Second Quarter 2016 Dearborn Partners Rising Dividend Commentary Carol M. Lippman, CFA

How Did We Do?

In the second quarter of 2016, the total return of the S&P 500 Composite Index ("S&P 500," the benchmark against which we compare our portfolios) was +2.46%.[1] The benchmark's total return for the first half of 2016 was +3.84%. The total return of our Dearborn Partners Core Rising Dividend separately managed account (SMA) portfolio was +4.36% in the second quarter and +10.95% in the first half. Our High & Rising Dividend portfolio's second quarter total return was +5.89% and in the first half of 2016 was +15.73%.

In the first half of 2016, the Utilities and Telecom sectors of the S&P 500 each returned more than +23%. The weightings of these two sectors in both of our Dearborn Partners SMA portfolios at least matched or exceeded the benchmark's sector weights. While it would be simple to pin our portfolios' outperformance on our sector representation, that would understate the case. Our greatest outperformance and contribution to return came from our allocation and stock selection in the Financial sector in each of our SMA portfolios. The S&P Financial sector declined -3% for the first half of the year whereas that sector's returns in our portfolios were roughly +27% and +16% in High & Rising and Core Rising, respectively.

For the second quarter, the returns of our stock selections were greater than those of the S&P 500's in all sectors except for the Consumer Discretionary sector in both of our portfolios and the Materials sector in High & Rising. According to Bank of America Merrill Lynch, High Quality (defined as Standard & Poor's quality ratings of B+ or better) outperformed low quality (B or worse) by 5 percentage points in the first half of 2016. We believe that the positive differentials between our portfolios' sector and total returns and the S&P 500's returns show that our disciplined stock selection with strict attention to high quality companies has been an especially important contributor to our results.

Surprising News Created Turmoil Toward the End of Second Quarter 2016

On Thursday June 23, 2016 residents of the United Kingdom (UK) voted on a referendum to either Remain in or Leave the European Union (EU). Most corporate and finance leaders cautioned that a vote to Leave (commonly referred to as Brexit—i.e., "British exit") would result in significant economic turmoil, including jobs being transferred away from the UK. Polls leading up to the day of the vote indicated that the results would likely be close, but Remain was expected to prevail. Instead, when all the votes were tallied, the majority voted to Leave. Discontented older residents who have not benefited from the prosperity that was originally promised would ensue by joining the EU, as well as immigration concerns, were the primary reasons attributed to the decision to Leave.

More than a quarter century ago, former British Prime Minister Margaret Thatcher foresaw problems with the EU and vehemently opposed her country joining. Senior members of her party, however, disagreed with her, challenged her leadership, and forced her to resign effective November 1990. At the end of June 2016, Britain's vote demonstrated how prescient PM Thatcher had been.

[1] *The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market. The inclusion of this index is for illustrative purposes only. You cannot invest directly in an index.*

Worldwide market reactions to the outcome were violent on Friday June 24 and Monday June 27, but we will describe only some U.S. markets. In a flight to safety, the benchmark U.S. 10-year Treasury bond, which had closed on June 23 to yield 1.74%, dropped to an intraday low of 1.27% on Friday June 24 and closed that day at a yield of 1.56%. On Monday June 27, continued fear and uncertainty drove demand for the benchmark to yield 1.44% at the close. The average stock in the S&P 500 dropped -6.6% those two days. The 86 companies in the S&P 500 Index that pay no dividends declined an average -7.96% the two trading days after Brexit. The 419 S&P 500 Index companies that pay dividends declined an average -6.32%.[2] Our portfolios held up even better in that market rout. During the cumulative decline June 24 through June 27, our Core Rising Dividend portfolio was down -3.68%, having held up almost as well as our High & Rising Dividend portfolio, which was down -2.65%.

From the date that the UK formally notifies the EU of their intentions to leave, Article 50 of the Lisbon treaty, the mechanism for the UK to negotiate the legal and financial frameworks of their relationship with the EU, sets a two-year deadline. Because no country has ever left the EU before, it is difficult to postulate what the direct and indirect effects may be on global economies. Some have predicted that the uncertainty and turmoil could spark recessions in countries across the Atlantic, thereby negatively affecting corporate revenues and earnings as well as global economic growth.

How might Brexit affect the companies in our portfolios? FactSet Research Systems has a proprietary algorithm that estimates revenue exposure by country. The following table of weighted average estimated revenue exposure to the UK and Europe of companies in the S&P 500, our Core Rising Dividend portfolio and our High & Rising Dividend portfolio would indicate that the UK affects our portfolios very little, as the country accounts for less than 3% of revenues. Determining Europe's exposure is more complicated, but its net exposure is estimated to be less than 10% of revenues in either portfolio. The effects of relative currency fluctuations on corporate earnings will also be difficult to determine.

	European Revenue Exposure	UK Revenue Exposure	Net Exposure without UK
S&P 500	11.50%	2.90%	8.60%
CRD	12.02%	2.41%	9.61%
HRD	11.62%	2.76%	8.87%

According to a July 4, 2016 Seeking Alpha article entitled, "As Trade Collapses, a Warning Sign Flashes,"

> "*The world economy will see the fifth consecutive year of subpar growth in international trade this year, marking the worst stretch seen since the 1980s. Back at the beginning of April, the WTO (World Trade Organization) announced it expected the volume of international trade to grow by just 2.8% during 2016. For most of the past three decades, world trade has grown at twice the rate of global GDP growth.*
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[2] In the second quarter of 2016, the S&P 500 actually contained 508 companies. As the S&P 500 is rebalanced quarterly, because of corporate actions, the number of companies included may not always total 500.

Unfortunately, these depressing global trade growth and global GDP growth figures are likely to be downgraded over the next few weeks as the effects of Brexit ripple across the global economy.

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A weaker euro as a result of the ECB's actions following Brexit adds to pressure on Asia's U.S. dollar-denominated exports." [3]

These trends actually started playing out in the data back during the first quarter. Developed economy demand weakened from +3.7% year over year in the three months to November 2015 to 1.2% year over year in the three months to March 2016.

Media interviews with numerous "authorities" have provided varying views on possible outcomes as a result of Brexit. We consider St. Louis Federal Reserve President James Bullard to be among the most learned, knowledgeable, and respected authorities. Here are paraphrased excerpts from Bullard's interview on Bloomberg TV on July 1, 2016 during which he discussed Brexit and "The St. Louis Fed's New Characterization of the Outlook for the U.S. Economy" (dated 6/17/16).

"This is a big issue for the UK. They have to plot a course for a new relationship with the Continent. It will take a long time for the UK to negotiate trade agreements with the Continent. As an example, the EU and Canada took seven years to negotiate their trade relationship. Brexit's effect will not have a big impact on the U.S., possibly zero, and probably little on Europe. Would there be further contagion to Europe? So far we are not seeing such indications. … We are in a low growth, high liquidity regime, with no evidence that we would be coming out of that any time soon. The large liquidity premium—i.e., people love holding government paper—is out of character with previous decades. As a result, there is little threat to inflation heating up or going negative. … Brexit by itself will not fuel or influence inflation around the world. We need faster productivity growth. I do not see other countries copying this vote." [4]

This is, of course, only one person's opinions, and he is probably attempting to provide calm and reassurance to markets and investors. What does appear to be happening in the marketplace, however, is a shift from the attitude of complacency since the fall of 2011 when investors perceived that zero short-term interest rates and quantitative easing would fuel and support the stock market, especially stocks of risky companies with high debt levels and poor quality. Lately, as uncertainty and fear have spread, many investors appear to believe that a more conservative approach may be warranted.

Interest rates worldwide remain very low; some government bond yields are negative, meaning that risk-averse people are willing to pay central banks to hold their money, keep it safe—i.e., the liquidity premium to which President Bullard referred. As central banks have offered reassurances that rates will likely stay low for some time, many investors have come to the realization that the stock market is essentially the only place to get income returns greater than those available from most fixed income investments. Markets rebounded sharply the last three trading days of June. The

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[3] Hargreaves, Rupert. "As Trade Collapses, A Warning Sign." SeekingAlpha.com, July 4, 2016. http://seekingalpha.com/article/3986057-trade-collapses-warning-sign-flashes

[4] http://www.bloomberg.com/news/videos/2016-07-01/fed-s-bullard-brexit-s-u-s-impact-possibly-zero

S&P 500, which dropped to just below 2,000 intraday on June 27, climbed more than 5%, ending the quarter barely below 2,100.

Financially solid, defensive, well-managed businesses with the ability to consistently increase dividends have historically helped investment portfolios. Once again, the power of rising dividends from the high quality companies we work hard to find for our portfolios cushioned the fall of stock prices in the Brexit-induced, challenging markets—just as we discovered with our original research in the early 1990s. In strong markets we would hope to participate, but probably would not outperform. Our primary objectives have been to offer a relatively conservative strategy that allows investors to **participate** in what we truly believe is the long-term wealth-building potential offered by the stocks of solid companies, and **stay in the market** throughout any turmoil and volatility, knowing that there is a high likelihood of receiving dividends that have the potential to increase over time. We think the sharp rebound of the market after the two-day post-Brexit sell-off reinforces the importance of being in the stock market at all times.

Plus, our portfolios offer better income than many alternatives. As of June 30, 2016, the current yields on 46 (94%) of the 49 companies in our Core Rising Dividend SMA portfolio exceeded the 1.44% current yield on the U.S. 10-year benchmark Treasury bond and 24 (96%) of the 25 companies in our High & Rising Dividend SMA portfolio had current yields higher than that of the long bond. We promise to maintain our disciplines and to continue to work hard to try to include in our portfolios what we consider to be financially solid companies with the potential to increase dividends over time.

Cumulative Income Summary

Here is the cumulative dividend income from an initial $200,000 investment on September 30, 2011 (the inception date of our SMA portfolios) through June 30, 2016 in each of:

	Current Yield	Cumulative Income*
Core Rising Dividend SMA	2.4%	$35,169
High & Rising Dividend SMA	3.0%	$45,555
S&P 500	2.2%	$31,581

**The S&P 500 dividend income in the table above is calculated by creating hypothetical investable "share units" by dividing the assumed initial $200,000 investment by the price of the index (1131.42) on September 30, 2011 (the inception date of our Rising Dividend SMA portfolios), resulting in 176.77 share units. The dividends per share unit of the index, provided by S&P Dow Jones Indices, are applied to the calculated units on a quarterly basis. The total represented in the table is the sum of those quarterly dividends per share unit, from December 31, 2011, through June 30, 2016.*

Dividend Increases

In the first half of 2016, 27 companies in our Core Rising Dividend SMA portfolio announced 30 dividend increases averaging about 7.2% more than those particular companies paid a year earlier. Two companies in this portfolio announced dividend increases after only one quarter, one company increased its dividend after only two quarters, one company increased after three quarters, and one company increased its dividend after five quarters. In our High & Rising Dividend SMA portfolio, 14 companies announced 17 dividend increases averaging about 6.4% more than those particular

companies paid a year earlier. Two companies in this portfolio increased dividends after only one quarter and one company increased after only two quarters.

Thank you for your interest in our Dearborn Partners Rising Dividend Strategy.

Dearborn Partners Rising Dividend Separately Managed Account Portfolios

Average Calendar Year Dividend Increases

Year	Core Rising	High & Rising	CPI*
2012	18.4%	18.2%	1.7%
2013	12.8%	8.5%	1.5%
2014	12.1%	7.2%	0.8%
2015	9.7%	7.4%	0.5%
H1 2016	7.2%	6.4%	1.0%

** Consumer Price Index for All Urban Consumers Unadjusted 12-month Percent Change. First half (H1) 2016 CPI through June.*

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