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HIGH YIELD DIVIDEND NEWSLETTER

These High Yield Dividend Ideas Are Soaring!

Latest Changes to High Yield Dividend Newsletter
Previously Added: 5% in CubeSmart (CUBE), 5% in Utilities SPDR (XLU) – August 22

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"THE FEDERAL RESERVE HAS CUT INTEREST RATES TWICE SO FAR THIS YEAR, A COMPLETE REVERSAL FROM WHERE WE WERE HEADING BACK IN LATE-2018. COMBINED WITH ADDITIONAL MONETARY EASING EFFORTS IN THE EU AND ELSEWHERE, BOND-LIKE INVESTMENTS SHOULD CONTINUE TO PERFORM WELL GOING FORWARD" – CALLUM TURCAN

Image Shown: *The Utilities Select Sector SPDR ETF (XLU) has been a strong performer during 2019, as the Fed has pursued a more dovish stance. We expect utilities to continue to catch favor in this environment.* ***The XLU was added to the High Yield Dividend Newsletter August 22.***

By Brian Nelson, CFA

The Valuentum team recently sat down to talk about what we think is a "head fake" rotation from "growth" into "value" as the very short-term spike in rates has now largely faded amidst the long-term trend toward lower borrowing costs, a phenomenon that has led to more than $15 trillion in negative-yielding debt across the globe.

Where just a couple decades ago, savers could get a 7% yield on a short-term certificate of deposit, it's quite possible we may never see those days again. **That means that we expect high yield dividends to remain extremely popular as income vehicles**, offering support to a comparatively riskier group of companies.

One of the areas that we are liking more and more is the utilities sector (image shown above), a theme that we highlighted more recently in the High Yield Dividend Newsletter portfolio in the Utilities Select Sector SPDR ETF. Utilities may have boring business models, but **there's nothing boring about the dividends they pay. The XLU yields ~2.9%.**

We're pretty excited about what might be ahead for another recently added idea in the High Yield Dividend Newsletter portfolio, and that's AT&T (T). The company has come under activist fire from Elliott Management, and the hedge fund is calling for the stock **to hit $60 per share** in the coming years. We cover AT&T in more detail in the upcoming article. Though AT&T has a lot of work ahead of it to hit those levels, we recently increased our fair value estimate to $40 per share, implying nice upside--**and AT&T a solid dividend yield (~5.5%) to boot!**

With all the controversy surrounding vaping deaths coupled with the increased scrutiny on the tobacco industry, in general, Philip Morris (PM) and Altria called off merger negotiations resulting in a nice spike in Philip Morris' stock to pre-announcement levels. Though we liked the deal from a strategic standpoint, we did note that the market believed the value composition of the transaction wasn't as fair to Philip Morris shareholders. In any case, the deal is off (for now), and Philip Morris closed more than 5% higher on the session September 25. **Philip Morris yields a whopping 6.2%!**

Another one of our favorite high yield names is Digital Realty (DLR), and this one has been on fire, moving more broadly with the REIT group, which as with the utilities sector, continues to benefit from expectations for rates to continue to decline. **The High Yield Dividend Newsletter portfolio has a 10% weighting in the Vanguard Real Estate ETF, which is up almost 30% this year on a total return basis!** We think utilities and REITs are a core part of any High Yield Dividend Newsletter portfolio.

All things considered, we're expecting ongoing strength across many of the ideas in the high yield dividend space, as frankly, investors don't have too many other places to look to capture lofty yields for income (some have even been contemplating negative interest rate policy in the US). **We're very excited at how well the High Yield Dividend Newsletter portfolio is performing during 2019, and we reiterate that this portfolio is focused on generating juicy high-yield dividend income over the long haul.**

We trust you are doing great. Thank you!

Activist Takes a Run at AT&T

By Callum Turcan

Please note a version of this piece was published on Valuentum on September 10.

High Yield Dividend Newsletter holding AT&T (T) was back in the news on September 9 as activist investor Paul Singer, founder of Elliott Management, announced that the hedge fund manager had acquired a $3.2 billion stake in the company. Through a four-point plan, dubbed *"the Activating AT&T Plan"* according to the letter the fund manager sent AT&T pushing for change, Elliot Management thinks shares of AT&T could hit $60/share by 2021. **We recently raised our fair value estimate for AT&T to $40/share, and shares of T yield 5.5% as of this writing.**

Part of Elliott Management's strategy involves AT&T formally committing to allocating half of the firm's post-dividend free cash flows to debt reduction and half to share buybacks. Deleveraging and taking advantage of AT&T's undervalued equity would help shares of T better converge towards our estimate of its intrinsic value while generating shareholder value in the process (in Elliott Management's view). The high end of our fair value estimate range sits at $48/share.

AT&T's net debt load stood at $171.3 billion at the end of 2018 (total debt of $176.5 billion less $5.2 billion in cash and cash equivalents) after the firm acquired DirectTV in 2015 and Timer Warner in 2018. Deleveraging efforts through the first half of this year shaved AT&T's net debt load down to ~$162.1 billion by the end of June 2019, represented by $8.4 billion in cash and cash equivalents less $170.6 billion in total debt.

In 2018, AT&T generated $22.4 billion in free cash flows while spending $13.4 billion on its dividend payments. Furthermore, AT&T's free cash flows have averaged $18.3 billion over the past three full fiscal years. Management expects AT&T will generate ~$28.0

in free cash flows in 2019, guidance which was raised during the company's second-quarter 2019 earnings report by $2.0 billion. **That should allow for meaningful deleveraging activities going forward, and we really like the guidance raise.**

We caution that AT&T's enormous debt burden, while very manageable given its strong free cash flow profile, represents the biggest threat to its growth trajectory and dividend payouts. By bringing this burden down, we think AT&T could unlock a lot of shareholder value (by reducing financial risk) and Elliot Management seems to be pushing management to do just that. We would prefer AT&T allocate more towards debt reduction instead of share buybacks.

Management indicated that AT&T was going to begin buying back a meaningful amount of its stock in the medium-term during the firm's second quarter 2019 conference call with investors, indicating deleveraging activities may slow down to make room for share repurchases. Here's what AT&T's CEO Randall Stephenson had to say during the call (emphasis added):

> *"Since we closed the merger last June [in 2018], net debt is down $18 billion.* ***We expect to further reduce net debt about another $12 billion in the second half of the year, and that should get us to a 2.5 times net debt to adjusted EBITDA range by year-end. And to the extent that we can overachieve on that objective, you can expect we'll take a hard look at allocating capital to share buybacks in the back half of the year.*** *Wireless is about half of our overall EBITDA and it continues to fire on all cylinders."*

One of the benchmarks Elliott Management has laid out is for AT&T to bring its leverage ratio down below 2.0x by 2022. By the end of 2019, AT&T's management is aiming for the company's leverage ratio to hit 2.5x (defined as net debt to adjusted EBITDA). The company could pursue additional divestments to enhance its current deleveraging strategy. There's been talk of AT&T divesting DirecTV given the sateliite-TV provider is hemorrhaging subscribers, however, AT&T's management has since pushed back on that notion. AT&T's COO John Stankey sees DirecTV playing a key role in the rollout of the new streaming service HBO Max (AT&T acquired HBO when it purchased Time Warner) next year and assisting in very targeted advertising.

Elliott Management thinks that by following the hedge fund's four-point plan and other recommendations, AT&T could save $5.0 billion a year by reducing its SG&A expenses (Elliott Management sees AT&T's administrative operations being very bloated), outsourcing non-core functions, rationalizing its spending on procurement, and consolidating its facilities. That's an intriguing proposition, but one that might prove overly optimistic.

By the end of 2021, AT&T hopes to realize $1.5 billion in annualized cost synergies and another $1.0 billion in annualzied revenue upside due to its 2018 acquisiton of Time Warner. That $85.4 billion cash-and-stock deal left AT&T heavily indebtied, and set the stage of its push into entertainment and streaming. **It has been reported that DirecTV is considering not renewing its exlcusive contract for the NFL Sunday Ticket, which costs ~$1.5 billion per year according to the WSJ.** AT&T's COO noted recently that it would be hard to justify renewing that contract after the 2022 season ends as the deal no longer generates the kind of synergies and upside it used too. In light of cord cutting efforts, AT&T would rather shift spending to where subscriber counts are growing, not declining.

Keep in mind that rolling out services like HBO Max, which is expected to be an upsized version of HBO with additional content, will push up on operating expenses as new content and administrative staff are required as part of the planned 2020 launch. For instance, Ellen DeGeneres has signed on to produce three shows for HBO Max, and the service has locked in the rights for the very popular but also very expensive 'Friends' sitcom once Netflix (NFLX) loses the rights to the show in 2020. HBO Max is expected to cost more than HBO, which runs at $14.99 per month (plus taxes depending on the location), in order to cover those additional costs. AT&T's streaming strategy isn't looking to compete on price per se as much as on the quality of content to win over subscribers. HBO has produced popular shows like 'Game of Thrones' and the 'The Sopranos' which are generally regarded as Tier 1 content.

It's clear that Elliott Management doesn't agree with AT&T's approach to M&A as well as its media-and-entertainment strategy going forward. AT&T is coming up against some significant competitive headwinds. Beyond established players like Netflix, Hulu (majority owned by Walt Disney Company (DIS), with Comcast (CMCSA) owning the remainder), and Amazon's (AMZN) Prime service, AT&T is also fending off new low-cost competitive threats from free cash flow cows Disney and Apple (AAPL).

AT&T has reportedly hired Goldman Sachs (GS) to fight off Elliott Management's push for change. **Shares of AT&T have started to converge towards their intrinsic value, and we see room for additional upside ahead.** Investors are beginning to take notice of the future free cash flow potential the telecommunications and media giant offers.

Disclosure: *Callum Turcan owns shares of Apple Inc (AAPL).*

Empirical Support for Porter's "Gospel," Plus Comments on the "Head Fake" Rotation

Please note a version of this piece was emailed out to subscribers on September 23.

"Let's be very clear: There is strong empirical quantitative evidence that the price-to-fair value equation ("factor") is predictive of returns, which is what matters for value investors, and in Morningstar's case, the moat assessment is just part of that overarching conclusion (fair value estimate). Researchers continue to attack the moat "factor" on grounds that don't make any sense, in my view, and are cherry-picking parameters to assess value investing." – Brian Nelson, CFA

By Valuentum Analysts

In the latest installment of Valuentum's Economic Roundtable, the team talks more about economic moats (this time, in the context of competitive strategy, in the lens of famous academic Michael Porter and his well-renown 5 Forces model), as well as why the recent rotation from "growth" into "value" may not last. We have lots to say, and let's get things started with the following prompt from the Institutional Investor, The Gospel According to Michael Porter:

Value investing used to be about betting on the underdog — finding the down-and-out losers and gambling that they might have one more fight left in them.

Today's value investors have a new gospel: Harvard Business School professor Michael Porter's Competitive Strategy.

Porter's theory is that power leads to profits. The wider the moat, the greater the market share, the greater a company's ability to squeeze profits from competitors, suppliers, and customers. Porter tells a modern parable of the Five Forces — the professor's signature analysis framework — that gave Goliath a sustainable competitive advantage over David.

But the founder of value investing, Benjamin Graham, was a poor Jewish immigrant who made his name betting on the Davids of the stock market. The legendary Graham believed that investors could make money by betting against consensus when that consensus went against the numbers.

There is perhaps no greater gap between consensus and numbers today than in the application of Porter's competitive strategy to investing. Unlike Graham's quantitative methodology, which has endlessly been empirically proven, Porter's competitive strategy principles have no empirical foundation. There is simply no evidence — not a single quantitative study — to support his conclusions.

Brian Nelson: Boy, where do you begin? Okay, well, there are many types of value investors. For starters, as I write in *Value Trap*, Valuentum is a subset of value investors, and we don't like to bet against the market. We like to bet on undervalued ideas *that are going up*, or ideas that both the market and our team agree are undervalued (we view an appreciating stock price as the market thinking shares should be valued higher). We like betting with the market, not against it. So, the idea that value investors only like "down-and-out-losers" couldn't be further from reality.

Brian: Now onto the second assumption: that value investors *only* focus on competitive strategy, or Porter's 5 Forces, more commonly found in the frameworks of moat analysis. As we talked extensively about in our latest Economic Commentary, "Quant Quake, "Quac-cidental Correlation," and Economic Moats," Porter's 5 Forces analysis, or moat analysis, is only one part of value investing; moat analysis helps in assessing value, but it is not the conclusion, the fair value estimate. The most important part of value investing is buying stocks below an informed estimate of their intrinsic value, or a price-to-fair value estimate ratio far below 1.

The moat may signal a company is a strong economic value-generator, but strong value-creation says little about whether the company may be a bargain. Whether a company is a bargain or value stock is what the price-to-fair value ratio reveals. Quite simply, a wide moat can be overvalued, a no moat can be undervalued, much like a high P/E stock can be undervalued or a low P/E stock can be overvalued. Only through a comparison of a company's price and intrinsic value can the merits of the investment opportunity be considered. In assessing value investing, the P/FV is the ratio to test, not Porter's 5 Forces or the moat "factor."

As I write in *Value Trap*, there are numerous studies from Morningstar and Valuentum that show the predictive power of fair value estimates. In the October/November 2013 edition of Morningstar Advisor magazine, for example, Morningstar noted that the fair value estimate "has significant forecasting capability even when other independent variables such as size, book-to-market ratio, volatility, and momentum are controlled for. The t-stat is 2.83, which indicates that the predictive power is statistically significant at the 1% level."

A huge shout-out to the authors of the piece. It offers excellent quantitative work showing how Porter's 5 Forces or moat analysis can inform the fair value estimate, which is what competitive analysis is intended to do (help enhance the likelihood of risk-adjusted price-to-fair-value convergence). Even though the moat can be viewed as a "factor," much like size or book-to-market or momentum, and that's how it is being presented quantitatively, when it comes to evaluating the merits of value investing, however, only studies that consider a comparison of a company's price with that of its estimated intrinsic value are relevant. The moat is just one part of the value equation.

Valuentum has also run studies on its own fair value estimates. Where the Morningstar study compares the performance of undervalued versus overvalued stocks, a recent Valuentum study from 2017 compared the likelihood of price-to-fair value convergence, itself. In our paper, "How Well Do Enterprise-Cash-Flow-Derived Fair Value Estimates Predict Future Stock Prices," in the bucket of undervalued stocks in the study, more than 80% of fair value estimates resulted in price-to-fair value convergence (closing ~30% price gaps over a future 3-year period, on average). Furthermore, roughly 40% of overvalued stocks converged to their fair value estimates in the study, despite the time of the data in the study occurring during one of the strongest bull markets in history. [In all, ~59% of stocks in the study converged to their estimated intrinsic value estimates.]

Figure 5: 80%+ Convergence of Undervalued Stocks (FV > Price)

	Time Intervals for Convergence								No Convergence in 8
	1	2	3	4	5	6	7	8	
Counts	829	452	295	151	79	42	31	30	475
Percent of Convergence	34.8%	19.0%	12.4%	6.3%	3.3%	1.8%	1.3%	1.3%	19.9%
Average Percent Change for Convergence	9.0%	16.2%	22.8%	27.3%	30.3%	27.0%	22.7%	25.3%	28.2%

Notes: This data set takes into account only the instances in which the fair value estimate at a given point in time was greater than the corresponding price. The number of instances is recorded in the table, as is the percentage of those instances in which price-to-fair value convergence took place within eight time intervals. The average percentage to price-to-fair value convergence is calculated.

Let's be very clear: There is strong empirical quantitative evidence that the price-to-fair value equation ("factor") is predictive of returns, which is what matters for value investors, and in Morningstar's case, the moat assessment is just part of that overarching conclusion (fair value estimate). Researchers continue to attack the moat "factor" on grounds that don't make any sense, in my view, and are cherry-picking parameters to assess value investing. Furthermore, the article that was block quoted above credits the University of Chicago school for simply backtesting that "the best-returning stocks are the small value companies like those Graham invested in…" Walk forward studies regarding these same parameters, however, have indicated a much less-clear picture. In fact, the book-to-market ratio has failed more in live testing than in all of the backtest that made it infamous, and researchers such as AQR's Cliff Asness suggest that there's really not a size effect "factor".

Brian: It's quite the conundrum that this article reveals. Many try to discredit moat investing by looking at it solely as one "factor," but it is just one part of arriving at a fair value estimate, and the fair value estimate is most important. Further, critics of Porter's 5 Forces suggest that there's no empirical evidence supporting Porter's 5 Forces, but there really shouldn't be because it is the price-to-fair value ratio that's most important (the emprical support for Porter's 5 Forces is indirectly revealed in the efficacy of the fair value estimate). Such critics point to the Chicago school's empirical work regarding book-to-market and size, but both of these "factors" just aren't lining up empirically in walk-forward performance, and this is actually how these quantitative factors should be judged, unlike the moat. **The reality is that the price-to-fair value ratio should be the prime value statistical metric to be used in any empirical quantitative value study.**

I don't even think the industry is operating under the correct assumptions to even get close to measuring what it is trying to measure when it comes to value investing. I won't repeat myself too much here, but readers can learn more about what I am talking about in my book *Value Trap*. The bottom line is that an analyst/investor has to understand competitive strategy ("moats") to make good financial forecasts, and the analyst/investor needs to make good financial forecasts to arrive at a good fair value estimate, and the analyst/investor needs a good gap (Benjamin Graham called this gap a margin of safety) between a fair value estimate and the share price to identify a value stock, to become a good value investor. This is just the basic value process.

Valuentum overlays its own unique value process with the view that there really is no "true" fair value estimate, but rather that the goal of value investing is to properly assess what others think the true intrinsic value estimate should be. We combine the enterprise valuation (FCFF) process, which results in a fair value estimate, with behavioral multiple analysis, and technical/momentum indicators to bolster our view on whether price-to-estimated fair value convergence may occur (on the basis of our subjective fair value estimates; the market eventually must agree with us for us to be right). Quantitative research studying backward-looking ambiguous and realized factors, however, is simply confusing "everybody," even while most of the widely-accepted empirical research of the past continues to fail, from the CAPM to the three-factor model and beyond.

Callum Turcan: This is just a thought and something we did touch on in the past, and that comes down to whether the "moat" factor (thinking about the Morningstar study with respect to moats, not the fair value estimate study referenced above) is being misclassified for smaller companies. For example, smaller SaaS companies might have substantially larger moats than first glance (particularly when those SaaS firms reach a certain velocity), as companies like Inovalon Holdings Inc (INOV) and Avalara (AVLR) have large moats created by the regulatory complexities of the environments they are operating in (on top of these types of firms needing to be based in the US or have a serious US presence, which further limits competition as foreign companies are less likely to jump in, a lot less likely given the regulatory complexities and potential legal penalties when doing things wrong when it comes to healthcare and compliance activities).

[INOV and AVLR were recently highlighted in Valuentum's presitigious Exclusive publication: https://www.valuentum.com/articles/20160505]

Matthew Warren: I think the article misses Porter's focus when it talks only about large size and market share as being the end all. Small market cap companies with small market share can dominate a niche and score very well on Porter's 5 Forces. SaaS companies are a great example. I am a believer in the framework as a great tool towards analyzing company moats against the backdrop of industry structure.

Over long periods of time, the stock returns should mirror the fundamental performance of the company, barring massive initial overvaluation. I think Brian's point about Morningstar and Netflix (NFLX) is a great example of where missing an emerging moat on a massive compounder can be a huge error of omission. Missing investing early in Amazon (AMZN) would be a similar story for so many investors.

Also, I would argue Buffett's lower returns in later years are due to the size of Berkshire Hathaway (BRK.A, BRK.B), not the fact the he started focusing on moats.

Matt: If anything, Buffett himself has said he has had to park money in lesser-advantaged companies like utilities due to sheer size.

Callum: To your last point Matt, that was a huge reason behind Berkshire Hathaway's desire to help fund Occidental Petroleum's (OXY) recent purchase of Anadarko Petroleum (ex-ticker APC), buying a $10 billion preferred issue from Occidental that came with a generous (relative to what Occidental's long-term bonds were yielding) 8% coupon along with warrants. Before that, there was the large preferred stake Berkshire took in Goldman Sachs (GS) to help Goldman ride out the Great Financial Crisis, which in the end worked out very handsomely for Berkshire.

These large and extremely lucrative opportunities only come around so often, when Berkshire can lock in a nice 8% return in a bond-like investment (keeping seniority in mind, of course, during adverse economic conditions) on top of upside via warrants while the ten-year US Treasury is yielding ~2% or less.

Matthew: That's true. Size and a huge cash pile definitely gives Berkshire these unique opportunities that usually come up during times of stress. I think Berkshire's size makes it hard for them to buy publicly-traded equities though. Berkshire could take out all of Inovalon, and it wouldn't move the needle.

Callum: Oh for sure Matt--the only needle-moving bet for Berkshire when it comes to publicly-traded equities is to put down tens of billions on a large tech or financial company, but that leaves Berkshire few options on what securities to invest in. Instead of finding alpha across all domestic securities, Buffett and Munger are forced to choose between making a $50 billion bet on Apple (AAPL) and Facebook (FB) or further increasing its exposure to financials given the existing Wells Fargo (WFC) stake, as such a large investment in any other publicly traded firm would likely send equity prices up well north of their intrinsic value. Even a company with a market cap of $200 billion could see shares run higher than Berkshire would like, just given its sheer size. I'm 100% with you there.

Matthew: Invesco posted the following on its blog on September 12, "Be wary of the market leadership rotation."

Callum: I've only seen notes (like this one from Invesco's Krishna Memani) from investors highlighting how the most recent rotation out of "growth" and into "value" is a head fake.

The argument against this being a head fake is that if economic growth stabilizes (due to potential stimulus action in Germany, China managing the slowdown in its economy, and the American consumer remaining strong, among other factors) and interest rates begin to structurally increase, then the justification for hiding out a recession in secular growth plays becomes weaker potentially driving greater investor interest in "value" plays (industrials and other cyclical plays) thus maintaining the rotation. I doubt the outlook for the global economy will change anytime soon as things are still sharply slowing down in developed markets all across the globe.

Brian: I generally agree with the takeaway from the piece not to "let the talk of rotation or regime change sway you into making meaningful changes in your portfolio." While we may have a similar conclusion as Invesco, the reasoning is somewhat different. The recent rotation from "growth" into "value" was backed by rising interest rates and more optimism surrounding the economy.

One might expect rising interest rates to hurt long-duration high growth equities as the larger cash flows further into the future are worth less (given the discount mechanism of rates), while global economic growth may not necessarily benefit the secular growers as much as those beholden to the general economic cycle (cash flows of secular growers are less dependent on core growth than cyclicals).

That's why under a scenario of lower rates and lower economic growth, which is what we are generally expecting over the longer haul (relative to the opposite conditions experienced more recently that have driven the "rotation"), high growth equities may continue to win against what is traditionally viewed as their "value" counterparts. The value of the long-duration cash flows of traditional "value" equities aren't as sensitive to interest rates, and general economic conditions are more impactful to them.

Brian: The situation that Invesco lays out is rather consistent with the Theory of Universal Valuation, and the takeaway is rather independent of "growth" versus "value" talk, too, as we generally view many of the fast-growing equities on the market today as undervalued, also consistent with the Theory of Universal Valuation. Where some talk "value" versus "growth," we continue to expect undervalued, growthy portfolio constituents that are revealing strong momentum to do well. Note how many of our best undervalued ideas are "growth" stocks.

Matthew: My inclination is that Mr. Memani is right. I think we are heading for slow growth at best or more likely right into a recession in the next 6-18 months. That's just my best guess and not something that's investible. If I'm right, the rotation is definitely a head fake.

I think the latest Fed cut is a Rorschach test. To me, they are cutting ahead of a recession. Others will hope it's a mid-cycle "insurance" cut that gives growth a boost. (I don't think rate cuts will be a meaningful boost to the real economy).

Here's what Buffett has to say about value versus growth:

> *But how, you will ask, does one decide what [stocks are] "attractive"? Most analysts feel they must choose between two approaches customarily thought to be in opposition: "value" and "growth,"...We view that as fuzzy thinking...Growth is always a component of value [and] the very term "value investing" is redundant. -- Warren Buffett, Berkshire Hathaway annual report, 1992*

-- THE HIGH YIELD DIVIDEND SPOTLIGHT IS ON THE NEXT PAGE --

High Yield Spotlight: Covering Crown Castle (CCI), One of America's Largest Cell Tower REITs

Crown Castle (CCI)--3.3% yield—is a cell tower REIT that bills itself as the largest provider of shared communications infrastructure in the United States. Crown Castle officially became a REIT in January 2014 for the tax benefits. Supported by ~40,000 cell towers, ~65,000 small cell nodes (either operational or under construction), and ~75,000 route miles of fiber, Crown Castle services every major domestic market. We like the REIT's free cash flows and investment grade credit rating (BBB-/Baa3/BBB), but note that like most REITs, Crown Castle comes with a fair amount of leverage. Crown Castle is very well positioned to capitalize on the upcoming rollout of 5G across the US. From the start of 2014 to the Fall of 2019, Crown Castle's quarterly dividend per share has grown from $0.35 to $1.125, with AFFO growth expected to keep the momentum going (albeit at a slower pace than in the recent past).

During Crown Castle's second quarter 2019 earnings update, management modestly increased the REIT's full-year revenue, adjusted EBITDA, and AFFO guidance. Crown Castle is targeting ~8% growth in AFFO per share this year. On an annualized basis, the REIT is targeting a ~76% AFFO payout ratio (most recent dividend payout on an annualized basis per share divided by expected AFFO per share) in 2019, which is solid. AFFO payout ratios below 80% provide a buffer in case exogenous shocks stymie the financial performance of the REIT in question. The graphic down below showcases Crown Castle's guidance for 2019:

OUTLOOK FOR FULL YEAR 2019

(dollars in millions, except per share amounts)	Full Year 2019
Site rental revenues	$4,950 to $4,980
Site rental cost of operations[d]	$1,442 to $1,472
Net income (loss)	$896 to $956
Net income (loss) attributable to CCIC common stockholders	$783 to $843
Net income (loss) per share—diluted[e][f]	$1.88 to $2.02
Adjusted EBITDA[g]	$3,393 to $3,423
Interest expense and amortization of deferred financing costs[h]	$674 to $704
FFO[f][g][i]	$2,363 to $2,393
AFFO[g][i]	$2,464 to $2,494
AFFO per share[e][g][i]	$5.90 to $5.97

Image Shown: *Crown Castle expects high single-digit growth in its AFFO per share in 2019.* ***Image Source:*** *Crown Castle - Second Quarter 2019 Supplement Information Package*

At the end of June 2019, Crown Castle had $0.1 billion in short-term debt and $17.5 billion in long-term debt on the books versus just $0.4 billion in cash, cash equivalents, and restricted cash on hand. On a trailing-twelve month basis, Crown Castle's net debt to adjusted EBITDA ratio stood at 5.0x at the end of June 2019. Crown Castle remains capital market dependent and we would like to see the REIT's leverage ratios move down somewhat from current levels. **While Crown Castle is quite levered, please note its annual free cash flows averaged $0.8 billion from 2016-2018.** That wasn't enough to cover $1.6 billion in total annual dividend payments on average during this period, but **REITs with meaningful free cash flows generally have an easier time retaining access to capital markets as compared to those that aren't consistently free cash flow positive.**

In June 2019, Crown Castle announced that the size of its revolving credit line had been increased by $0.75 billion and that the maturity date of the now $5.0 billion revolver was pushed back to June 2024. Crown Castle's revolving credit line carries an interest rate of LIBOR plus 1.00%-1.75% depending on its unsecured credit rating. That's on top of a modest commitment fee (on the amount drawn) which is also influenced by Crown Castle's unsecured credit rating. As of June 30, 2019, that interest rate on that revolver stood at 3.5% with only $0.5 billion of its capacity drawn. Furthermore, Crown Castle issued a combined $0.9 billion in 3.1% Senior Notes due 2029 and 4.0% Senior Notes due 2049 in August 2019 at near face value. **This indicates Crown Castle retains access to capital markets at attractive rates.**

Crown Castle's growth trajectory is very promising as we enter the early stages of the 5G era. First, a brief history of US capital investment in wireless infrastructure. As you can see in the graphic below, every major wireless transition (from 2G to 3G to 4G) led to sharp increases in capital expenditures on network infrastructure. Rising capital expenditures on US wireless infrastructure to support the rollout of 5G extends Crown Castle's growth trajectory as there's an ever greater need for cell towers, small cell nodes, and fiber optic cabling. A longer growth runway allows for better dividend growth opportunities. Additionally, greater US wireless investment helps ensure high utilization rates at Crown Castle's existing assets, along with room to push through organic revenue increases via higher fees over time.

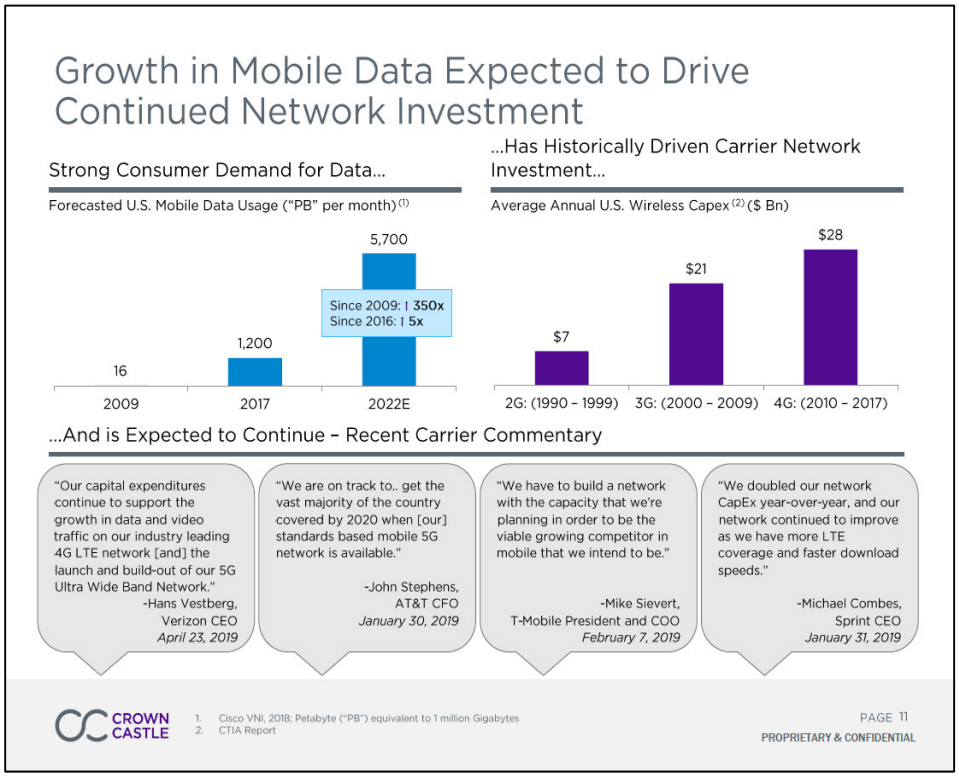


Image Shown: *Every transition in the telecommunication space has led to material increases in the levels of annual capital investment on network infrastructure in the US.* ***Image Source:*** *Crown Castle – IR Presentation*

Growth in mobile data usage is expected to be explosive as you can see in the graphic on the next page, with US mobile data traffic expected to rise five-fold from 2017 to 2022. Download speeds at 5G are fast enough to enable entire movies and TV shows to be downloaded in mere seconds, which is largely why Crown Castle (citing data from Cisco Systems (CSCO)) sees mobile video rising to 80% of total mobile traffic by 2022, up from 64% in 2017. A better mobile experience will drive growth in the total number of connected devices in the US, further strengthening the trend of rising domestic data consumption.

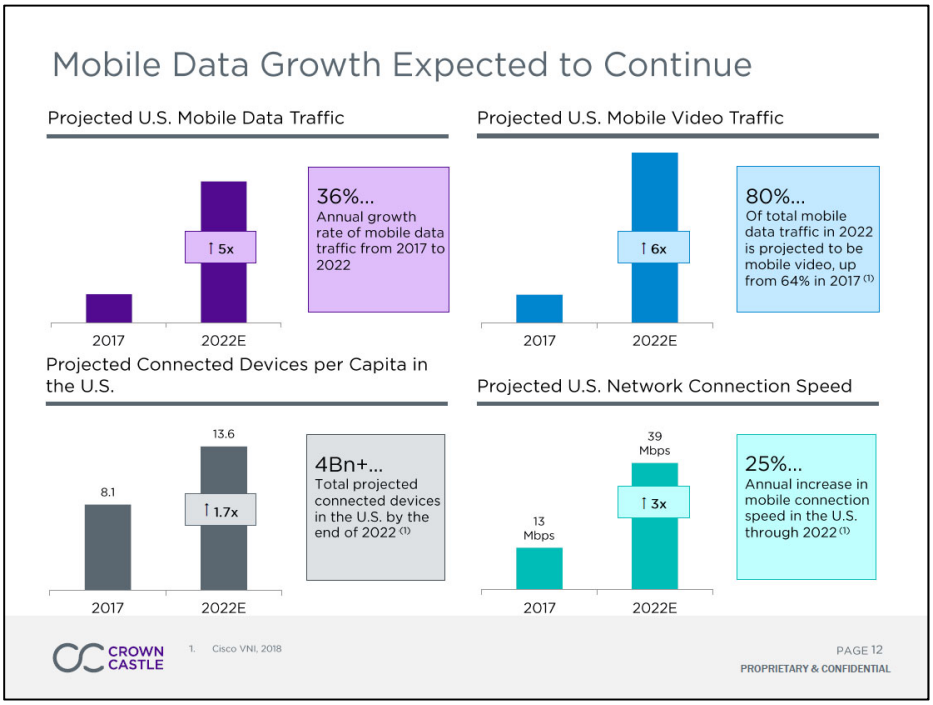


Image Shown: *Crown Castle sees secular growth trends supporting its long-term financial trajectory.* ***Image Source:*** *Crown Castle – IR Presentation*

Crown Castle's future financials are supported by long-term agreements with its tenants. At the end of June 2019, the REIT had ~$24 billion in remaining contract payments from its tenants with a weighted-average remaining contract term of five years. The REIT had a little over two tenants per tower at the end of June 2019. **Crown Castle notes that its returns grow meaningfully when catering to multiple tenants at the same cell tower, largely due to the ability to leverage existing infrastructure.**

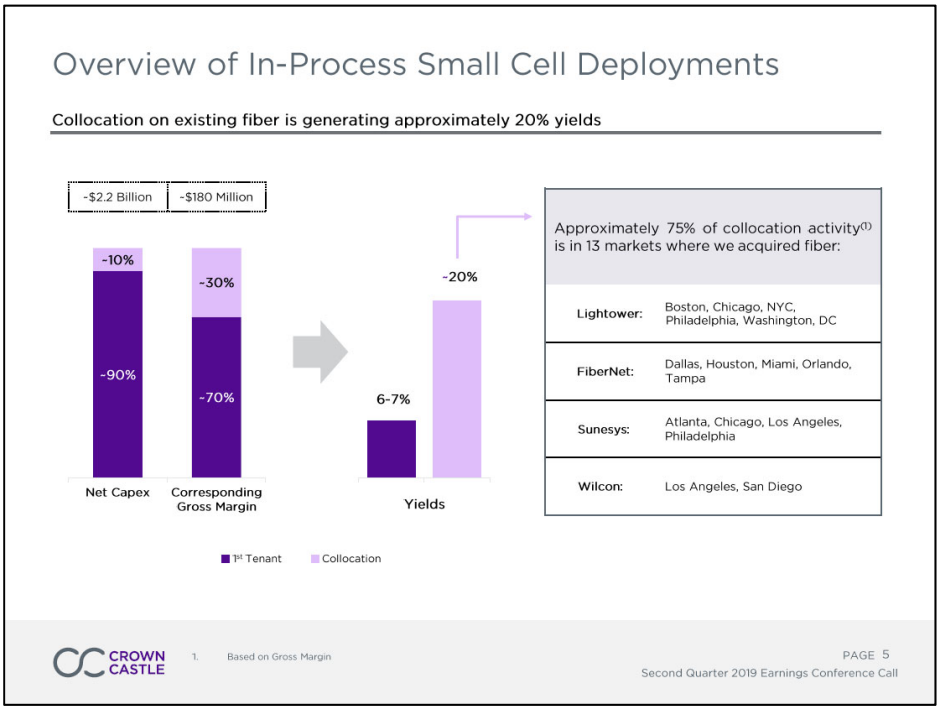


Image Shown: *Colocation substantially enhances Crown Castle's project economics.* ***Image Source:*** *Crown Castle – IR Presentation*

Here's what Crown Castle's CEO Jay Brown had to say concerning colocation projects and the expected returns, from the REIT's second quarter 2019 conference call with investors (emphasis added):

> *"When these projects are complete [regarding small cell nodes and other related infrastructure under construction], we expect to have invested just over $2 billion of capital, both to build new systems for anchor tenants and to co-locate new small cells on existing fiber networks.* ***These projects are expected to generate a recurring yield of approximately 8%, the blend of first tenant economics in the 6% to 7% range and co-location economics of approximately 20%, which is consistent with our disciplined underwriting requirements.***
>
> *As the data shows, similar to the development of the tower business, we are seeing significant demand from multiple customers for the same asset, which results in co-location economics.* ***The small cell co-location on existing fiber accounts for nearly 30% of the incremental cash flows we expect to generate from these projects, but only 10% of the incremental capital investment.*** *This operating and capital leverage is very much like what the tower business has exhibited over time, and we believe our strategy of investing early in fiber for small cells will pay off in much the same way that our early investment in towers continues to. And whether we have built or acquired the fiber, we are seeing co-location economics as we add small cell customers to the existing fiber.* ***To that end, approximately 75% of the co-location activity is coming from the markets where we acquired the fiber in recent years.****"*

5G requires a lot denser infrastructure than previous telecommunications rollouts. Part of this process involves using an enormous amount of small cell nodes, attached to things such as streetlights, utility poles, etc., about a couple hundred feet apart with each of those small cell nodes connected to fiber optic cabling. That creates a lot of potential revenue generating opportunities for a company like Crown Castle.

Management did note that local permitting issues were delaying the construction time of these projects, sometimes by a significant margin (average construction times per small cell node is now expected at 18-36 months, up from 18-24 months previously). **However, the company still expects to bring 10,000 small cell nodes online in 2019. That's up ~30% from 2018 levels, even if that's at the lower end of Crown Castle's previous forecast (called for 10,000-15,000 small cell nodes to be completed in 2019).** Over the long-term, management doesn't think permitting delays will have a significant impact on the REIT's growth trajectory.

Crown Castle has a tad more leverage than we would like, but its dividend is still well supported by free cash flows, access to capital markets, and strong secular growth tailwinds. The rollout of 5G combined with colocation economics should go a long way in bolstering Crown Castle's future financial performance.

Disclosure: *Callum Turcan does not own any of the securities mentioned in the article above.*

Portfolio Holding: Global X Super Income Preferred ETF (SPFF)

By Matthew Warren

In this piece, we are going to take a closer look at the Global X Super Income Preferred ETF (SPFF), which has a 10% weighting in the High Yield Dividend Newsletter portfolio. **SPFF yields ~6.6% on a trailing-twelve month basis as of this writing.** SPFF is based on and is supposed to largely mirror the underlying index which is the S&P Enhanced Yield North American Preferred Stock Index. It "invests in 50 of the highest yielding preferreds in the U.S. and Canada." Please see some of the summary facts below:

FUND DETAILS	As of 9/20/19
Key Facts	
Ticker	SPFF
Inception Date	7/16/12
CUSIP	37950E333
ISIN	US37950E3339
Bloomberg Index Ticker	SPPEYN
Primary Exchange	NYSE Arca
Stats & Fees	
Net Assets	$196,412,374
NAV	$11.73
Shares Outstanding	16,750,000
Total Expense Ratio	0.58%
Distributions	
30-Day SEC Yield	5.85%
12-Month Dividend Yield	6.58%
Distribution Yield	5.77%
Distribution Frequency	Monthly

Image Source: *Global X Website*

As you can see up above, the ETF makes monthly distributions and has done so each month since inception on 07/16/2012. Please be sure to check with your tax advisor: "Income from preferred stocks may be treated as qualified dividends (QDI), rather than as interest income." With that out of the way, let's now have a look at the historical performance of the SPFF ETF, which is highlighted in the upcoming graphic on the next page.

PERFORMANCE HISTORY

PREMIUM DISCOUNT CHART

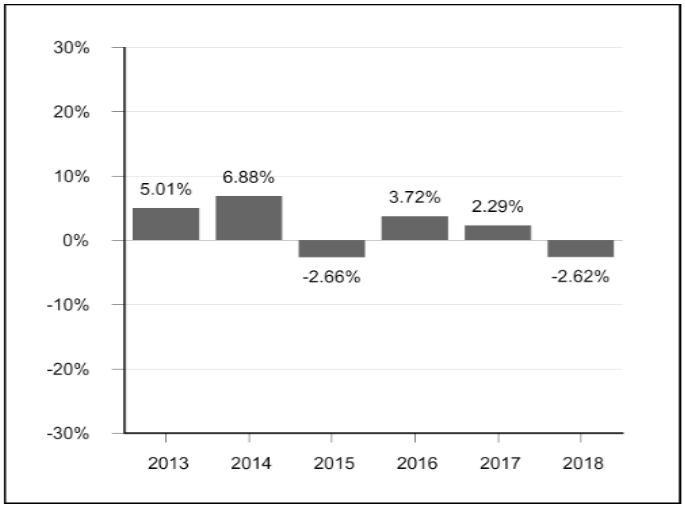
Cumulative % Data as of month end (8/31/19)	FUND NAV	CLOSING PRICE	INDEX
1 Month	0.25%	0.16%	0.28%
3 Months	3.02%	3.02%	3.22%
6 Months	4.07%	4.16%	4.35%
Since Inception	27.33%	29.44%	33.09%
Avg Annualized % Data as of month end (8/31/19)	**FUND NAV**	**CLOSING PRICE**	**INDEX**
1 Year	3.35%	3.45%	3.62%
3 Years	1.61%	1.49%	2.14%
5 Years	1.81%	1.79%	2.49%
Since Inception	3.45%	3.69%	4.09%
Avg Annualized % Data as of quarter end (6/30/19)	**FUND NAV**	**CLOSING PRICE**	**INDEX**
1 Year	3.72%	4.07%	3.93%
3 Years	1.62%	1.65%	2.11%
5 Years	1.68%	1.65%	2.33%
Since Inception	3.28%	3.53%	3.91%

Cumulative return is the aggregate amount that an investment has gained or lost over time. Annualized Return is the average return gained or lost by an investment each year over a given time period.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost and current performance may be lower or higher than the performance quoted.

Image Source: *Global X Website*

As you can see, even with dividends included, the total return of this ETF has not been stellar since inception, with an average annualized return of 3.69% since inception on a closing price basis. **But then, this historical return has led us to the present moment when the SPFF offers a 6.6% yield when the ten-year US government bond offers less than a 2% yield.** While the ETF's closing price has traded close to NAV, it has trailed the index over all periods, largely due to the total expense ratio of 0.58%, an amount that we find reasonable considering the nature of the ETF.



Best Quarter:	03/31/14	4.53%
Worst Quarter:	12/31/18	-4.60%

Image Source: *Global X Website*

Let's continue by inspecting the top 10 holdings of the SPFF, which you can see in the graphic below. Banks make up most of the preferred share holdings with some other financials sprinkled in as well along with a REIT and a utility. In total, the top 10 positions make up just over 37% of the total ETF:

Global X SuperIncome Preferred ETF				
Fund Holdings Data as of 09/20/2019				
% of Net Assets	Name	Market Price ($)	Shares Held	Market Value ($)
5.256	ALLY 7.94313 02/15/40	26.18	394,332.00	10,323,611.76
5.015	HSBC 6.2 PERP	26.37	373,534.00	9,850,091.58
4.074	USB 6 1/2 PERP	27.96	286,207.00	8,002,347.72
3.581	VER 6.7 PERP	25.58	274,963.00	7,033,553.54
3.434	DB 8.05 PERP	26	259,419.00	6,744,894.00
3.416	AEGON 6 3/8 PERP	26	258,080.00	6,710,080.00
3.388	CNP 7 09/01/21	52.6	126,539.00	6,655,951.40
3.074	WFC 6 5/8 PERP	28.01	215,556.00	6,037,723.56
2.982	JPM 6.15 PERP	25.84	226,675.00	5,857,282.00
2.898	COF 6 PERP	25.35	224,547.00	5,692,266.45
37.118				

Image Source: *Global X Website*

However, because the ETF holds multiple preferred shares from some issuers, let's look at the top ten exposures to a given corporate issuer in the below graphic:

Global X SuperIncome Preferred ETF				
Fund Holdings Data as of 09/20/2019				
% of Net Assets	Name	Market Price ($)	Shares Held	Market Value ($)
2.224	MS 7 1/8 PERP	28.95	150,896.00	4,368,439.20
2.135	MS 6 7/8 PERP	28.24	148,521.00	4,194,233.04
1.144	MS 6 5/8 PERP	25.82	87,029.00	2,247,088.78
5.503				
2.532	C 8.63575 10/30/40	27.32	182,092.00	4,974,753.44
1.742	C 6 7/8 PERP	28.12	121,693.00	3,422,007.16
1.115	C 7 1/8 PERP	28.46	76,962.00	2,190,338.52
5.389				
3.434	DB 8.05 PERP	26	259,419.00	6,744,894.00
1.924	DB 6.55 PERP	24.93	151,597.00	3,779,313.21
5.358				
5.256	ALLY 7.94313 02/15/40	26.18	394,332.00	10,323,611.76
5.015	HSBC 6.2 PERP	26.37	373,534.00	9,850,091.58
2.531	GS 6 3/8 PERP	27.97	177,776.00	4,971,630.28
2.407	GS 6.3 PERP	26.95	175,492.00	4,729,509.40
4.938				
2.898	COF 6 PERP	25.35	224,547.00	5,692,266.45
1.679	COF 6.7 PERP	25.29	130,425.00	3,298,448.25
4.577				
4.074	USB 6 1/2 PERP	27.96	286,207.00	8,002,347.72
2.501	NLY 6.95 PERP	26.02	188,862.00	4,914,189.24
1.408	NLY 6 1/2 PERP	24.95	110,853.00	2,765,782.35
3.909				
1.825	BAC 6.2 PERP	26.27	136,485.00	3,585,460.95
1.807	BAC 6 1/2 PERP	25.59	138,700.00	3,549,333.00
3.632				
47.651				

Image Source: *Global X Website*

You can see that the top ten exposures make up nearly 48% of the total ETF. All these issuers are financials and most of them are amongst the largest of large banks. Preferred shares are bond-like instruments, but they are lower in the pecking order than bonds (but above common equity) in the case of a bankruptcy. Even when banks started failing in the great financial crisis (GFC,) the government (Fed and US Treasury) started working out plans to protect the largest and most systemically important financial institutions across the country. Let's cover some background on how to think about preferred in the capital stack, as it relates to banks more specifically, and how we got here from the GFC.

Hypothetically, if a government lets equity holders fail, then newly issued equity funding would dry up. **If preferred shares were to then get wiped out, perceived shaky banks would be unable to rollover their preferred funding when it comes due and additional funding would be required.** Years ago, the Treasury asked Congress passed the Troubled Asset Relief Program (TARP), which was signed into law by then President Bush. **Amongst other things, this allowed the Treasury to make preferred equity investments into some of the largest US banks, thereby shoring up confidence that they had enough capital to weather the storm of bad assets taking place, especially with mortgages and asset-backed securities.**

The reason we bring up the past and the GFC is this stress case provides a bit of a model about how a similar financial crisis might be handled if it were to happen again. While the regulators would have you believe that they wouldn't conduct a massive bailout program in the future and would instead have the banks fail in an orderly fashion (in fact, living wills have been formed and new laws/regulations put in place to facilitate "orderly" failures), we think this generally only applies to one-off bank failures, in our view.

If the bank failures were widespread, we think the government would be forced to step in again at either the preferred or the equity level with bailouts (which would help protect the bank preferred holdings in the SPFF ETF). Failing this, a Great Depression might easily follow a the next financial crisis, one that might cause the country's largest banks to fail in spectacular domino fashion. The reason being is that the big banks are essential plumbing to the house that is the US economy. If credit stopped flowing, there would be a backup in economic activity, a flood of defaults, and a substantial step backwards in GDP.

If you agree with our analysis, then you would join me in the conclusion that the largest US banks preferred shares would be safe even if another considerable financial crisis were to emerge. The same cannot necessarily be said for some of the foreign issuers, though we think Germany (Deutsche Bank) and the UK (HSBC) would likely follow the same playbook. **It is really some of the smaller or less important issuers where the risk of bankruptcy during a financial crisis comes into play, though there aren't too many of those institutions included in this ETF.** Regarding a more normal macro-economic environment, the issuers' preferred shares are protected by the cushion of net income available to common shareholders, so let's have a quick look at the earnings power of the top 10 issuers in the form of return on common equity and return on tangible common equity.

As you can see in the upcoming graphic on the next page, all the top 10 issuers except for Deutsche Bank and Annaly Capital Management have a nice cushion of earnings attributable to common shareholders that could get wiped out before there were any pressure on preferred shareholders. In the case of Deutsche Bank, it is a national champion and clearly systemically important to Germany and the overall Eurozone. We believe it would be protected from failure in all but the most severe circumstances. If protected from failure, it would most likely be with capital injected at the common or (equal to SPFF holders) at the preferred level. Fair warning that this is an analytical hypothesis, which might not play out in the real world under severe stress. **As for Annaly, it has produced income attributed to common shareholders in 3 out of the past 5 years in an amount that outweighed the losses in the other two years at an approximately 3/1 ratio.** These cumulative earnings are substantially larger than the dividends on preferred stock paid out every year.

Global X SuperIncome Preferred ETF			
Fund Holdings Data as of 09/20/2019			
% of Net Assets	**Name**	**2018 ROE (%)**	**2018 ROTCE (%)**
2.224	MS 7 1/8 PERP	11.5%	13.2%
2.135	MS 6 7/8 PERP		
1.144	MS 6 5/8 PERP		
5.503			
2.532	C 8.63575 10/30/40	9.4%	10.9%
1.742	C 6 7/8 PERP		
1.115	C 7 1/8 PERP		
5.389			
3.434	DB 8.05 PERP	0.0%	1.0%
1.924	DB 6.55 PERP		
5.358			
5.256	ALLY 7.94313 02/15/40	9.4%	12.3%
5.015	HSBC 6.2 PERP	7.7%	8.6%
2.531	GS 6 3/8 PERP	13.3%	14.1%
2.407	GS 6.3 PERP		
4.938			
2.898	COF 6 PERP	12.5%	18.6%
1.679	COF 6.7 PERP		
4.577			
4.074	USB 6 1/2 PERP	15.4%	19.3%
2.501	NLY 6.95 PERP	NA	NA
1.408	NLY 6 1/2 PERP		
3.909			
1.825	BAC 6.2 PERP	11.0%	15.5%
1.807	BAC 6 1/2 PERP		
3.632			
47.651			

Image Source: *Company Annual Reports and Earnings Presentations*

Having discussed the crux of the risk-reward, let's focus on an additional risk or two. As previously mentioned, preferred shares are bond-like investments. As such, they should also be very sensitive to interest rates. When rates go up by a meaningful amount, the cash flow stream is worth less, and vice versa. Rates have come way down over the past year, which has served as a positive catalyst. Though, rates have then recently backed up a bit, taking some momentum out of the value of preferred shares and other bond-like instruments. This hard-to-predict back and forth at the whim of the bond markets should continue for bond-like instruments like the SPFF.

The final risk that I want to discuss that comes with the 6.6% yield offered by SPFF is that of tracking and liquidity. SPFF attempts to mirror an underlying index which requires trading liquidity in each underlying issue. The issues form the overall Net Asset Value (NAV.) The SPFF ETF trades on the exchange and can trade at a premium or discount to NAV. In a case where a large shareholder or group of shareholders were selling SPFF, it is possible that it might be hard to sell some of the underlying issues, causing liquidity problems and the potential for the value of those illiquid

securities to trade lower. The SPFF could then trade at a larger discount to NAV, causing more holders to want to sell. And that vicious circle could continue in a very distressed type of market environment such as a financial crisis. This is true of all ETFs but is certainly true of one holding a lot of bank preferred stocks in the situation of a financial crisis.

Setting this tail risk aside, and if you agree with our hypothesis that the powers that be would come to the rescue of systemically important financial institutions, **it seems like SPFF is offering a substantial yield premium over 10 year US Treasury Bonds and the opportunity for investors to pick up substantial yield of 6.6%, if they require it to fund their retirement.**

Disclosure: *Matthew Warren does not own shares in any of the securities mentioned above.*

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Disclosure: *Brian Nelson and Matthew Warren do not own any shares of any securities mentioned in their authored articles. Callum Turcan owns shares of Apple Inc (AAPL). Please contact info@valuentum.com for more information regarding Valuentum's editorial policies.*

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We can't begin to tell you how excited we are about the high yield space during 2019. We think we did pretty good during 2018 given the uncertainty regarding Fed policy, but as you've noticed since the December 2018 bottom in the market, high yield dividend equities have come roaring back!

We think this is the beginning of what could be a nice run in the space given a more "dovish" stance by Fed policy. We also think the High Yield Dividend Newsletter portfolio positions us fairly well for whatever the market may throw at us. We're pretty well-diversified, and we've started to identify some pretty good individual equity ideas of late.

The high yield dividend equity arena trades a lot like junk bonds, meaning that interest rates play a key role in how equities will perform. As interest rates fall, high yield stays in vogue, but as interest rates rise, many look elsewhere. This impacts pricing greatly.

We're laser focused on identifying high yielding stocks that have sustainable yields, and if the income stream becomes threatened, we won't hesitate to say goodbye to a name. The 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 Div Yield
CORE			
Alerian MLP ETF	AMLP	5.0%	8.49%
Global X SuperDividend ETF	SDIV	5.0%	9.87%
Global X SuperIncome Preferred ETF	SPFF	10.0%	6.51%
iShares International Select Dividend ETF	IDV	5.0%	6.31%
iShares MSCI Australia ETF	EWA	5.0%	5.48%
iShares U.S. Preferred Stock ETF	PFF	5.0%	5.59%
PowerShares Senior Loan Portfolio	BKLN	5.0%	5.04%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	6.37%
Utilities Select Sector SPDR	XLU	5.0%	2.96%
Vanguard Real Estate ETF	VNQ	10.0%	3.29%
EQUITY			
AT&T	T	5.0%	5.39%
BP PLC	BP	5.0%	6.48%
CubeSmart	CUBE	5.0%	3.65%
Digital Realty Trust	DLR	5.0%	3.33%
Enterprise Products Partners	EPD	5.0%	6.16%
Magellan Midstream Partners	MMP	5.0%	6.10%
Philip Morris	PM	5.0%	6.16%
Public Storage	PSA	5.0%	3.26%
Cash*	-	0.0%	2.25%
		100.0%	**5.51%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 10/1/2019. Est. Div. Yield retrieved from YahooFinance.

** Reflects high end of federal funds rate*

SCREEN OF THE MONTH – THE FINANCIALLY-HEALTHIEST DIVIDEND PAYERS YIELDING OVER 2%

The following is a list of stocks that have the highest multiplicative combination of their dividend yield and Dividend Cushion ratio, per our estimates. We exclude the business models of master limited partnerships and real estate investment trusts in this screen and focus exclusively on corporates. We also make a few other tweaks with respect to business model risk considerations.

Income investors have a lot to choose from, and this screen is one of our favorites -- it focuses on identifying the financially-healthiest dividend-payers with yields over 2%. We've overlaid the screen with an Economic Castle assessment to consider business-model risk, too!

Note: *The 'Multiple' in this list considers a company's dividend yield and Dividend Cushion ratio as a multiplicative combination. Though it is a robust and largely objective measure, there could be exogenous or secular dynamics that could impact the business, where a dividend may not be as strong as the financials indicate. This screen was included in the June edition of the Dividend Growth Newsletter.*

Company Name	Symbol	Sector	Div Yield	Economic Castle	Multiplier
General Motors	GM	Consumer Discretionary	4.1%	Attractive	14.13
Alliance Resource Partners	ARLP	Energy	12.6%	Attractive	12.89
Gilead Sciences	GILD	Health Care	3.9%	Very Attractive	12.17
Fluor	FLR	Industrials	2.9%	Attractive	11.79
Lear Corp	LEA	Consumer Discretionary	2.8%	Attractive	10.98
Guess	GES	Consumer Discretionary	2.7%	Attractive	10.48
Automatic Data Processing	ADP	Information Technology	2.1%	Very Attractive	10.36
Abercrombie & Fitch	ANF	Consumer Discretionary	3.1%	Attractive	10.17
Hewlett-Packard	HPQ	Information Technology	3.1%	Attractive	9.74
Bristol-Myers Squibb	BMY	Health Care	3.4%	Very Attractive	9.29
Western Union	WU	Information Technology	4.5%	Neutral	9.22
American Eagle	AEO	Consumer Discretionary	2.6%	Attractive	9.19
Gap	GPS	Consumer Discretionary	3.6%	Attractive	8.46
Caterpillar	CAT	Industrials	3.0%	Very Attractive	8.41
Total	TOT	Energy	5.1%	Neutral	8.27
Huntsman	HUN	Materials	2.7%	Attractive	8.25
Omnicom	OMC	Consumer Discretionary	3.5%	Unattractive	8.01
Dick's Sporting	DKS	Consumer Discretionary	3.0%	Attractive	7.96
Tapestry	TPR	Consumer Discretionary	4.1%	Attractive	7.93
Foot Locker	FL	Consumer Discretionary	2.3%	Attractive	7.74
QUALCOMM	QCOM	Information Technology	3.6%	Very Attractive	7.71
H&R Block	HRB	Consumer Discretionary	3.7%	Very Attractive	7.67
Archer-Daniels-Midland	ADM	Consumer Staples	3.3%	Attractive	7.66
Walgreens Boots Alliance	WBA	Consumer Staples	3.3%	Attractive	7.64
AVX Corp	AVX	Information Technology	2.5%	Attractive	7.50
Manpower	MAN	Information Technology	2.4%	Attractive	7.47
Ford	F	Consumer Discretionary	6.5%	Neutral	7.47
Amgen	AMGN	Health Care	3.1%	Very Attractive	7.37
Ethan Allen	ETH	Consumer Discretionary	4.0%	Unattractive	7.31
Cisco	CSCO	Information Technology	2.6%	Very Attractive	7.17
Applied Materials	AMAT	Information Technology	2.0%	Very Attractive	7.01
Harley-Davidson	HOG	Consumer Discretionary	4.2%	Attractive	6.97
Cardinal Health	CAH	Health Care	4.2%	Attractive	6.95
Novartis	NVS	Health Care	3.0%	Attractive	6.93
AmerisourceBergen	ABC	Health Care	2.0%	Very Attractive	6.92
Paychex	PAYX	Information Technology	2.8%	Very Attractive	6.92
Cheesecake Factory	CAKE	Consumer Discretionary	2.8%	Attractive	6.86
Altria Group	MO	Consumer Staples	6.7%	Very Attractive	6.78
Johnson & Johnson	JNJ	Consumer Staples	2.9%	Attractive	6.73
KLA-Tencor	KLAC	Information Technology	2.4%	Very Attractive	6.69
Williams-Sonoma	WSM	Consumer Discretionary	3.4%	Attractive	6.69
ABB	ABB	Industrials	4.4%	Attractive	6.62
Garmin	GRMN	Industrials	2.9%	Attractive	6.59
Weyerhaeuser	WY	Materials	5.4%	Attractive	6.55
Best Buy	BBY	Consumer Discretionary	2.7%	Very Attractive	6.53
British American	BTI	Consumer Staples	6.6%	Unattractive	6.53
Tupperware	TUP	Materials	3.7%	Attractive	6.53
Hillenbrand	HI	Consumer Discretionary	2.5%	Attractive	6.52
Taiwan Semiconductor	TSM	Information Technology	3.2%	Attractive	6.48
Cedar Fair	FUN	Consumer Discretionary	6.9%	Attractive	6.40

Note: The 'Multiple' in this list considers a company's dividend yield and Dividend Cushion ratio as a multiplicative combination. Though it is a robust and largely objective measure, there could be exogenous or secular dynamics that could impact the business, where a dividend may not be as strong as the financials indicate.

For example, there may be stocks that are dealing with a secular shift toward digital consumption or navigating changing consumer preferences as millennials seek 'experiences' not 'things' (e.g. fashion). These may not be the best dividend growth stocks to consider. The Dividend Cushion is only one factor that we use in assessing the overall health of a company's dividend.

DIVIDEND REPORT PAGE 2 – FORD MOTOR COMPANY (F)

Ford F FAIRLY VALUED

Buying Index™ 4 Value Rating

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Neutral	$7.00 - $14.00	HEALTHY	POOR / 1.2	VERY POOR	6.45%

Assessment of Company Dividend Strategy

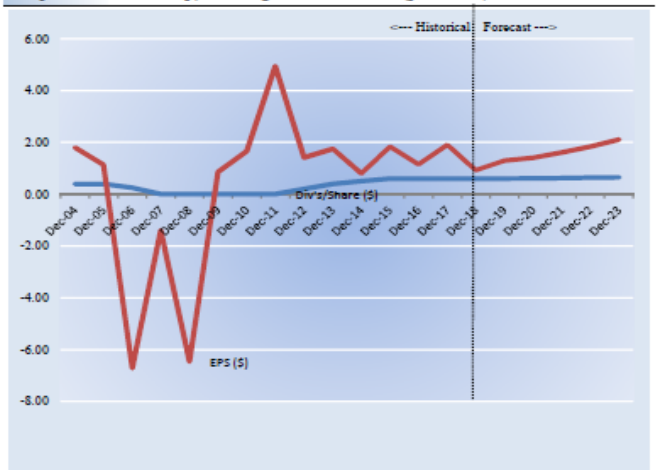
Key Strengths

Ford has benefit materially from the pent-up demand that persisted following the Great Recession, but US sales levels have likely peaked. Ford's expectations for 2019 financial results are for 'potential improvement from 2018,' as it works to execute on the strategy laid out in 2018. We're huge fans of the 'One Ford' movement, and we like that the executive team continues to brew a culture of innovation. Ford may be the most resilient of any domestic automaker, but its credit rating was recently downgraded to one notch above junk. Cyclical troughs are notoriously difficult to navigate for capital-intensive manufacturers, and we're keeping an eye on investment levels in emerging opportunities.

Potential Weaknesses

There was a time when many thought the entire domestic auto industry was going to fold, where sustaining a dividend payout by one of the Big 3 was a mere afterthought. No – this wasn't during the Great Depression during the 1930s. This was during the Financial Crisis of 2009 that claimed some of the strongest domestic automakers in bankruptcy, including GM and Chrysler. Pent-up demand and a strong product line-up have aided Ford's fortunes during the past few years, but relatively high fixed costs, commodity input exposure, and cyclical end market demand mean long-term dividend prospects remain uncertain. The company's financial debt load adds to our concerns, and competition in the next generation of autos is only heating up.

Graphical Relationship, Earnings and Dividends (per share)

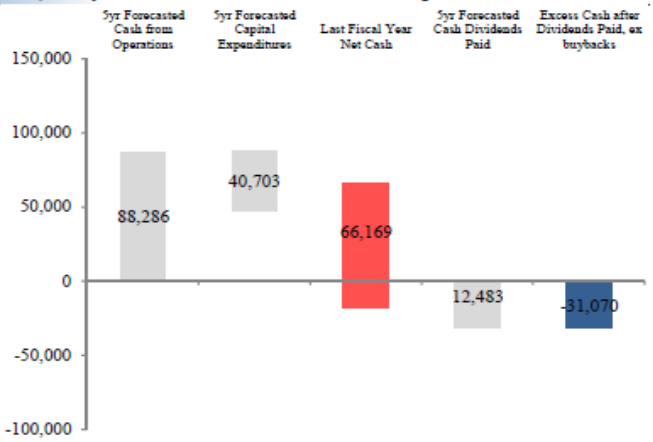


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. Ford'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

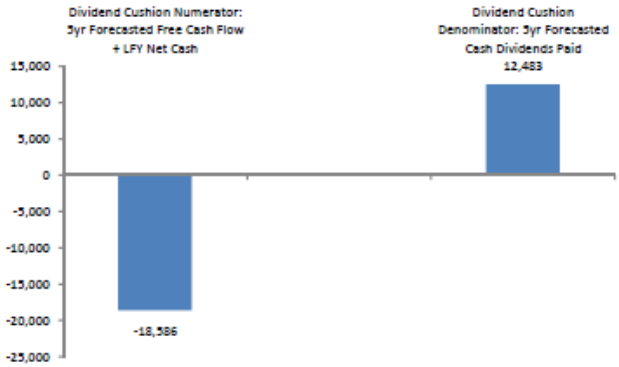


Source: Company Filings, Valuentum Projections

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, Ford'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, Unadjsuted Dividend Cushion Ratio Deconstruction - Raw



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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