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HIGH YIELD DIVIDEND NEWSLETTER

Making Several Big Changes to the High Yield Dividend Newsletter Portfolio

Latest Changes to High Yield Dividend Newsletter
***New* Weighting Changes: 2.5% Reduction in BP, EPD, MMP (Bringing Each Weighting Down to 2.5%) – April 1**
***Newly* Added: 7.5% to SJB – April 1**

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Image Shown: *We are adding some hedge protection to the High Yield Dividend Newsletter portfolio after the high-yield spread over comparable US Treasuries spiked in March 2020.*

> ***"WE ARE ADDING HEDGE PROTECTION TO OUR HIGH YIELD DIVIDEND GROWTH NEWSLETTER PORTFOLIO IN LIGHT OF HIGH-YIELD SPREADS BLOWING OUT IN MARCH 2020."***
>
> ***– CALLUM TURCAN***

By Callum Turcan

Dear members,

We are making some big changes to the High Yield Dividend Newsletter portfolio in light of the ongoing OPEC-Russia-Shale price war and how that has impacted pricing for raw energy resources, namely crude oil. This has placed a tremendous amount of stress on credit markets given how heavily indebted the independent upstream space is, and the threat that poses to capital markets. Additionally, the ongoing coronavirus ('COVID-19') pandemic is further stressing credit markets by highlighting longstanding weaknesses in industries that existed long before the pandemic reared its ugly head.

Trimming Positions in BP, EPD, and MMP

BP plc (BP) remains best of breed within the large integrated energy majors space and assets such as 1) its Whiting refinery in Indiana (the refinery can purchase heavy sour Canadian crude at steep discounts to national and global benchmarks, refine those barrels given past investments that enabled the refinery to process more "complex" crude types, and then sell those refined petroleum products at prices based on national and global benchmarks), 2) its petrochemical BP Acetyls Asia business that tends to do well when feedstock prices move aggressively lower (BP is invested in several petrochemical complexes in East and Southeast Asia through joint-ventures that make acetic acid, a key feedstock in the building blocks of the 21st Century), and 3) its massive retail footprint (BP is moving into and aggressively expanding its footprint in Mexico to capitalize on changes to the country's petroleum sector in recent years) offer up several examples of how BP can generate meaningful cash flows during times of low raw energy resources pricing.

That said, BP's large upstream operations means the firm is heavily dependent on raw energy resources pricing as it relates to its financial performance. Certain international contracts can offer some downside protection in very low pricing environments such as the one the industry is currently contending with, particularly when BP is acting as a sub-contractor (this is the case in various Middle Eastern countries, like Iraq for example). While BP will also benefit from its annual Gulf of Mexico legal liabilities shifting materially lower going forward as compared to levels in the recent past, these factors aren't enough to offset the likely meaningful decline in its cash flow generation from its upstream operations.

Shares of BP yield around 10.3% as of this writing on March 31, and we view it as prudent to trim the holding in our HYDN portfolio down to ~2.5% from ~5.0% previously. BP's gearing ratio stood at 31.1% in the fourth quarter, above its long-term target of 20%-30%. We caution that BP likely needs to retain access to capital markets to refinance its current debt burden, however, divestment proceeds and the ability to scale back capital expenditures to make room for a better free cash flow profile offers somewhat of a cushion.

Since the start of 2019, BP announced $9.4 billion in divestments and now plans to raise $15.0 billion via asset sales by the middle of 2021. That guidance may prove a tad optimistic.

BP exited 2019 with $22.5 billion in cash and cash equivalents along with $0.2 billion in 'other investments' classified as short-term. Stacked up against $10.5 billion in short-term debt and $57.2 billion in long-term debt, BP has a decent cushion to cover its upcoming maturities but that can only go so far should raw energy resource prices remain subdued for a prolonged period of time. **On April 1, BP significantly reduced its organic capital expenditure guidance for 2020.**

The firm generated ~$10.4 billion in free cash flow in 2019 and spent $6.9 billion in cash on its common dividend along with $0.2 billion towards non-controlling interests, on top of $1.5 billion in share repurchases. Free cash flows will become harder to come by going forward, but reduced capital expenditure expectations provides a level of support.

Enterprise Products Partners L.P. (EPD) is one of the few midstream master limited partnerships ('MLP') that's starting to draw attention to the need to focus on free cash flows instead of distributable cash flow ('DCF'), a flawed metric that doesn't take growth-related capital expenditures into account (and thus isn't a true measure of a firm's ability to make good on its future distribution obligations). The midstream MLP has one of the most diverse energy infrastructure asset bases around that includes long-haul crude oil and natural gas pipelines, storage terminals, marine terminals that service surging US exports of anything from crude oil to natural gas liquids to petrochemicals to refined petroleum products, processing plants for natural gas and natural gas liquids, petrochemical complexes, and more.

However, **as a capital-market dependent entity**, meaning Enterprise Products needs to retain constant access to capital markets to refine its large debt load while making good on its distribution obligations, **risks are growing at the midstream MLP.** At the end of 2019, Enterprise Products had $27.6 billion in total debt inclusive of short-term debt, and please note roughly $2.0 billion of that matures within a year (another $1.3 billion matures in 2021).

We view it as prudent to trim the concentration of EPD in our HYDN portfolio given the high likelihood US production of raw energy resources will come down over the coming quarters and years in the face of the subdued pricing environment and related cuts in upstream capital expenditures. This will inevitably pressure utilization rates at some of its assets, and thus its cash flows. We are reducing the concentration of EPD in our HYDN portfolio down to ~2.5% from ~5.0% previously. Units of EPD yield roughly 12.5% as of this writing on March 31.

Magellan Midstream Partners L.P. (MMP) is a midstream MLP that was one of the first to realize the flaws of incentive distribution rights ('IDRs') and removed those from the picture more than a decade ago, long before many of its peers. We appreciate that the firm has issued out minimal (relatively speaking) equity over the past decade as well, preferring to tap debt/credit markets for funds. Magellan Midstream has been focusing a lot more so on growing its refined petroleum pipeline, marine terminal, and storage businesses over the past couple of years and part of that strategy has involved divesting chunks of its crude oil pipeline operations. We like the pivot towards assets that are better positioned to maintain higher utilization rates in any raw energy resources pricing environment.

That being said, like Enterprise Products, **Magellan Midstream is a capital market dependent entity** and needs to retain constant access to capital markets to refinance its debt burden while maintaining its ability to make good on its distribution obligations. Magellan Midstream exited 2019 with $4.7 billion in total debt and no near-term maturities, offering the firm some breathing room. Given the rising exogenous shocks coming to the US shale patch and Magellan Midstream's exposure to those shocks, namely through its crude oil pipeline operations, we view it as prudent to trim the HYDN portfolio's exposure to the name down to ~2.5% versus ~5.0% previously. Units of MMP yield approximately 11.3% as of this writing on March 31.

Adding a Hedge: ProShares Short High Yield ETF

As market volatility skyrockets and chances for a "credit crunch" or implosion in credit markets grows, we are adding the ProShares Short High Yield ETF (SJB) at a **~7.5% weighting** as a temporary hedge to the HYDN portfolio. The purpose of this addition is to provide a temporary hedge against a sharp rise in the interest rates on high yielding debt, and please note the goal of the ETF is to:

> *ProShares Short High Yield seeks daily investment results, before fees and expenses, that correspond to the inverse (-1x) of the daily performance of the Markit iBoxx® $ Liquid High Yield Index.*

This is done by the fund managers of SJB entering into swap agreements with various banks covering the iShares iBoxx $ High Yield Corporate Bond Index, including the iShares iBoxx $ High Yield Corporate Bond ETF (HYG) [which tracks this index] while SJB holds various US Treasury bills (these transactions involve SJB receiving the cash flows from corporate debt with a "junk" credit rating while paying out the cash flows from its US Treasury holdings). Effectively, the cash flows to SJB grows when the yield spread between high-yielding bonds and "riskless" US Treasuries grows (and vis-versa if the spread shrinks). As of the end of 2019, the iShares iBoxx $ High Yield Corporate Bond Index was composed almost entirely of corporate debt with junk credit ratings (only a marginal amount carried the lowest investment grade credit rating from one of the two biggest credit rating agencies).

We see adding a temporary hedge to our HYDN portfolio as prudent given recent action in credit and equity markets. Please note that the ETF's distribution has been quite volatile historically (those quarterly distributions started in 2018). The last ex-dividend date was March 25. SJB carries a net expense ratio of 0.95% given the greater complexities of using derivatives, such as swaps, to short junk-rated corporate debt.

Concluding Thoughts

We think these changes will better position the High Yield Dividend Newsletter portfolio in the face of tremendous exogenous headwinds. The ongoing COVID-19 pandemic was the unexpected event that many did not see coming, and in order to adjust, trimming risk in certain areas and adding a hedge against a blowout in the yield on high-yielding debt is prudent, in our view.

Importantly, while we expect the changes on the three energy positions to be more long-term oriented, the addition of the SJB is a short-term hedge that we fully expect to remove from the portfolio in the coming months **(note/warning: the SJB has eroding pricing action due to volatility as it acts as a hedge against an adverse outcome in the high yield sector)**. We will continue to keep our members informed of ongoing changes in the market and how that may impact the high yielding world going forward.

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

Covering a High Quality REIT

Realty Income Corporation (O) is a real estate investment trust ('REIT') that invests in single-tenant commercial properties in the US, Puerto Rico, and as of 2019, the UK. **We like Realty Income's ability to navigate serious market downturns**, seen through its strong historical operational performance and view **the REIT's ability to tap equity markets as key to bolstering its dividend coverage on a forward-looking basis.** Shares of O yield roughly 5.6% and now trade well below our fair value estimate of $60 per share as of the end of normal trading hours on March 31.

There are some risks, namely that Realty Income is a capital-market dependent entity and needs to retain access to debt and equity markets during these turbulent times. On March 2, Realty Income successfully completed a 9.0 million secondary share offering that raised $677 million net, and its underwriters have the option to purchase an additional 1.35 million shares. Those proceeds are going to go towards paying down the balance on its $3.0 billion unsecured credit line and for other corporate purposes. Realty Income appears to retain quality access to capital markets at this time; however, its relatively weak technical performance over this past week is concerning.

Realty Income pays out a monthly dividend and has done so for 597 consecutive months as of its March 2020 press release announcing its payout for April 2020. In 2019, Realty Income's adjusted funds from operations ('AFFO') grew by over 4% year-over-year to $3.32 per share, and the REIT's current AFFO payout ratio (annualized dividends stand at $2.796 per share) sits at ~84% on a backward-looking basis and ~79% (at the midpoint of 2020 guidance) on a forward-looking basis as management expects the REIT's AFFO will grow to $3.50-$3.56 this year (that guidance will be put to the test by the ongoing COVID-19 pandemic).

We appreciate Realty Income's high quality tenant base, as many of its tenants operate in non-discretionary industries (convenience stores, grocers, pharmacies, etc.) that should continue to witness high levels of demand for their consumer staples and other offerings during the pandemic.

However, we caution that Realty Income exited 2019 with $7.9 billion in total debt, inclusive of short-term debt. The REIT appears to retain quality access to capital markets and can use equity issuances as needed to manage the current situation, at least for now. Its $3.0 billion revolving credit line matures in March 2023, providing Realty Income with ample access to liquidity during these turbulent times, and the REIT has the option to push that maturity date back through two-six month extensions (Realty Income notes that this can happen "at its option" in its 2019 Annual Report). At the end of 2019, that credit facility had $2.3 billion in available borrowing capacity. **Realty Income carried investment grade credit ratings (A3/A-/BBB+) at the end of 2019.**

Maintaining a high occupancy rate is also key, and since the 1990s, Realty Income's year-end occupancy rate has never gone below 96.0% (that ratio stood at 98.6% at the end of 2019) and that includes periods during both the dot-com bust and the Great Financial Crisis ('GFC'). We like Realty Income's high quality business model. Realty Income is included at a very modest weighting in our Dividend Growth Newsletter portfolio.

Utilities Outperform During These Harrowing Times

Image Shown: *Shares of the Utilities Select Sector SPDR ETF (shown by the blue line up above) have significantly outperformed the S&P 500 (show by the orange line up above) as measured by the SPDR S&P 500 Trust ETF over the past year, as of the end of the normal trading session on March 31, as investors seek out stability during these harrowing times. Please note that's before taking dividend considerations into account, which would expand the outperformance of XLU over SPY even further.*

By Callum Turcan

As of the end of the normal trading session on March 31, utility equities have been outperforming the broader market during these harrowing times relatively speaking, measured here by the S&P 500 (SPY). Year-to-date, the SPY is down roughly 20% while the Utilities Select Sector SPDR ETF (XLU) is *only* down roughly 14% (not including dividend considerations). Furthermore, over the past two years, XLU is up approximately 10% (before considering dividends, which are quite material) while the S&P 500 index is down almost 1% (again, before factoring in dividend considerations) as of this writing. When including dividends, the outperformance of XLU over SPY would grow materially.

We include shares of XLU in our High Yield Dividend Newsletter portfolio because utilities are a great source of stable income streams. While power and heating demand will fluctuate as US households and businesses contend with the ongoing coronavirus ('COVID-19') pandemic, the economy will continue to require utility services to function as normally as possible given the environment.

Covering NextEra Energy

XLU can trace part of its outperformance back to NextEra Energy Inc (NEE), a power generation utility focused on renewables and natural gas. Over the past two years, NEE is up over 47% (not including dividends) as of the end of normal trading hours on March 31, and as of March 30, ~15.1% of XLU's portfolio holdings were represented by NEE.

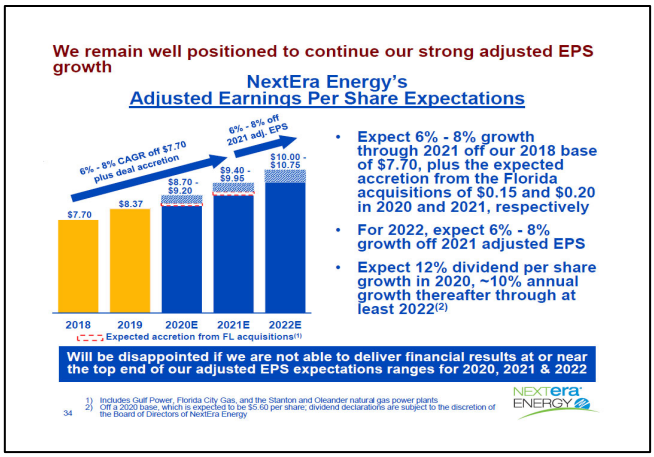

Image Shown: *NextEra Energy is targeting meaning EPS growth which underpins management's goal to deliver strong dividend per share growth over the coming years.* ***Image Source:*** *NextEra Energy – February/March 2020 IR Presentation*

Through massive green energy investments, natural gas plant investments, and recent acquisitions, supported in part through its NextEra Energy Partners LP (NEP) spinoff, NextEra Energy Inc intends on realizing nice high single-digit EPS growth over the coming years.

Some of NextEra Energy's recent acquisitions include buying Gulf Power (electric utility that serves Northwest Florida), Florida City Gas (gas utility that services Miami-Dade and other counties in Florida), and stakes in two natural gas plants in Florida from Southern Company (SO) through deals worth a combined ~$6.5 billion (those deals closed in 2018 and 2019). Looking ahead, NextEra is in the process of potentially acquiring South Carolina Public Service Authority (known as Santee Cooper), a water and electric utility owned by the government of South Carolina. Other utilities, including Duke Energy Corporation (DUK), are also reportedly attempting to buy Santee Cooper. In the upcoming graphic down below, NextEra Energy provides some of its rationale behind making such a deal.

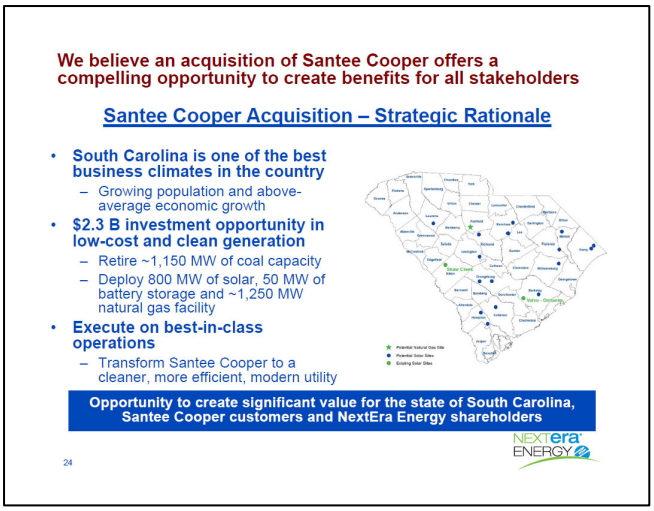

Image Shown: *NextEra Energy seeks to continue expanding its utility operations in Southeastern US regions.* ***Image Source:*** *NextEra Energy – February/March 2020 IR Presentation*

As you can see in the graphic up above, **NextEra Energy intends on retiring a substantial amount of coal-fired power generation capacity** (in the event it does acquire Santee Cooper) **and will replace that capacity with solar plants and natural gas-fired plants, supported by battery storage** (which presumably will primarily support its solar plants). Natural gas and solar underpin NextEra Energy's growth ambitions.

Expanding its presence in the Southeastern US is how NextEra Energy plans to target powerful demographic trends and the economic growth associated with a growing population, which generally leads to rising demand for various utility services and ultimately cash flow growth opportunities for a company like NextEra Energy.

Concluding Thoughts

Other than NextEra Energy, the Utilities Select Sector SPDR ETF's top holdings include Dominion Energy Inc (D), Southern Company, Duke Energy, and American Electric Power Company Inc (AEP). To varying degrees, all of these utilities are targeting modest to meaningful EPS growth over the coming years which underpins the growth trajectory of their dividends on a per share basis.

We caution that utilities need to retain access to capital markets in order to refinance their debt loads, which are quite large, however, as investment grade rated entities with recession-resistant operations and substantial cash flows, we see that as being the case going forward (for top rated and large utilities such as the ones mentioned above, particularly those focused on regulated utility markets). Tapping debt markets is also an important part of how utilities raise funds for growth, whether that be for capital expenditures (NextEra Energy expects to invest $12.0 billion to $14.0 billion per year towards capital expenditures through 2022) or for acquisitions (such as the aforementioned deals with Southern Company and NextEra Energy).

One of the big appeals of XLU is that the ETF isn't exposed to the kinds of risks posed by single-security selection. The embattled PG&E Corporation (PCG), Pacific Gas and Electric Company, offers a prime case study in what can happen when investors select utilities that are poorly navigating the complex regulatory and operational environment. We continue to like XLU in both our High Yield Dividend Newsletter portfolio, and shares of XLU yield ~3.5% as of this writing.

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

[Please see next page for a summary of portfolio activity during 2019.]

Tracking the High Yield Dividend Newsletter	Price -- 12/31/2018 or at open*	Interim Dividends	Price -- 12/31/2019 or at close**
CORE			
Alerian MLP ETF (AMLP) -- *removed* November 18	8.73	0.78	7.83
Added 2.5pts of AT&T (T) -- November 18	*39.21*	-	39.08
Added 2.5pts of Philip Morris (PM) -- November 18	*84.57*	1.17	85.09
Global X SuperDividend ETF (SDIV)	17.10	1.54	17.69
Global X SuperIncome Preferred ETF (SPFF)	11.03	0.71	11.74
iShares International Select Dividend ETF (IDV)	28.71	1.73	33.57
iShares MSCI Australia ETF (EWA)	19.25	0.90	22.64
iShares U.S. Preferred Stock ETF (PFF)	34.23	2.00	37.59
Invesco Senior Loan Portfolio (BKLN)	21.78	1.11	22.82
ProShares High Yield -- Interest Rate Hedged (HYHG)	62.09	3.97	65.44
Utilities Select Sector SPDR (XLU) -- *added August 22*	*61.61*	0.99	64.62
Vanguard Real Estate ETF (VNQ) - *added April 1*	*85.91*	2.53	92.79
EQUITY			
AT&T (T)	28.54	2.04	39.08
BP PLC (BP)	37.92	2.46	37.74
CubeSmart (CUBE) -- *added August 22*	*35.13*	0.65	31.48
Digital Realty Trust (DLR)	106.55	4.32	119.74
Enterprise Products Partners (EPD)	24.59	1.76	28.16
Iron Mountain (IRM) -- *removed August 1*	32.41	1.22	29.97
Magellan Midstram Partners (MMP)	57.06	4.04	62.87
Omega Healthcare Investors (OHI) -- *removed March 1*	35.15	0.66	34.72
Philip Morris (PM) -- *added August 1*	*82.41*	2.34	85.09
Public Storage (PSA)	202.41	8.00	212.96
Schlumberger*, added January 18, removed August 1*	*43.00*	1.00	38.07
Realty Income Corporation (O) -- *removed April 1*	63.04	0.68	72.03
Tallgrass Energy LP (TGE) -- *removed August 1*	24.34	1.59	18.25

* As shown in the January 2019 edition of the High Yield Dividend Newsletter, or price at entry point

** Price as of December 31, 2019, or price at close

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

High Yield Spotlight: DXC Technology Company (DXC) Secures Major Divestment to Bolster Balance Sheet

Our **High Yield Dividend Newsletter Spotlight for April 2020** is DXC Technology Company (DXC)---6.4% yield---as the firm possess the liquidity levels, cash flow profile, and financial means to weather the ongoing coronavirus ('COVID-19') pandemic and emerge on the other side. DXC offers end-to-end information technology ('IT') solutions and services which includes; optimizing data architectures, modernizing IT operations, allowing for both safe and scalable IT operations by leveraging cloud-computing technology that's secured by trusted cybersecurity offerings, and allowing for the enterprise technology stack to work seamlessly given the growing demand for enterprise IT operations to run and manage very complex tasks. That includes DXC using the enterprise technology stack (when properly set up) to locate and analyze actionable data that can be used by its clients to generate incremental revenues and provide insights into trends that had previously gone unnoticed.

For some background information, please note that DXC successfully completed its IPO in April 2017 after being spun out of Hewlett Packard Enterprise Company (HPE) by merging with Computer Sciences Corporation, which resulted in the standalone entity that we are covering in this Spotlight article, DXC Technology. A year later, DXC spun out its U.S. Public Sector business by combining that business with Vencore Holding Corp. and KeyPoint Government Solutions in 2018, which formed the publicly-traded company Perspecta Inc (PRSP). DXC does not appear to own any shares of Perspecta, and Hewlett Packard Enterprise does not appear to own any shares of DXC, as both spinoffs involved distributing those shares to the equity holders of DXC and HPE, respectively.

The company has over 6,000 customers around the world, over 200 of which are Fortune 500 companies, highlighting its strong foothold in this competitive IT realm. With operations in over 70 countries, DXC is able to capitalize on growing demand for complex enterprise IT needs which sets itself up nicely when the global economy is growing. As a company with a strong cash flow profile, a product of relatively low capital expenditure requirements, we view DXC's dividend coverage as quite solid on a forward-looking basis.

DXC completed its all-cash acquisition of Luxoft (a "global digital strategy and software engineering firm") through a ~$2.0 billion deal by equity value in June 2019. By acquiring Luxoft, DXC plans to speed up its transition towards the offerings of the future and away from its legacy businesses. During DXC's third quarter of fiscal 2020 quarterly conference call, the firm's CFO Paul Saleh had this to say as it relates to DXC's stronger operational segments:

> *Cloud and security revenue was up 1.9% sequentially and 9.9% year-over-year. Book-to-bill was 1.5x, which is the best book-to-bill we've had since Q3 of last year. Moving up the stack, application and industry IP was up 3% sequentially and up 0.4% year-over-year. Book-to-bill for this layer of the stack was 1.1x. This is the first time in four quarters that our application business excluding our enterprise cloud applications grew sequentially.*
>
> *Data analytics, engineering services business, revenue there was up 3.5% sequentially and up year-over-year by two fold. Excluding Luxoft, data analytic and engineering services grew 0.9% on a year-over-year basis. Book-to-bill was 1.5x with solid performance across the board. Lastly, advisory revenue was up nearly 5% sequentially, but down 8.5% year-over-year against a strong prior year performance. Book-to-bill was 1.1x.*

When unexpected events like COVID-19 slow the global economy to a crawl, DXC's operational and financial performance takes a hit as well. Shares of DXC have fallen aggressively year-to-date and are trading well below their September 2018 peak; however, recent technical action could mean investors are beginning to warm back up to the name. **Recent refinancing activities and a major divestment indicate that the firm should retain the liquidity levels to ride out the storm.** Please note that DXC's legacy businesses had taken a beating in fiscal 2020 (even before COVID-19 came into the picture), however, there are several bright spots coming from its analytics and cloud/security segments. For reference, DXC's third quarter of fiscal 2020 ended on December 31, 2019.

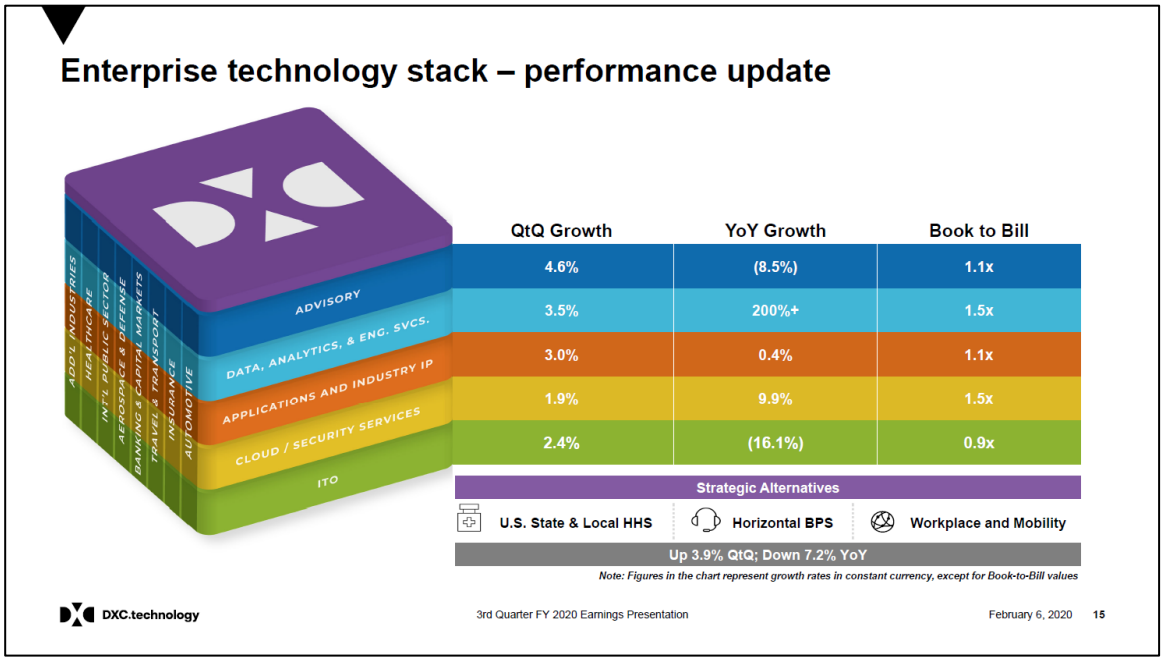

Image Shown: *DXC's legacy businesses have come under pressure of late, but the firm has found success in growing its 'data, analytics, and engineering services' and 'cloud/security services' business lines.* ***Image Source:*** *DXC – Third Quarter of Fiscal 2020 Earnings IR Presentation*

We view DXC's strategic shift as an essential maneuver as the company seeks out growing opportunities in adjacent offerings, and so far, there are positive signs that these moves are panning out favorably (keeping in mind declines elsewhere have played a key role in subduing investor sentiment towards the name). More work needs to be done on this front, but DXC is moving in the right direction which we appreciate.

At the end of December 2019, DXC was sitting on $2.6 billion in cash and cash equivalents versus $1.6 billion in short-term debt and $7.3 billion in long-term debt, good for a net debt position of $6.3 billion (**DXC announced a major divestment in March 2020 that will fundamentally change this picture**, which we'll cover later on). During the first three quarters of fiscal 2020, DXC generated a little less than $2.1 billion in net operating cash flow and spent just over $0.2 billion on capital expenditures (defined here as 'purchases of property and equipment').

Please note that we don't classify activities such as 'payments for transition and transformation contract costs' and 'software purchased and developed' as capital expenditures, as those are more so in the realm of mergers and acquisitions, and furthermore, that DXC has historically generated a meaningful amount of positive cash flow from its 'cash collections related to deferred purchase price receivable' investing activity (which we don't add to its net operating cash flow figure).

Considering DXC generated ~$1.8 billion in free cash flow during the first nine months of its fiscal 2020, we view its pro forma (post-divestment) net debt position as manageable. We'll have more to say on that in just a moment. As it relates to DXC's dividend obligations, the company spent $0.2 billion on its payout during the first nine months of fiscal 2020, indicating its payout coverage is solid. Taking a step back, please note that on average, DXC generated ~$1.4 billion in annual free cash flow from fiscal 2017 to fiscal 2019, while its annual dividend obligations averaged ~$0.2 billion during this period.

Our Dividend Cushion ratio, which in the numerator takes into account a firm's forecasted free cash flows over the next five fiscal years less its net debt or plus it net cash position, while the denominator is the firm's forecasted dividend obligations during this period, for DXC stands at 4.8 which allows for an "EXCELLENT" Dividend Safety rating. Furthermore, we rate DXC's Dividend Growth rating at "EXCELLENT" as well and expected payout growth is factored into the denominator within our Dividend Cushion calculations. On March 10, DXC announced its quarterly dividend of $0.21 per share would be paid out on April 14 for shareholders on the record as of March 25, highlight management's commitment to maintaining DXC's payout during these turbulent times.

On March 24, DXC notified the administrative agent in charge of its $4.0 billion multi-currency revolving credit facility that it intended to borrow $1.5 billion from that facility. Please note $3.93 billion of the revolving credit facility matures January 2025, and $0.07 billion matures January 2024, meaning these are relatively long-term borrowings. DXC intends on using these borrowings to pay off outstanding debt under its €1.0 billion (approximately USD$1.1 billion) commercial paper program **in order to shift its borrowings to longer dated maturities in light of ongoing turbulence seen in credit markets of late** (according to an 8-K filing published March 24, 2020). We appreciate this maneuver as it will improve DXC's debt maturity profile, bolster its liquidity position, and better allow the company to navigate the various pitfalls created by the COVID-19 pandemic.

As of March 2019, **DXC maintained investment grade credit ratings with all three major credit rating agencies** (BBB/Baa2/BBB+) according to its fiscal 2019 annual report. Moody's Corporation (MCO) reaffirmed DXC's Baa2 investment grade credit rating in February 2020, however, the agency changed its outlook from stable to negative. With that in mind, we look like to stress here that this was before DXC announced it would refinance its short-term borrowings with long-term borrowings, which should improve its credit profile.

Furthermore, on March 9, DXC entered into an agreement to sell its U.S. State and Local Health and Human Services Business for Veritas Capital (a New York-based PE firm) for $5.0 billion in cash (the deal was announced by press release on March 10), with those proceeds going towards debt reduction. **DXC's balance sheet should improve materially over the coming quarters** after the deal closes, even as the global economy comes to a crawl, as those divestment proceeds would go a long way in paring down its net debt load.

We caution that DXC spent a lot repurchasing its shares in fiscal 2019, allocating over $1.3 billion to stock buybacks that fiscal year which was up sharply from fiscal 2018 levels of $0.1 billion. During the first three quarters of fiscal 2020, DXC bought $0.7 billion of its shares back, however, that was down year-over-year. Given the serious exogenous headwinds facing the firm, we would prefer management continue to scale back DXC's share repurchases to allow for cash to build on the balance sheet.

Management expects DXC's fiscal 2020 financial performance will weaken significantly from fiscal 2019 levels, with the firm's non-GAAP diluted EPS expects to fall from $8.34 down to $5.25 - $5.75 while its revenues are expected to slip from $20.8 billion down to $19.5 billion - $19.8 billion, as you can see in the upcoming graphic down below. **However, we view this weakness as already being priced into its current share price and will stress here that its dividend obligations remain rather small relative to its free cash flows.**

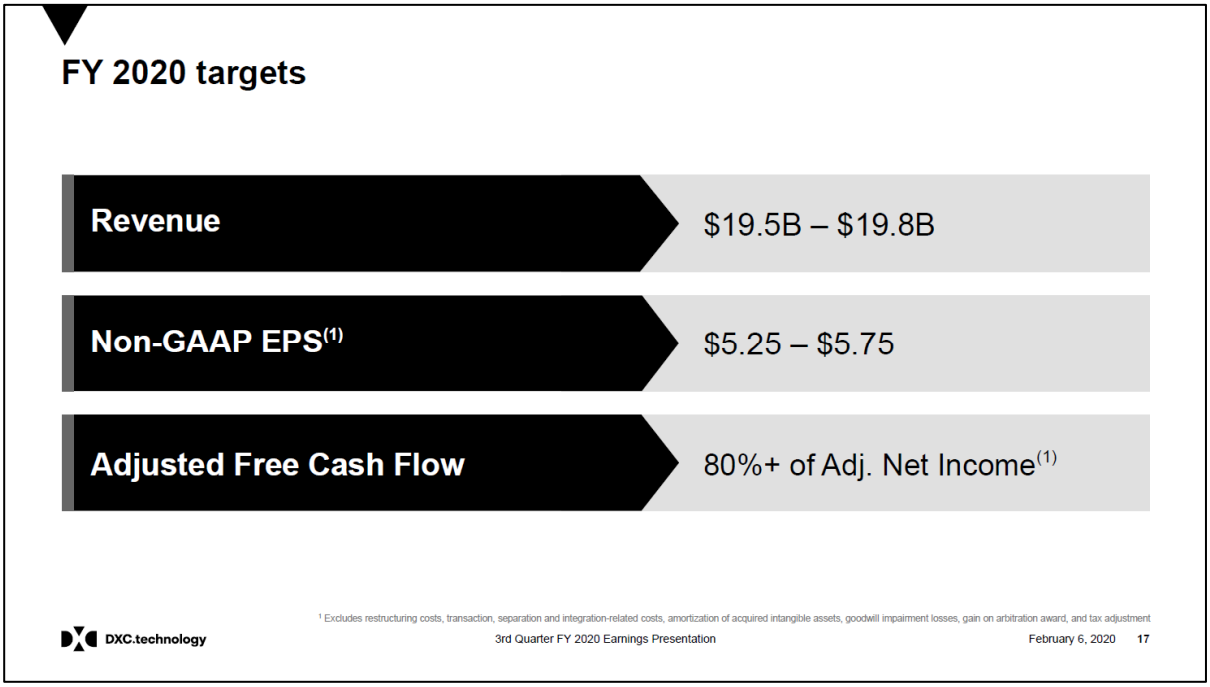

Image Shown: *DXC's financial performance in fiscal 2020 is expected to weaken versus fiscal 2019 levels.* ***Image Source:*** *DXC – Third Quarter of Fiscal 2020 Earnings IR Presentation*

DXC will provide an update on its fiscal 2021 outlook in May 2020 during its fourth quarter and full-year fiscal 2020 earnings report. While its outlook will depend materially on the state of the global economy, having relatively low capital expenditure requirements provides for better financial flexibility. Cutting down its debt load immensely via divestment proceeds represents a huge win for DXC.

Shares of DXC have fallen aggressively over the past year as investors have grown worried about its legacy businesses dragging down its higher growth operations (such as data analytics and engineering services). Management has come out swinging by refinancing the company's short-term debt with long-term debt while raising $5.0 billion in cash via a large divestment which will be used for major deleveraging activities. DXC's quality cash flow profile and relatively low dividend obligations puts the company in a prime position to navigate the ongoing COVID-19 pandemic.

As long as management continues to remove their foot from the share buyback pedal and follows through with improving the company's balance sheet as planned, DXC should emerge on the other side of this pandemic with its dividend payout intact with room for upside. However, **we caution that should DXC's big divestment not go through as planned, that would change our outlook towards the firm immensely** given how important it is for DXC to pare down its net debt load during these harrowing times. That situation should be closely monitored going forward.

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

REITs in the Face of COVID-19

Image Source: *Simon Property Group Inc – Fourth Quarter 2019 Fact Sheet*

By Callum Turcan and Matthew Warren

The real estate investment trust ('REIT') universe, which was established by the US Congress back in 1960 and has evolved in the years since, is now comprised of over 200-listed REITs with a market capitalization of over $1 trillion, owning gross assets of over $3 trillion, as per the National Association of Real Estate Investment Trusts ('NAREIT'). Property types run the gamut with 13 official sectors. To qualify as a REIT and thus to gain the favorable tax advantages provided to such entities in the US, a company must invest at least 75% of its assets in real estate, gather at least 75% of its gross income from rental of real property, interest on mortgages financing real property, or from sales of property, and pay at least 90% of taxable income as dividends each year. REITs must also be an entity that is taxable as a corporation, managed by a board of directors or trustees, have a minimum of 100 shareholders, and have no more than 50% of its shares held by five or fewer individuals. **We include the Vanguard Real Estate ETF (VNQ) in both our High Yield Dividend Newsletter and Best Ideas Newsletter portfolios.**

The vast bulk of REITs are equity REITs, meaning that they own various properties that they rent out for income, which is ultimately passed back to investors in the form of dividends. Mortgage REITs, a much smaller group of companies, own mortgages on real properties or mortgage-backed securities and earn interest that way. Public non-listed REITs are registered with the SEC but do not trade on exchanges. Private REITs are real estate funds that are exempt from SEC registration and do not trade on an exchange. The REIT sectors include Office, Industrial, Retail, Lodging, Residential, Timberland, Health Care, Self-Storage, Infrastructure, Data Center, Diversified, and Specialty.

Equity REITs own portfolios of real property and usually also manage those properties. The money to invest in those properties comes from equity issued to the public and often some amount of debt. The debt can be held at the corporate level where it is rated by the rating agencies based on overall corporate credit quality. Additionally, the debt can be held against individual properties as mortgages, which can also be turned into commercial mortgage-backed securities ('CMBS'). As mentioned above, the overall REIT sector is levered about 3 to 1, but there are vast differences between various publicly traded REITs.

This is where the trouble comes in during the time of the ongoing coronavirus ('COVID-19') pandemic. Highly-levered REITs and REITs, in general, are capital-market dependent entities, meaning they must retain continuous access to capital markets at attractive rates in order to refinance their maturing debt loads, while still being able to fund their dividend obligations and potentially growth-related capital expenditures as well.

Here's a good example of what can happen when a healthcare crisis meets a financial crisis. The Cheesecake Factory (CAKE) recently announced that it will not be paying rent and that it has furloughed numerous employees. Many of its stores are closed thanks to very subdued end customer demand resulting from stay-at-home mandates enacted in many states around the country. It is not clear how long these mandates will be in place, but in the meantime, restaurants are either trying to switch over to takeout and delivery, or they are simply shutting down in the interim. The same is true for non-essential retail shops.

Simon Property Group (SPG) is one of the largest operators of premium mall and outlet shopping centers in the US and counts The Cheesecake Factory as one of its many clients. Due to the stay-at-home orders, Simon Property was forced to close all its domestic (US-based) locations from March 18 to March 29, and furthermore, many of its tenants' shops are still closed or on life support. **Shares of SPG are down ~63% year-to-date as of the end of the normal trading session on March 31, and while the REIT has not cut its payout yet, there's a very real likelihood that it could as tenants like The Cheesecake Factory stop paying rent.** Simon Property amended, extended, and upsized its now $6.0 billion unsecured revolving credit line on March 16 to provide the REIT with the liquidity it needs to wait out the pandemic, but that process may involve a large payout cut as well. Please be aware that at the end of 2019, Simon Property had almost $24.2 billion in 'mortgages and unsecured indebtedness' versus less than $0.7 billion in cash and cash equivalents on hand.

As tenant arrears and defaults grow, the REIT industry's revenues and cash flows will come under pressure and yet they still must pay their debt, insurance, maintenance, and the like. What does this mean? It means that the REITs with the most problematic customers and the most debt will be in the most trouble. Hence, investors should be very careful with balance sheet analysis during these precarious times. It also means that there will likely be dividend cuts. Examples of REIT dividend cuts include Apple Hospitality REIT (APLE) suspending its monthly dividend of $0.10, Chatham Lodging Trust (CLDT) suspending its monthly dividend of $0.11, Macerich (MAC) cutting its quarterly dividend from $0.75 to $0.50, RLJ Lodging Trust (RLJ) cutting its dividend from $0.33 to $0.01, Ryman Hospitality Properties (RHP) suspending its quarterly dividend of $0.95, and Sotherly Hotels Inc. (SOHO) suspending its quarterly dividend of $0.13 per share. These dividend cuts all took place just during the week ending March 20, 2020.

The Hotel REIT sector is obviously coming under a lot of immediate pressure as people "cocoon" in their homes, cancel existing travel plans, and stop booking new trips. We also expect that retail and restaurant tenants will be under a tremendous amount of pressure. Even after stay-at-home orders are lifted, there will be lingering effects until a vaccine or very effective anti-viral is developed, in our view. Internet shopping, which was already taking market share, will only continue to grow at the expense of numerous physical retailers. We think mall-based retailers will fare the worst, while more defensive retailers like grocers, discounters, hardware stores, dollar stores, pharmacies, convenience, and club stores will fare much better due to their non-discretionary nature and convenience factor. Realty Income (O), a holding in our Dividend Growth Newsletter portfolio, is heavily exposed to the more defensive retailers and we view the REIT's outlook as safer for that reason compared to the outlook of many of its peers.

Regarding the three REITs that are included in our High Yield Dividend Newsletter portfolio, we think they will hold up quite a bit better than other REITs. **Demand for data has skyrocketed during the COVID-19 pandemic, which benefits Digital Realty Trust (DLR), a data center REIT. Year-to-date, shares of DLR are up ~16% as of the end of the normal trading session on March 31.** Digital Realty recently closed on its acquisition of Interxion, which provides the REIT with a significantly larger presence in Europe, particularly in major metropolitan areas. We include shares of DLR in both our High Yield Dividend Newsletter and Dividend Growth Newsletter portfolios and continue to be very optimistic about its long-term prospects.

Regarding Public Storage (PSA) and CubeSmart (CUBE), two self-storage REITs within our High Yield Dividend Newsletter portfolio, we view the storage of personal items as a relatively recession-resistant category for REITs. **Additionally, unlike most REITs, Public Storage and CubeSmart have historically been quite free cash flow positive.** The space is supported by very powerful long-term secular growth tailwinds, though capacity in the US has gotten ahead of itself of late (a situation that's correcting itself, with self-storage overcapacity likely to dissipate by 2021 according to various management teams within the industry). Furthermore, there will (unfortunately) be those that are forced to trade down from homes to apartments which in turn could materially grow demand for self-storage offerings, while there will also (unfortunately) be those that lose their jobs and end up not being able to keep making good on their financial commitments, forcing them to hand in their keys.

We would also point out that there was an enormous amount of pressure on the most levered REITs during the Great Financial Crisis ('GFC'). Back then, the cost and availability of debt and equity capital to the REIT industry changed overnight. Strong balance sheets, investment-grade credit ratings, and staggered debt maturities are so important in this industry. **One never knows when capital markets might dry up.** Debt is increasingly becoming available on tougher terms and for some, becoming more expensive as the yield spreads of both high-yield and investment grade debt are blowing out over comparable US Treasury yields. Some of the most levered entities will turn out to be stranded and face distress—either distressed capital raising and/or bankruptcy.

For those that make it through without permanent capital impairment, we would expect the equities to come screaming back, assuming the base cost of debt remains low and yield spreads revert to more normalized levels over time. We view this as a logical assumption considering the massive amount of backing the Federal Reserve is providing to the overall debt market (including the commercial mortgage and CMBS markets).

With less leverage, expect lower returns for the industry, but this will be mostly concentrated in the most levered players. With a deep downturn in economic activity, expect weaker tenant fundamentals for the near future. Depending on the magnitude and duration of this downturn, tenant fundamentals could be quite weak for a while.

Another space that has been simply hammered concerns healthcare REITs, specifically for senior housing, assisted living facilities, and skilled nursing homes. For instance, Sabra Health Care REIT (SBRA), which has properties across the senior healthcare spectrum (assisted living, skilled nursing, hospitals, etc.), cut its quarterly payout from $0.45 per share to $0.30 to preserve capital (the cut is for its expected upcoming dividend declaration in May 2020). COVID-19 is wreaking havoc on the space as facilities are forced to hunker down, and finding new tenants is no easy task as many facilities are now shut off from the outside world in order to protect their existing tenants from the pandemic. Omega Healthcare Investors (OHI), a former newsletter portfolio holding that focuses on assisted senior living facilities (including skilled nursing properties), has now drawn down a portion of its revolving credit line to maintain liquidity levels as the REIT gets ready to ride out the storm. For now, Omega Healthcare's dividend remains intact, however, that could change.

We would be remiss if we didn't address the tail risk scenarios regarding ownership of commercial properties. In the case of a deflationary depression, one simply does not want to own real estate. There would not be enough tenants to go around and the oversupply would cause lower and lower rents. Marginal and over-levered properties/portfolios would be absolutely hammered. In the other tail risk of hyperinflation, well-located and well-positioned properties with appropriate amounts of financial leverage would provide a very good hedge against hyperinflation, just like "moaty" companies would. Let us hope that we don't need to worry about either tail, but we must admit that both tail risks have grown during the COVID-19 pandemic. We sincerely hope everyone, their loved ones, and their family members stay safe out there.

Disclosure: *Callum Turcan and Matthew Warren do not own shares in any of the securities mentioned above.*

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

THE SIMULATED HIGH YIELD DIVIDEND NEWSLETTER PORTFOLIO

We think the High Yield Dividend Newsletter portfolio positions us fairly well for whatever the market may throw at us, whether it's COVID-19 or another calamity. We're pretty well-diversified, and we've started to identify some pretty good individual equity ideas of late. That said, **high yield investing is inherently risky.**

In many respects, 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			
Global X SuperDividend ETF	SDIV	5.0%	10.13%
Global X SuperIncome Preferred ETF	SPFF	10.0%	6.17%
iShares International Select Dividend ETF	IDV	5.0%	5.79%
iShares MSCI Australia ETF	EWA	5.0%	4.46%
iShares U.S. Preferred Stock ETF	PFF	5.0%	5.52%
PowerShares Senior Loan Portfolio	BKLN	5.0%	4.90%
ProShares High Yield—Interest Rate Hedged	HYHG	5.0%	6.29%
Utilities Select Sector SPDR	XLU	5.0%	3.07%
Vanguard Real Estate ETF	VNQ	10.0%	3.60%
EQUITY			
AT&T	T	7.5%	7.14%
BP PLC ***REDUCED***	BP	2.5%	10.33%
CubeSmart	CUBE	5.0%	4.93%
Digital Realty Trust	DLR	5.0%	3.23%
Enterprise Products Partners ***REDUCED***	EPD	2.5%	12.45%
Magellan Midstream Partners ***REDUCED***	MMP	2.5%	11.26%
Philip Morris	PM	7.5%	6.41%
Public Storage	PSA	5.0%	4.03%
ProShares Short High Yield ***ADDED***	SJB	7.5%	1.25%
Cash*	-	0.0%	0.00%
		100.0%	**5.56%**

This is not a real money portfolio. Inception 1/1/2018. Data as of 4/1/2020. Est. Div. Yield retrieved from YahooFinance.

** Reflects federal funds target rate range*

DIVIDEND REPORT PAGE 2 – EXXON MOBIL CORPORATION (XOM)

Exxon Mobil XOM FAIRLY VALUED

Buying Index™ 5 **Value Rating**

Economic Castle	Stock Fair Value Range	Dividend Track Record	Dividend Safety / Cushion™	Div Growth Potential	Dividend Yield
Attractive	$27.00 - $41.00	HEALTHY	GOOD / 0.2	EXCELLENT	10.63%

Assessment of Company Dividend Strategy

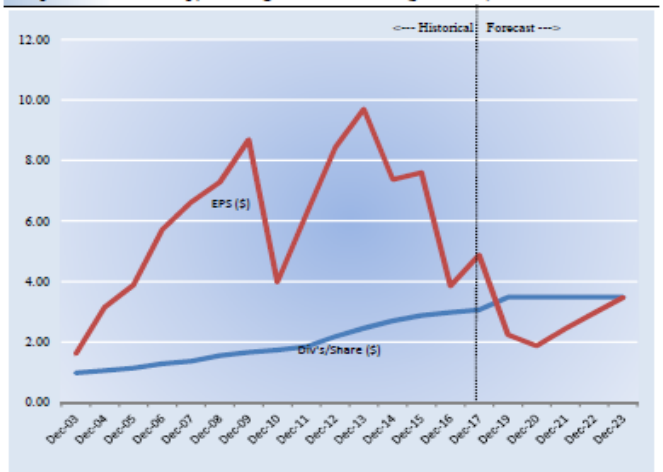
Key Strengths

Exxon Mobil is our favorite dividend growth idea out of the oil and gas majors, though free cash flow generation is improving across the space alongside rebalancing oil markets. We're huge fans of Exxon Mobil's integrated model, and we point to resiliency of the company's downstream and chemicals operations as a reason to be optimistic even in the face of suppressed energy resource pricing. A focus on cost management will remain par for the course, and capital and exploration expenditure management will be ongoing. For a firm of Exxon Mobil's size, the company handled the recent commodity malaise incredibly well. Its strong credit rating and 35+ year track record of consecutive annual dividend increases speak of strength.

Potential Weaknesses

Exxon Mobil's dividend is stronger than that of its peers, in our opinion, but the Dividend Cushion ratio is still picking up some long-term risk, particularly in the event of a prolonged downturn in energy resource prices. We encourage readers to focus on changes in the ratio itself than any qualifier such as GOOD or POOR, for example, but we wouldn't be doing our job if we said that there's nothing that could derail the energy behemoth's dividend strength. With an AA+ rating from the credit rating agencies and positive free cash flow generating capacity even during difficult times, we don't think income investors have too much to worry about. We're watching its debt load closely in any case.

Graphical Relationship, Earnings and Dividends (per share)

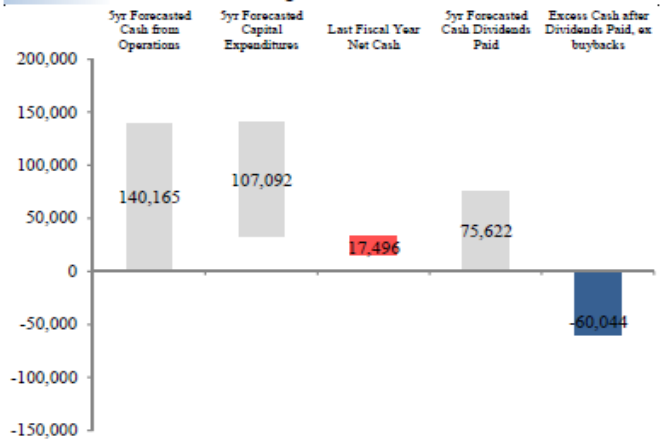


The graph above shows the relationship between a firm's earnings per share and its dividends per share.

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. Exxon Mobil'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.

Dividend Cushion Cash Flow Bridge

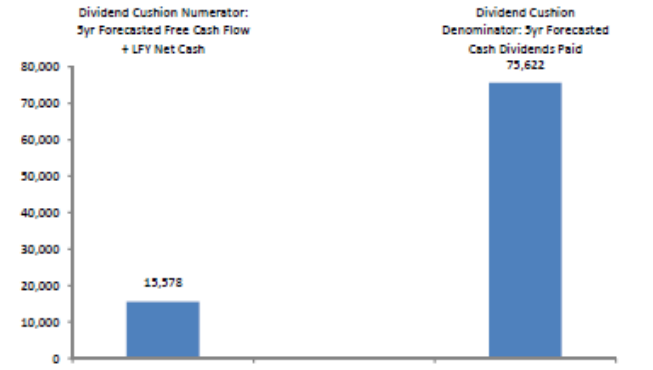


Source: Company Filings, Valuentum Projections

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, Exxon Mobil'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.

Dividend Cushion Ratio Deconstruction



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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