Monthly Update

August 2016

Be Careful of High Dividend Stock Strategies

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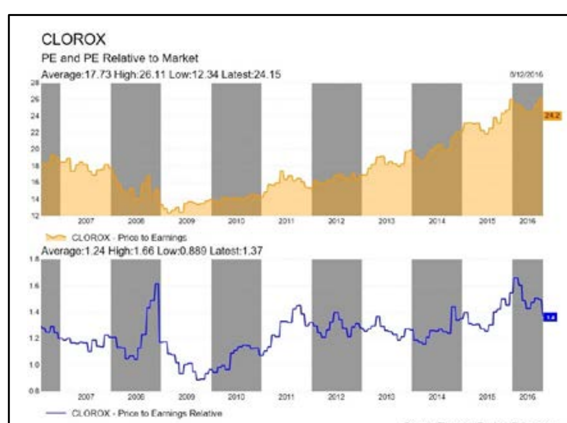
We recently hosted an excellent dinner for some of our most kind relatives and friends. Many are retired and are simply enjoying life, and the vast majority are extremely worried about their investments generating income – justifiably so in this near zero interest rate environment. Interest rates (10-Yr US Treasury) have declined an astonishing 50% from the 3% rate in December 2014 to today's 1.5%.

The conversation turned into an inquiry session, as each party wanted to know what the others were doing for cash flow. All concurred that the old-fashioned muni bond laddering as well as your "age in bonds and the rest in stocks" strategies are passé. The most common response? Invest in high dividend paying stocks. Build a high quality, well diversified portfolio of blue chips that pay a 3-4% dividend and have solid fundamentals, and bet they will hold their value in the eventual bear market.

As a Principal at Lanier and a believer that diversifying strategies are essential for financial success, I forewarned our guests that these high dividend paying stocks may well be much riskier than advertised. The reason? VALUATION!

Valuation of securities is the best predictor of an asset's future performance over long periods of time. For example, the S&P 500 typically trades at 14-15 times earnings versus the current 20 times, and thus the brightest minds are projecting multi-year returns of just 4-6% versus historic returns of 10-11% per year. Unquestionably, the market is trading at a much higher risk level than normal. So what's the valuation picture look like for these popular higher dividend paying stocks?



The best valuation metric of stocks that I have used for now three decades is the historic price earnings ratio range relative to the S&P 500. For example, the top chart illustrates the price earnings ratio of Clorox over the last 10 years. It is currently at 24.2 versus an average of 17.7 – a 37% premium. The bottom chart shows Clorox usually trades at a 24% premium to the market. Expensive!

So we analyzed the higher dividend stocks as well as the securities held in several high dividend mutual funds and ETF's. The "usual suspects" in most of these funds include Microsoft (2.5% yield), AT&T (4.4%), Chevron (4.3%),

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Johnson & Johnson (2.6%), GE (2.9%), JPM Chase (2.9%), Clorox (2.4%) and Verizon (4.2%). The overall yield of the portfolios is approximately 3% versus the S&P 500's current yield of 2%.

We summarized the data: Many of the typical higher yielding dividend stocks – the ones many of our friends and relatives have flocked to for income – have a 20-30% higher premium regarding the stock's historic price earnings ratio range relative to the S&P 500. The search for income is accompanied with quite a high amount of risk! Both the overall market is expensive, plus the PE ratio premium on higher dividend paying stocks adds more downside risk due to noteworthy higher valuations. Yikes! Relatives and friends – be careful! So in a downdraft, these supposed safer blue chips truly have a long way down to their normal historic valuation levels.

In addition, we analyzed the 35 highest yielding stocks in the S&P 500. Twenty-five of the thirty-five are valued materially above their 10-year historic PE's, and the group overall is valued near 20% higher than its norm. Can you say "yield chase?" If the market went back to just normal valuation – down 20-30% – these stocks could fall an additional 10-20% or 30-50% to get to their normal PE's relative to the market. Ouch!

Our solution – invest like the largest endowment and pension funds do and decrease your risk to the overall market. Be sure to have a much lower exposure to the traditional stock and bond asset classes AND own a meaningful amount of real assets, hedge funds and managed futures – asset classes where access to the best and brightest is key. We call it the Lanier "better mousetrap."

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Key Points From Our Investment Meeting – 8/9/16

Macro Viewpoint

- Markets in the US and around the globe continue to rise as central banks continue with QE and zero interest rates
- Brexit outcome turns into non-event at least in the short term as markets rally
- Increased ISIS terror events lead to tensions around the world

Asset Class Comments

- Fundamental analysis of US corporations seem to have policies diverged from current market levels. Be cautious!
- Given lower expected returns for the stock and bond market over the next 7-10 years, investors need to think critically about how they will reach their long term goals
- We continue to believe this environment warrants the need for Diversifying Strategies

Performance Update

	Investment Vehicle	Total Return (%)							
						Annualized			
		July	QTD	YTD	1-Year	3-Year	5-Year	7-Year	10-Year
TRADITIONAL ASSETS									
Cash									
Vanguard Reserve Prime Money Market		0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.1%	1.1%
Fixed Income									
Domestic (Barclays US Agg)		0.6%	2.4%	5.5%	6.2%	4.3%	3.6%	4.5%	5.1%
Vanguard Total Bond Market	VBMFX	-0.2%	0.4%	5.7%	5.5%	3.9%	3.4%	4.2%	4.9%
Eaton Vance Floating Rate	EIBLX	0.9%	0.9%	3.8%	-0.6%	1.4%	3.0%	5.0%	3.4%
US Preferred Stock ETF	PFF	1.4%	1.0%	6.2%	8.0%	7.7%	7.0%	8.5%	4.2%
High Yield (Barclays US Corp HY)		1.6%	5.8%	8.1%	1.9%	3.2%	5.4%	8.9%	7.4%
Short Term High Yield	SJNK	1.0%	1.2%	8.9%	1.1%	-	-	-	-
Equities									
Domestic Large Cap (S&P 500 TR)		3.7%	2.5%	3.3%	4.6%	10.8%	13.2%	14.2%	7.6%
S&P Equal Weight	RSP	4.1%	4.2%	9.5%	5.0%	10.4%	13.0%	15.6%	8.6%
Domestic Mid Cap (S&P 400 TR)		4.3%	4.0%	7.9%	4.8%	9.6%	12.1%	15.5%	9.2%
Vanguard Mid-Cap ETF	VO	4.6%	4.5%	7.9%	2.1%	10.3%	12.3%	15.8%	8.5%
Domestic Small Cap (S&P 600 TR)		5.1%	2.8%	5.5%	5.4%	9.4%	12.9%	15.4%	8.7%
Vanguard Small-Cap ETF	VB	5.0%	5.4%	10.5%	2.0%	8.3%	11.8%	15.1%	8.6%
Developed Intl. (MSCI EAFE)		5.1%	-1.5%	-4.5%	-7.7%	1.9%	3.0%	5.4%	2.0%
MSCI EAFE	EFA	4.0%	3.5%	0.4%	-7.8%	1.7%	2.9%	5.1%	1.8%
Emerging Intl. (MSCI EM)		5.0%	0.7%	6.3%	-0.8%	-0.3%	-2.8%	2.9%	3.9%
Vanguard FTSE Emerging Markets ETF	VWO	5.1%	6.4%	15.3%	-0.9%	0.8%	-2.5%	3.2%	3.9%
Real Assets									
Real Estate (FTSE NAREIT US REIT)		2.8%	7.4%	11.2%	19.0%	13.6%	12.6%	18.6%	6.8%
Mortgage Real Estate	REM	3.5%	5.4%	19.5%	9.1%	7.6%	7.5%	7.9%	-
REIT ETF	VNQ	4.3%	1.9%	14.3%	20.9%	14.2%	12.8%	19.6%	7.5%
Commodities (Thomson Reuters/Jefferies CRB Index)		-9.0%	14.8%	16.4%	-19.3%	-19.1%	-15.2%	-7.4%	-8.1%
DBC	DBC	-7.0%	-6.4%	7.5%	-14.1%	-20.3%	-14.9%	-6.8%	-5.4%
DIVERSIFYING STRATEGIES									
Hedge Funds									
HFRI WCI		1.7%	2.2%	1.6%	0.2%	3.2%	2.8%	4.5%	3.8%
INFINITY*	OCEAN	1.0%	1.0%	-0.6%	-0.3%	5.9%	6.8%	7.4%	7.7%
Robeco Long/Short Equity	BPLEX	1.9%	2.8%	12.1%	16.6%	4.9%	7.1%	11.4%	10.8%
Boston Partners Global Long/Short	BGLSX	0.7%	1.1%	3.4%	3.6%	5.3%	4.0%	5.5%	4.5%
Managed Futures									
Barclays CTA Index		-1.3%	1.8%	1.2%	1.7%	3.0%	0.6%	1.5%	3.3%
WINTON*	WINTON	0.6%	0.6%	2.1%	-0.7%	3.2%	-0.2%	1.6%	3.8%
QIM*	QIM	-0.2%	-0.9%	7.6%	17.6%	2.6%	1.6%	-1.5%	3.5%
AQR Managed Futures Strategy	AQMNX	0.3%	0.1%	2.2%	2.4%	6.1%	4.3%	3.7%	4.9%
Natixis ASG Managed Futures Strategy	ASFYX	1.6%	0.4%	5.9%	3.2%	11.5%	4.5%	5.3%	6.0%

= Benchmarks
= Lanier Selections

* For Accredited Investors

Our Team

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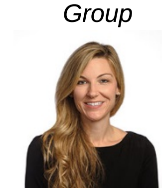
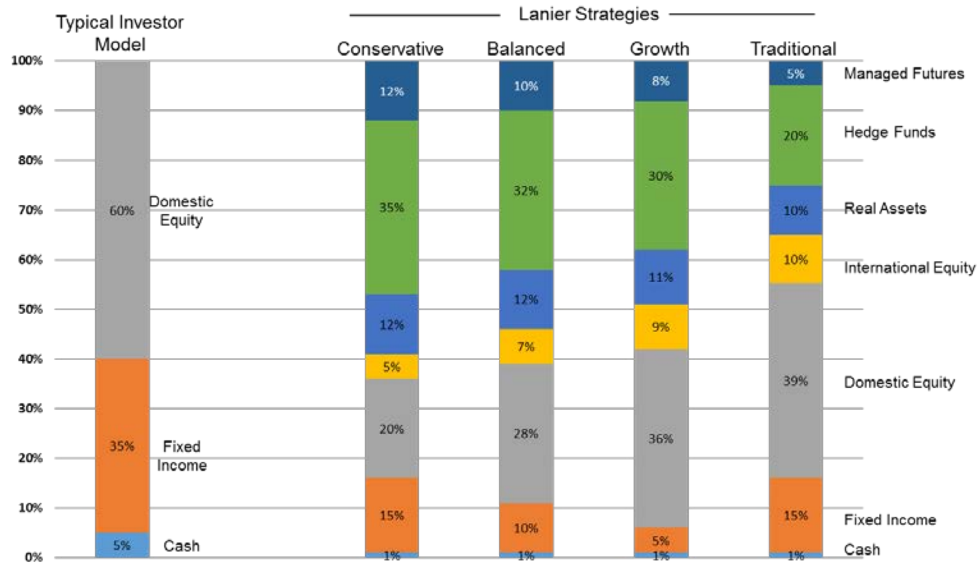


Stephanie E. Milby
Investment Associate

Building Confidence and Security in Your Financial Future

Our Approach

At Lanier, we believe that portfolios designed to deliver superior performance and lower correlation with the overall markets must decrease reliance on stocks and bonds and be complemented with a set of diversifying strategies and alternatives



Each of our clients has a unique set of needs (based on age, risk tolerance, income need, etc.) and an asset allocation model designed specifically to meet those needs. Consequently, actual client investment models can and do vary from the allocation percentages listed above.

Lanier Asset Management is an independent Registered Investment Advisory firm. Our mission: ***To Build Confidence and Security in our Clients' Financial Future***. We use an open architecture investment structure to combine the best of proprietary and independent investment strategies. At Lanier, we deliver superior service and performance to our clients as a result of four distinguishing elements:

- **People**: we are an independent firm, providing objective advice from experienced investment professionals working in your best interests
- **Investment Philosophy**: we seek to smooth investment returns, providing superior investment performance and a significantly lower correlation to the overall market
  - Focus on projected returns rather than historic for all asset classes
  - Similar to the largest U.S. endowments
- **Investment Process**: combine active and passive management in traditional asset classes; complement with diversifying strategies/ alternatives
- **Conviction**: we believe in our approach – this is how we invest our own money