LP	DCP	3.36%	Ba2	7.55%
Tallgrass Energy LP	TGE	3.27%	Ba2	6.78%
Spectra Energy Partners LP	SEP	2.80%	Baa2	7.96%
EnLink Midstream Partners LP	ENLK	2.66%	Ba1	8.72%
Shell Midstream Partners LP	SHLX	2.49%	NA	6.48%
Phillips 66 Partners LP	PSXP	2.45%	Baa3	5.83%
Genesis Energy LP	GEL	2.36%	B1	8.80%
Antero Midstream Partners LP	AM	2.31%	Ba2	5.58%
Enbridge Energy Partners LP	EEP	2.19%	Baa3	12.27%
NuStar Energy LP	NS	1.97%	Ba2	8.44%
Crestwood Equity Partners LP	CEQP	1.66%	Ba3	6.23%

*Credit rating according to Moody's (UR) = Under Review
AMLP Expense fee 0.85%

DIVIDEND REPORT PAGE 2 – REALTY INCOME (O)

Valuentum's Stock Dividend Research | Visit us at www.valuentum.com | Ratings as of 16-Aug-2018 | Data as of 10-Aug-2018

Realty Income Corp O 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	$46.00 - $70.00	HEALTHY	GOOD / 0.7	EXCELLENT	4.67%

Assessment of Company Dividend Strategy

Key Strengths

Realty Income is known as "The Monthly Dividend Company" thanks to its impressive track record of monthly dividend payments. The firm has increased its cumulative quarterly payout for more than 80 consecutive quarters and has paid more than 560 consecutive monthly dividends. The REIT's consistent fundamentals are the basis of its ongoing dividend strength; its occupancy rate has never fallen below 96%. Portfolio diversification helps maintain such occupancy levels as no one state accounts for more than 10.5% of total rent, and tenants in a given industry do not account for more than 11% of total rent. AFFO averaged just over $720 million from 2015-2017, easily higher than annual run-rate cash dividend obligations of nearly $690 million.

Potential Weaknesses

Real estate investment trusts pay out 90% of annual taxable income and therefore are unable to meaningfully reinvest internally-generated funds, resulting in external capital-market dependence. The weak internal cash-flow retention of most REITs translates into poor raw, unadjusted Dividend Cushion ratios, which could become severe during the depths of the real estate cycle. Even though a REIT's operating cash flow may be robust, the lack of cash accumulation on the balance sheet and the massive debt needed to purchase/develop new properties can become restrictive. The adjusted Dividend Cushion ratio, accounts for expectations of continued access to the capital markets, which while "normal," cannot be guaranteed in times of tight credit.

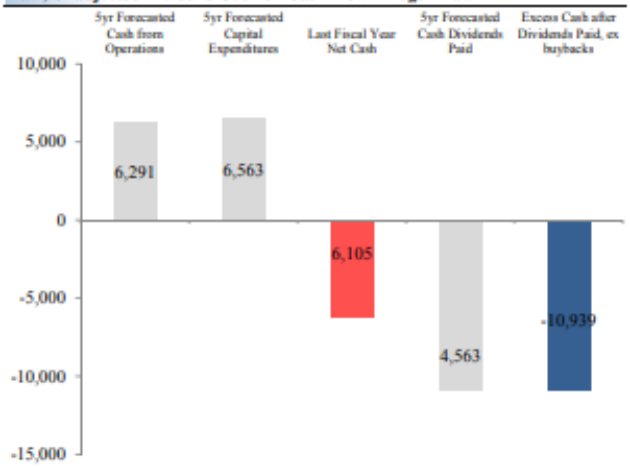
Graphical Relationship, Earnings and Dividends (per share)

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. Realty Income Corp'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

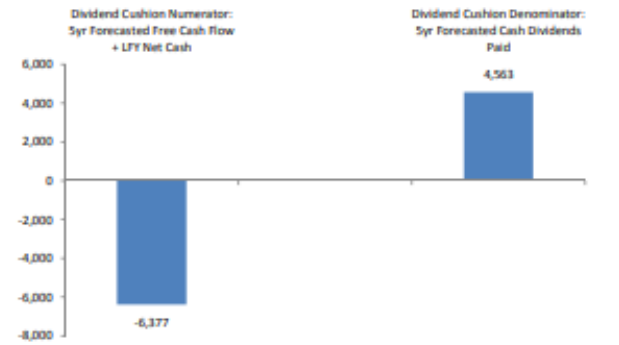


Source: Company Filings, Valuentum Projections

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, Realty Income Corp'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 – OMEGA HEALTHCARE (OHI)

Omega Healthcare OHI FAIRLY VALUED

Buying Index™ 4 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$25.00 - $41.00	HEALTHY	POOR / 0.8	VERY POOR	8.77%

Assessment of Company Dividend Strategy

Key Strengths

Omega Healthcare is the largest skilled nursing facility focused REIT with nearly 975 operating facilities in its portfolio as of December 31, 2017. The company is currently slightly above its target leverage range of a debt-to-adjusted EBITDA ratio of 4x-5x, and it continues to aim for a target dividend payout ratio of less than 85% of adjusted funds from operations or less than 90% of adjusted funds available for distribution. The first quarter of 2018 marked the 22nd consecutive quarter of quarterly dividend increases, but it marked the end of the streak as management prudently sustained the payout. Adjusted funds from operations averaged ~$520 million annually from 2015-2017, slightly in excess of yearly run-rate cash dividend obligations of ~$503 million.

Potential Weaknesses

Real estate investment trusts pay out 90% of annual taxable income and therefore are unable to meaningfully reinvest internally-generated funds, resulting in external capital-market dependence. The weak internal cash-flow retention of most REITs translates into poor raw, unadjusted Dividend Cushion ratios, which could become severe during the depths of the real estate cycle. Even though a REIT's operating cash flow may be robust, the lack of cash accumulation on the balance sheet and the massive debt needed to purchase/develop new properties can become restrictive. The adjusted Dividend Cushion ratio, accounts for expectations of continued access to the capital markets, which while "normal," cannot be guaranteed in times of tight credit.

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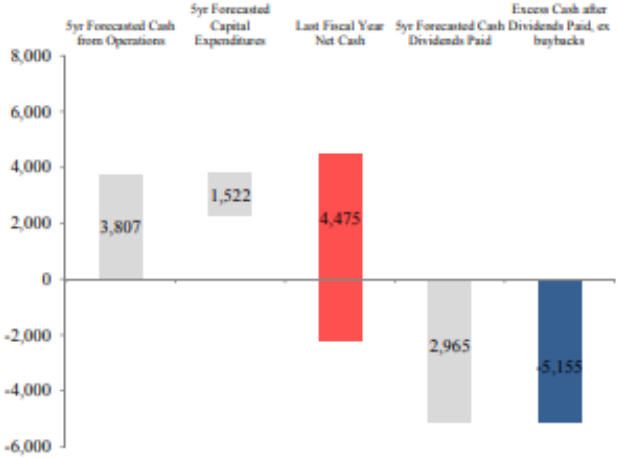

Source: Company Filings, Valuentum Projections

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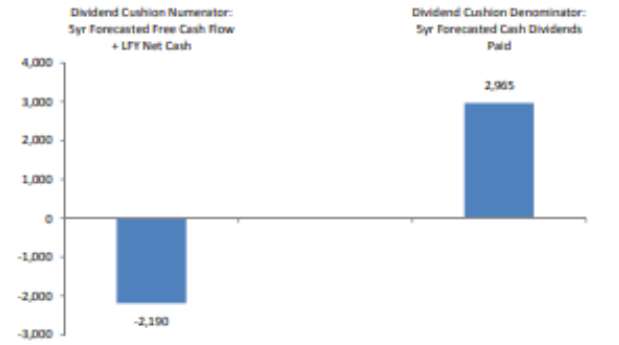

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DEFINITIONS

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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