Investment Insights

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The Model Wealth Program
Principle-Based Investing

"Principal-based investing means we focus on investment principals that have stood the test of time rather than basing our decisions on short-term market predictions. Our goal is to identify a small number of experienced managers who offer the potential to out-perform their peers over a long period of time. Our approach is to combine a well-defined quantitative and qualitative due diligence process with proprietary construction tools to build, manage and monitor our client's portfolios."

The Model Wealth Program is a managed fee-based investment program, available through Cornerstone Wealth Management, LLC. The MWP investment team has developed sophisticated long-term strategies in an effort to manage and control risk, to help investors pursue their financial goals. For more information about the program, contact your Cornerstone Wealth Management representative.

The Power of Dividends

> *"A cow for her milk, a hen for her eggs, and a stock, by heck, for its dividends!" - John Burr Williams*

Understanding Dividends

Common stock represents ownership in a corporation. As a stock-holder, the investor usually has voting rights (one vote per share) to elect the board of directors who oversee the major decisions made by the company's management. The investor also has a right to share in the company's profits, which are often distributed in cash. This cash payment is called a dividend.[1]

Investors often focus their attention on the potential for a company to grow its short-term profits, not its long-term dividends. Company executives often talk about the rosy outlook for near-term profit growth, and analysts follow the company's many man-hours trying to forecast how earnings might progress from one quarter to the next. But this involves a lot of guesswork. After all, there is great uncertainty and many factors that can impact the short-term profits of a company.

Contrast that approach with that of famed value investor Warren Buffett, widely believed to be one of the most successful investors of our time, who said:

"Intelligent investing is not complex, though that is far from saying it is easy. Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily understandable business whose earnings are virtually certain to be materially higher 5, 10 and 20 years from now." – Warren Buffett

But Buffett's approach is beyond the reach of many do-it-yourself investors. After all, how many of today's investors have attempted to calculate a "rational price" for some of today's most popular stocks? And could anyone be "virtually certain" of the 10 or 20-year outlook for companies in such rapidly changing fields as social media, e-commerce or electric cars?

Which do your prefer—Chicken or Eggs?

John Burr Williams, a 20th Century economist and a pioneer in the field of securities analysis, struck a bright line between being in the chicken business and being in the egg business. He believed that buying and selling chickens was nothing more than speculating on the short-term direction of price. On the other hand, investing in egg-laying chickens was completely different. He believed it was possible to calculate the present value of a chicken by estimating its total egg-laying potential during its lifetime, then discounting that value back to present. This concept, he felt, lies at the heart of fundamental stock analysis, and forms the basis for decisions made by what we believe are some of the most successful investment managers today.

It's also a different way for investors to think about investing. Instead of thinking about the short-term direction of the economy or stock market, it might make more sense to think about the long-term *income* growth potential of your investments.

"...the best treatment for stockholders is the payment to them of fair and reasonable dividends in relation to the company's earnings and in relation to the true value of the security..."

- Benjamin Graham

Key Takeaways:

- Instead of thinking about the short-term direction of the stock market, it might make more sense to think about the long-term income growth potential of your investments.
- We believe a properly diversified, professionally-managed portfolio that focuses on companies with the potential for rising income through dividend growth offers the potential for balance, stability, and a rising income stream to help pay monthly bills that are rising at the rate of inflation.
- Stocks that grow their dividend delivered much higher returns than stocks that did not grow their dividend historically.
- The Model Wealth Program Income Portfolio focuses on managers that have historically emphasized stocks with a history of increasing dividends and the potential for growing dividends.

Rising Income offers the potential to offset Rising Prices

We believe a properly diversified, professionally-managed portfolio that focuses on companies with the potential for rising income through dividend growth offers the potential for balance, stability, and a rising income stream to help pay monthly bills that are rising at the rate of inflation. Rising income investments can also make it easier for investors to exercise patience and ignore the short-term fluctuation in the stock market, focusing instead on the gradual long-term growth in income.

Because of inflation, someone who retires at age 65 in the United States can expect to live an average of 18-20 more years.[2] Even at a relatively low inflation rate of just 3 percent, the cost of living will nearly double during that time. In other words, 20 years from now, it will take more than $90,305 a year to buy the lifestyle that costs $50,000 a year today. We believe a professionally-managed portfolio of stocks that offer the potential for rising income through dividend growth can help investors keep up with the rising cost of living.

(1) Of course, dividend payments are not guaranteed and can be raised or lowered by the board at any time.

(2) Source: OECD Data, 2015 (latest available)

Income Today versus Income Tomorrow

Many investors ignore stock dividends because the current dividend yield of stocks seems unexciting. We believe the secret behind successful dividend investing lies not in the current value of dividends, but the potential value of dividends for years to come.

Consider a simple example using the broad market, as measured by the S&P 500. Here we see the history of the S&P 500's price, dividends, and earnings:

	S&P 500	Dividends	Earnings	Yield
1980	123.80	5.70	15.00	4.6%
1985	207.30	7.90	14.61	3.8%
1990	328.75	12.09	21.34	3.7%
1995	614.57	13.79	33.96	2.2%
2000	1330.93	16.27	50.00	1.2%
2005	1262.07	22.22	69.83	1.8%
2010	1241.53	22.73	77.35	1.8%
2015	2054.08	43.39	86.53	2.1%
2017	2664.34	48.93	109.88	1.8%

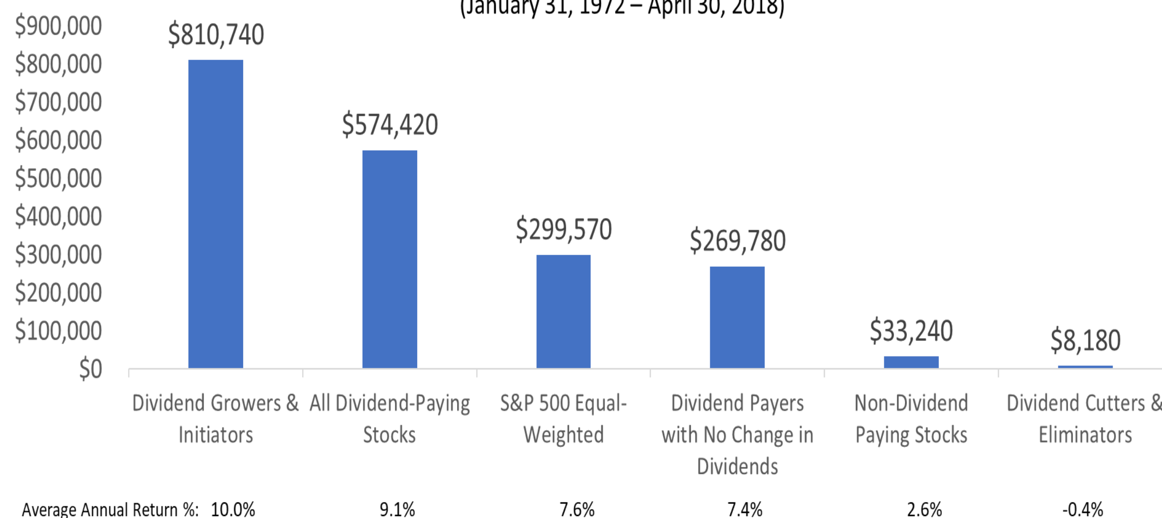
Source: Robert Shiller data. Dates shown are year-end. Past performance may not be an indicator of future results. Does not include fees or expenses. S&P 500 is and index and cannot be invested in directly.

This table shows how it can be a mistake to focus on current yield. In 1980, the S&P 500 price index was at 123.80. The companies that comprised the S&P 500 collectively paid dividends of $5.70, for a current yield of 4.6%.

Many investors felt that stocks were unattractive at the time because the economy was in recession, and many fixed income investments provided much higher yields. But the economy recovered from recession, and corporate profits started a steady, upward march. Just five years later, dividends had grown to $7.90, a cumulative increase of nearly 40%! Over the entire time-period, growth in earnings had its ups-and-downs with swings in the economy, but dividends grew at a steady pace. By the end of 2017, the S&P 500 paid dividends of $48.93, a dramatic increase from its level in 1980. It's also interesting to point out that this rise in dividend income occurred over a period when general interest rates fell dramatically. We believe a "current yield" calculation may not be an accurate indicator of how much income an investor will collect in the future. Unlike a fixed income investment (bond), the stock market (as measured by the S&P 500) has historically shown an increase in income. If dividends continue to grow, income for the investor should continue to grow as well. This focus on dividends does not even consider the growth in price of the S&P 500, which of course added significantly to the investor's total return.

The Performance of Dividend-Paying Stocks

How could an investor potentially tilt the odds even more in his favor than by just owning the S&P 500? Consider the illustration on this page, which contrasts the historical performance of different groups of stocks, characterized by their dividend policy. We studied the historical performance of dividend-paying stocks versus non-dividend payers. The results were impressive. Stocks that grow or initiate a dividend delivered much higher returns than stocks historically that didn't pay a dividend or cut their dividend.



Total return includes dividends. These calculations do not include any commissions or transaction fees that an investor may have incurred. If these fees were included, it would have a negative impact on the return. Source: Ned Davis Research. The S&P 500 is an unmanaged index and cannot be invested in directly. **Past performance does not assure future results.** This is a hypothetical example and is not representative of any specific situation. Your results will vary. The hypothetical rates of return used do not reflect the deduction of fees and charges inherent to investing.

Why not do this yourself?

A do-it-yourself approach to building a stock portfolio often fails because investors often make three mistakes:

- Focusing on companies that have exciting "stories" or interesting near-term prospects that often don't pay a dividend
- Focusing on companies that offer high current yield instead of companies that offer solid potential for long-term dividend growth
- Buying "yesterday's winners" by mechanically buying companies that have grown dividends historically, but whose best days are behind them. This approach often over-weights the portfolio in low-growth industries such as telecommunications, utilities and consumer staples.

Important Disclosures

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly. Economic forecasts set forth may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. Rebalancing a portfolio may cause investors to incur tax liabilities and/or transaction costs and does not assure a profit or protect against a loss.

Stock and mutual fund investing involves risk including loss of principal.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

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Securities offered through LPL Financial, Member FINRA/SIPC

The Model Wealth Program: Income Portfolio

Our Income portfolio focuses on managers we feel offer strong potential within the universe of equity managers that focus on dividend-paying stocks. The portfolio is properly diversified among managers in the three major asset classes: U.S. equity, international equity, and fixed income. We believe building a portfolio of multiple managers provides the opportunity for diversity of opinion and can reduce the impact of one manager's miscalculations or mistakes. We also rebalance the portfolio when market conditions push the portfolio out-of-balance in an effort to maintain a steady level of risk consistent with your long-term goals and objectives.

We offer five different choices for investors with varying risk tolerance and need for current income: Aggressive Growth, Growth, Growth & Income, Income with Moderate Growth, and Income with Capital Preservation. We believe a professionally-managed advisory account can help take the emotions out of the investment decision-making process, and offers an attractive solution for investors with long-term goals, like saving for, or investing in, retirement.

To learn more about our Income Portfolio, make an appointment with your financial advisor today.