LVW ADVISORS

THE ART OF SERIOUS INVESTING

LVW Advisors, LLC. is an independent Registered Investment Advisor based in Rochester (Pittsford), New York. Our team of experienced financial advisors provides customized investment management solutions and comprehensive wealth management plans for institutional investors, individuals and family offices. For more information, call us at 585-267-4900.

Why Dividends Matter

August 2014

Overview

> *"Basically, price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times he will do better if he forgets about the stock market and pays attention to his dividend returns and to the operating results of his companies."*
>
> - Benjamin Graham

It is a misconception that dividend investing is only for retirees. The importance of dividends and the contribution to overall total return should not be overlooked. This paper will demonstrate that portfolios focusing on growing dividends can deliver strong long-term returns regardless of the market cycle. Dividend-paying stocks, in general, tend to be higher quality companies with stronger balance sheets than non dividend payers. We believe that quality companies trade at more reasonable valuations than the market as a whole.

Not only do dividend stocks as a group have less volatility year-to-year, they outperform non-dividend paying stocks over time as well. Throughout 2013's nearly +30% run up in the major market indices, investors largely ignored that total return comes from two sources: price appreciation *and* dividends. In fact, over the last 90+ years, dividends have accounted for more than 40% of the total return equation. (See exhibit 1)

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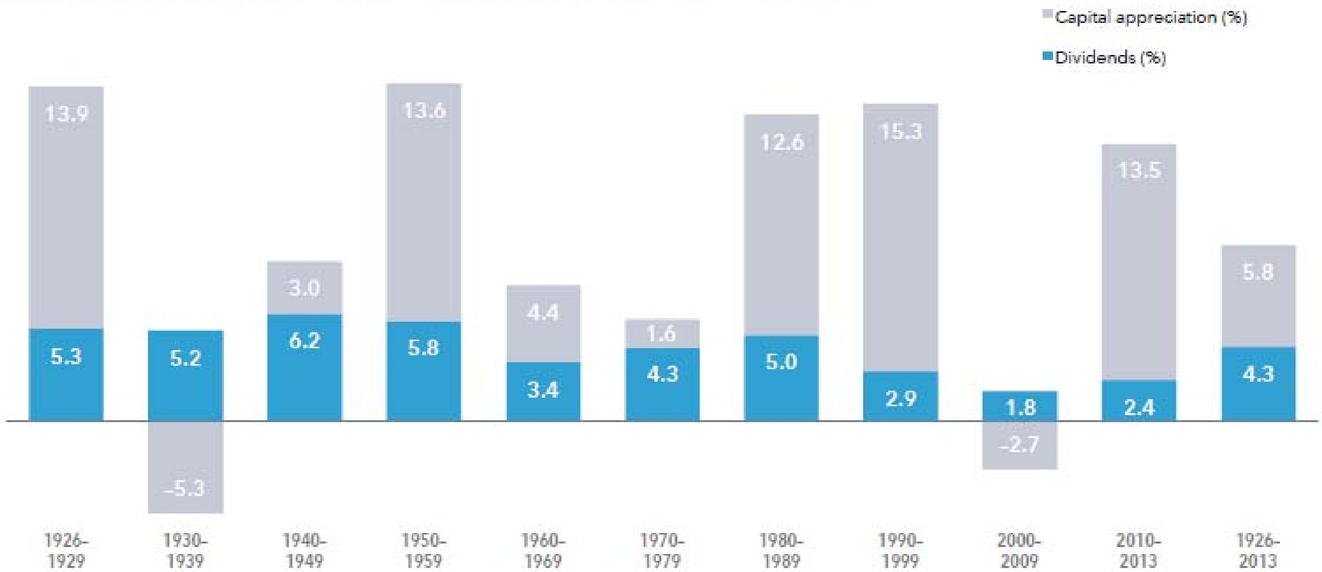
EXHIBIT 1

Dividends have been a significant component of total return in most decades*



Source: Zacks Investment Research

Investors who focus solely on price appreciation are implicitly pegging their total return only to the price change of the stocks they own. However, as history reveals, this can lead to disappointing results for investors over long time frames. With equity prices hovering near all-time highs investors could be disappointed with price returns over the next ten years. We believe a better approach for large cap allocations may be to own companies that focus on growing their cash flows and subsequently sharing those increased cash flows through shareholder friendly actions, such as increased dividends.

EXHIBIT 2

	Price Appreciation %	Income Return %	Total Return %	Price / Total Return %	Income / Total Return %
1930s	-5.3	5.7	0.1	Negative	--
1940s	3.0	5.7	8.9	34	64
1950s	13.6	4.7	18.9	72	25
1960s	4.4	3.1	7.7	57	40
1970s	1.6	4.1	5.8	28	71
1980s	12.6	2.3	17.2	73	13
1990s	15.3	1.8	18	85	10
2000s	-2.7	2.1	-0.9	Negative	--
1930-2011	**5.1**	**3.9**	**9.2**	**55**	**42**

Source: Zacks Investment Research

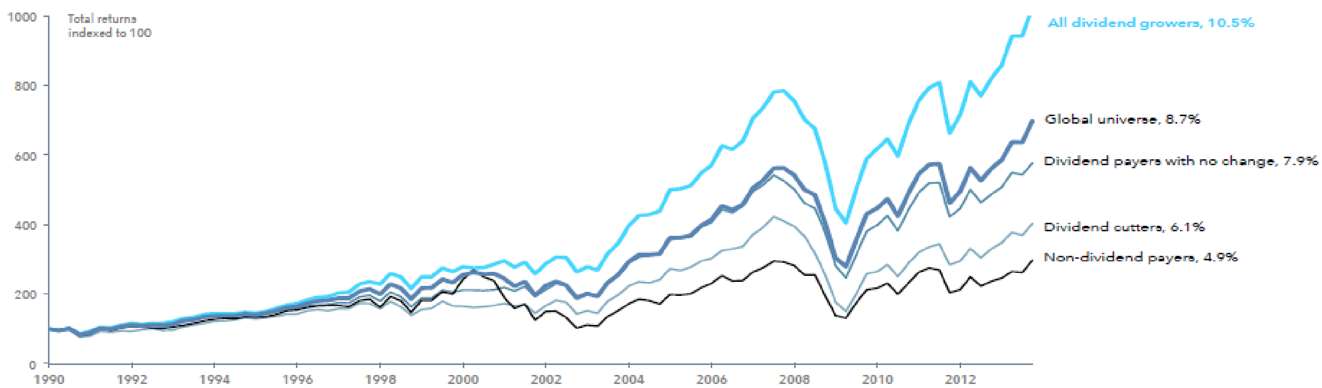
As Exhibit 2 suggests, we also studied the performance of dividend paying stocks in different inflationary environments. The results are nearly the same. During periods of rising inflation, cash flows tend to increase. During periods of lowering inflation, the consistent cash flows have insulated returns.

Just how important are dividends to your portfolio?

A recent study by Factset shows that dividend-paying stocks outperform their non-paying counterparts by a dramatic amount. From 1990 through 2013, non-dividend paying stocks earned just +4.9% return per year while dividend-paying stocks significantly outperformed with a +9.7% average annual return. Those that paid a dividend and *raised* it year after year performed even better – generating a compound annual return of +10.5%. Interestingly, dividend-paying stocks have delivered these results with lower volatility than non-dividend payers. Look at the dramatic effect this had on the growth of a $100,000 portfolio over that time:

EXHIBIT 3

Dividend growers have historically provided superior long-term returns around the globe



	All dividend payers	All dividend growers	Dividend growers ≥5%	Dividend payers with no change	Dividend cutters	Non-dividend payers	Global universe
Annualized returns (%)	9.7	10.5	11.1	7.9	6.1	4.9	8.7
Relative returns (%)	100.9	101.6	102.1	99.2	97.6	96.5	–
Volatility	14.9	14.3	14.4	15.6	17.2	20.1	15.8
Upside/Downside capture							
Upside capture	95	93	95	94	93	112	–
Downside capture	88	82	82	96	104	133	–

Global Universe is not a strategy or investment but represents a composite index for informational purposes only. All indices are unmanaged and it is not possible to invest directly in an index.

Data from December 31, 1989 through December 31, 2013.

Returns for global universe are total returns in U.S. dollars (with gross dividends reinvested) calculated as a weighted average of regional portfolio returns. The regional portfolios are defined as follows: from December 1989 to December 2004, the 1000 largest companies in the respective S&P Global BMI indexes for each of the North America (50% weight), Europe (25%) and Japan (10%) and the 500 largest companies in the Emerging Market (10%) and Pacific ex. Japan (5%). From December 2004 onwards, the regional portfolios consist of the 1000 largest companies in the respective MSCI Investable Market Indexes for North America, Europe and Japan and of the 500 largest companies in the Emerging Markets and Pacific ex. Japan indexes.

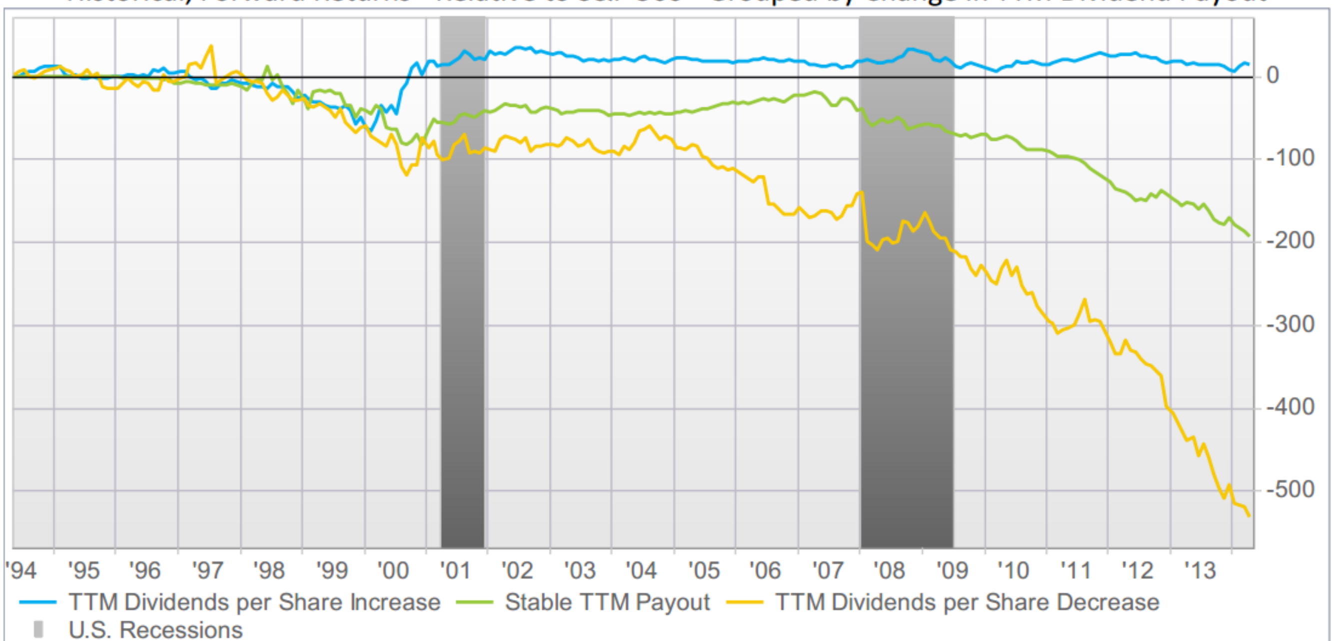
Sources: FactSet, Compustat, Worldscope, MSCI, CII Quant.

Dividends, a leading indicator?

Conversely, the repercussion of when a dividend-paying stock cuts or eliminates its dividend has led to under performance compared to the overall market. The same way rising dividends signal management's confidence in future earnings growth, a dividend cut signals problems. Exhibit 4 charts the precipitous drop in historical and future returns experienced by dividend-paying stocks that decreased their dividend payout.

EXHIBIT 4

Historical, Forward Returns - Relative to S&P 500 - Grouped by Change in TTM Dividend Payout



Source: FactSet Fundamentals via FactSet Alpha Testing

When selecting dividend-paying stocks, we believe it is important that managers focus on these critical data points:

- Current yield vs. historical average yield
- Dividend payout ratio (dividends per share versus earnings per share)
- Annual earnings growth compared to annual dividend growth
- Quality of dividend source

As Exhibit 4 (above) and Exhibits 5 & 6 (below) indicate, the *sweet spot* for dividend investing seems to be at the intersection of companies increasing their dividend regularly with the dividend representing a conservative but meaningful payout ratio and yield.

EXHIBIT 5

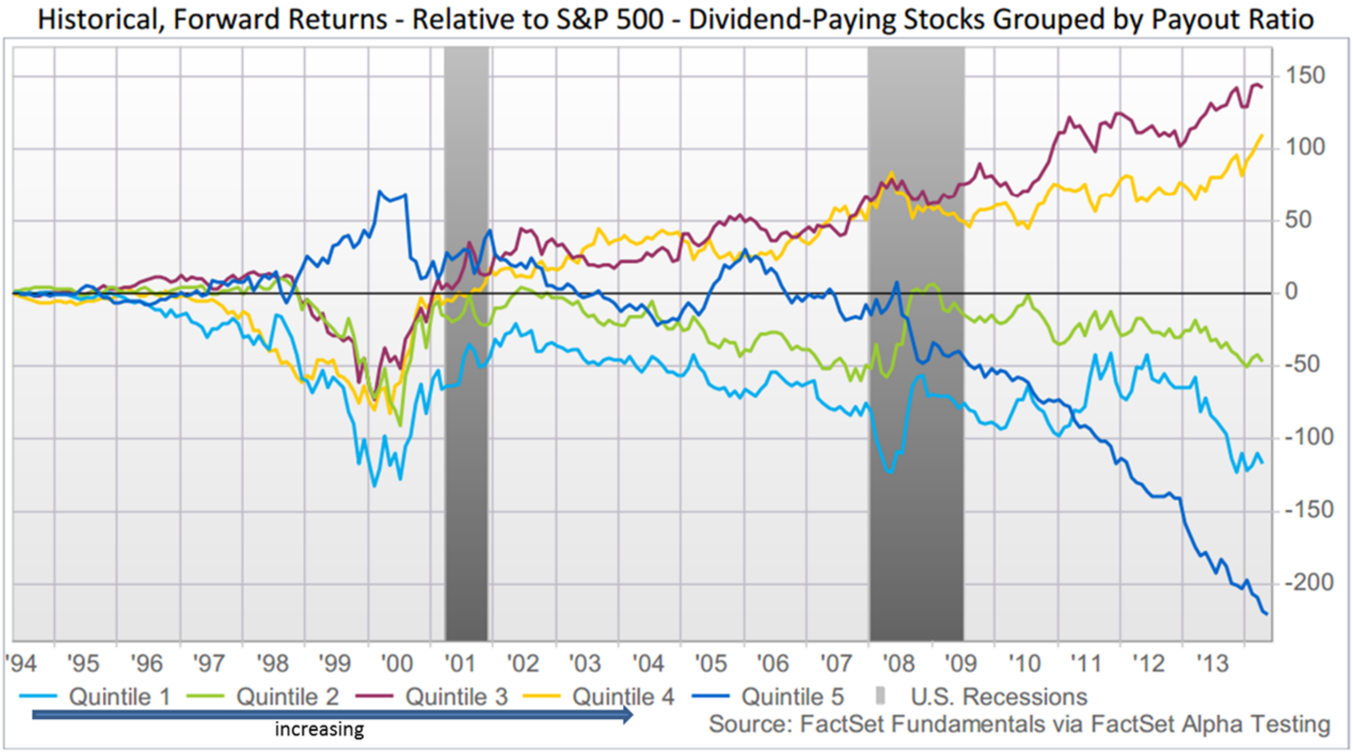


EXHIBIT 6

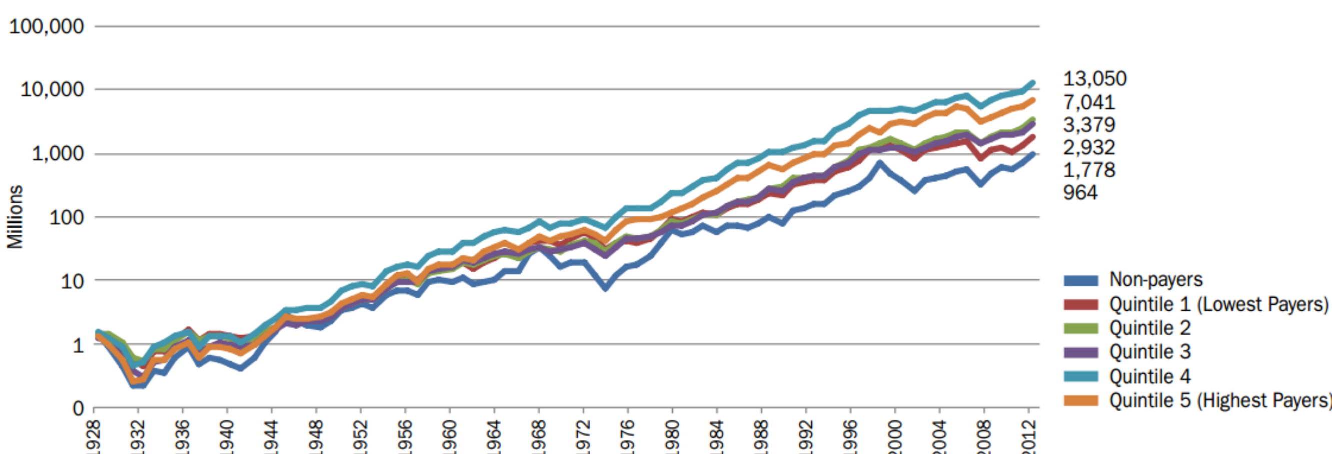


Table 1	Non-Payers	Quintile 1	Quintile 2	Quintile 3	Quintile 4	Quintile 5
Average Annual Total Return	8.32%	9.09%	9.91%	9.73%	11.65%	10.85%
Annualized Standard Deviation	33.78	23.03	19.51	20.79	21.42	24.26
Sharpe Ratio	0.14	0.24	0.32	0.30	0.38	0.30

Source: Kenneth R. French© and CRSP, 1/1/1928 - 12/31/2013

Past performance does not guarantee future results. The hypothetical example is for illustrative purposes only and does not represent the returns of any particular investment. All indices mentioned are unmanaged. It is not possible to invest directly in an index.

Each of the aforementioned characteristics is a critical factor when selecting a dividend strategy. As dividends have once again become more popular some companies are initiating dividends in hopes of attracting investors, but are doing so by borrowing to pay the dividend or growing their dividend faster than earnings are growing – which is unsustainable over the long-term. Dividend investing is not as simple as selecting the highest yielding stock or the company with the fastest short-term dividend growth. We posit that fundamental analysis is required, meaning active management is best for dividend strategies.

A bird in the hand

With tens of billions of dollars trading hands every day on the New York Stock Exchange alone, it's easy to lose sight that when purchasing a stock investors are effectively purchasing ownership interest in a business. Assume for a moment that you don't get a quote every day for your shares in that business and that you can't sell your ownership interest for several decades. Your focus would likely shift from price to *value.*

And the value of that business, whether publicly traded or privately held, is the present value of all future cash flows. After all, what is the point in owning a business – or any investment – if you're never going to receive any cash from it? When a company generates positive free cash flow, it has several options; the company can hold cash in reserve, fund organic growth, make acquisitions, pay down debt, or return it to shareholders through dividends or stock buybacks.

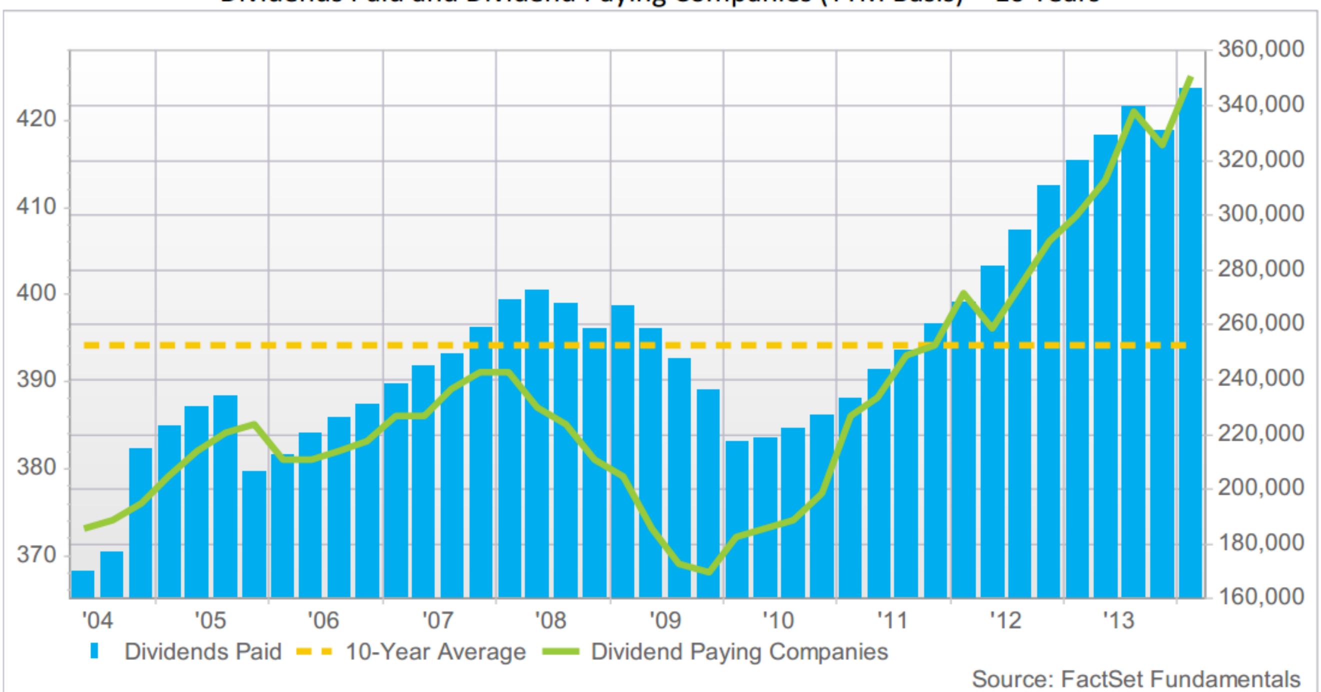
Many growth investors might view dividend payments negatively in lieu of earnings retention. But in a more risk-averse investing climate, dividend payments offer an advantageous method of returning value to shareholders. Shareholders, just like any owner, should be concerned about maximizing long-term value, not short-term EPS.

Are dividends making a comeback?

Historically, companies have paid out a little over half of their earnings in the form of dividends, while the stock market has averaged a dividend yield of 4.4%. But the roaring bull market of the 1980s and '90s shifted focus away from dividends. By the year 2000, the payout ratio was hovering around 30%, while the market was yielding just 1.2%. As of the end of 2013, the number of companies in the S&P 500 paying dividends (418) is at a 16-year high with over $300 billion in dividend payments. And the current payout ratio of 32% is near a 10-year non-recessionary high as the dollar amount of dividends paid has more than doubled since 2004. Despite record high prices, the S&P currently yields about 2.0%.

EXHIBIT 7

Dividends Paid and Dividend Paying Companies (TTM Basis) – 10 Years

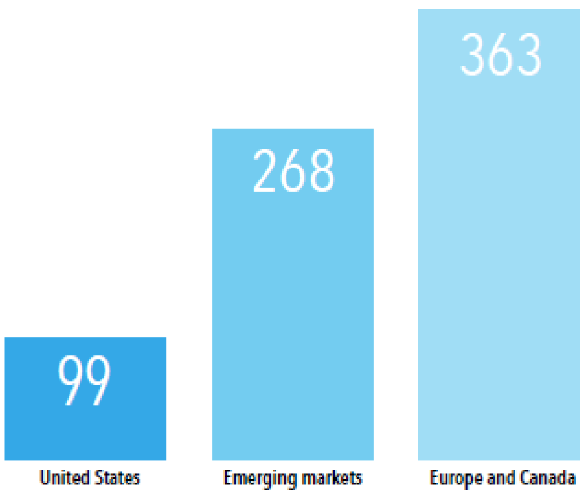


Dividend culture is international

As emerging markets evolve, new opportunities for income develop. The expansion of dividend culture abroad offers an additional dimension to international investing and potentially a source of higher yields. (See Exhibit 8 below)

EXHIBIT 8

Many companies with a dividend yield of more than 3% are outside the U.S. ...



... and those companies are represented in numerous sectors

	United States	Emerging markets	Europe and Canada
Consumer discretionary	7	21	33
Consumer staples	11	12	19
Energy	6	32	36
Financials	27	75	117
Health care	4	3	11
Industrials	5	20	40
Information technology	6	28	20
Materials	2	29	26
Telecommunication services	5	26	30
Utilities	26	22	31
Total	99	268	363

The Bottom Line: Dividend investing is not new and has come back into vogue with sweeping opportunity abroad. Historically, dividend-paying stocks have easily outpaced the performance of non-dividend paying stocks – and have done so with lower volatility.

We believe dividend investing under the framework of stocks with conservative but meaningful payout ratios and yields – with strong tracks records and future prospects of rising payouts – offers potential value in an environment where most assets are at or above fair value. Low interest rates, strong corporate balance sheets, and investor demand should help this trend continue.

Disclosure: Not FDIC insured - No Bank Guarantee - May Lose Value. For LVW Advisors and related companies Clients. Past Performance Of These Funds Is No Guarantee Of Future Performance*.* *The graphs and tables making up this report have been based on unaudited, third-party data and performance information provided to us by one or more commercial databases and, in some cases, by the fund managers directly. Performance figures may be estimates. While we believe this information to be reliable, LVW Advisors bears no responsibility whatsoever for any errors or omissions. Additionally, please be aware that past performance is not a guide to the future performance of any manager or strategy, and that the performance results displayed herein may have been adversely or favorably impacted by events and economic conditions that will not prevail in the future. Therefore, caution must be used in inferring that these results are indicative of the future performance of any strategy, fund, manager, or group of managers. An investment involves risks, including the risks of losing some or all of the invested capital and liquidity restrictions as defined in the offering documents. All performance numbers shown herein are net of actual fees and expenses and include the reinvestment of dividends and other income, as reported by the manager and/or by the commercial databases involved. THIS IS NOT AN OFFER TO SELL OR THE SOLICITATION TO PURCHASE AN INTEREST IN THESE FUNDS. Any such offer can only be made by means of a confidential private offering memorandum which any investor should review thoroughly prior to investing. Index benchmarks contained in this report are provided so that performance can be compared with the performance of well-known and widely recognized indices. The volatility of these indices may be materially different from that of the fund. You cannot invest directly in an index. Index results assume the re-investment of all dividends and interest. In addition, the fund's holdings may differ significantly from the securities that comprise the index. Moreover, the information provided is not intended to be, and should not be construed as, investment, legal or tax advice. Nothing contained herein should be construed as a recommendation or advice to purchase or sell any security, investment, or portfolio allocation. Any investment advice provided by LVW Advisors is client specific based on each clients' risk tolerance and investment objectives. Please consult your Advisor directly for investment advice related to your specific investment portfolio.*

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