



GLOBAL FOCUS CAPITAL LLC
INSIGHT THAT MATTERS

Special Topics Equity Income Generation

Trends and Fundamental Characteristics

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The Setting

- ▶ Global investors have been desperately seeking yield in the last decade
- ▶ Traditional sources of income such as bonds have dried up as monetary authorities around the world have been extremely accommodative post 2008 Financial Crisis
- ▶ Investors seeking yield have flocked to strategies other than fixed income such as dividend paying stocks
- ▶ Income generating assets do not only deliver regular cash flow to investors, but historically have also somewhat protected stock holders during equity market downturns

The Concerns

- ▶ The single minded pursuit of yield at all costs carries its own risks especially after a period of continued demand growth for such strategies
- ▶ Moreover, the ability of companies to consistently raise dividends has come under scrutiny especially in light of a slowdown in economic growth and the collapse in commodity prices
- ▶ In addition, market observers have worried for a while now about the potential over-valuation of income producing stocks
- ▶ Finally, investors have become more concerned about choosing an income generating strategy that also provides a measure of downside principal (price) protection

Methodology

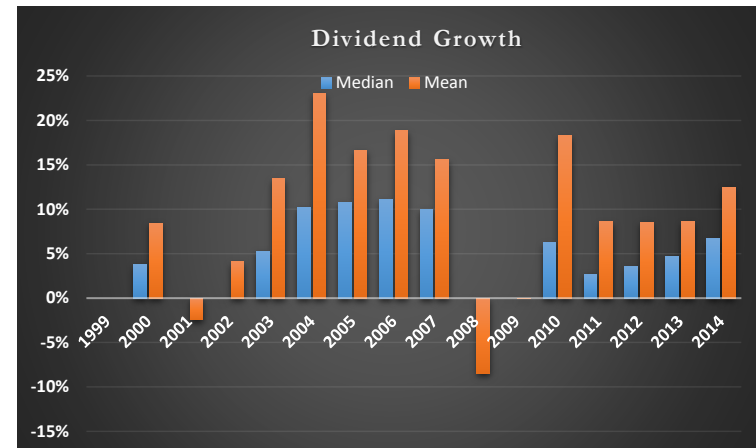
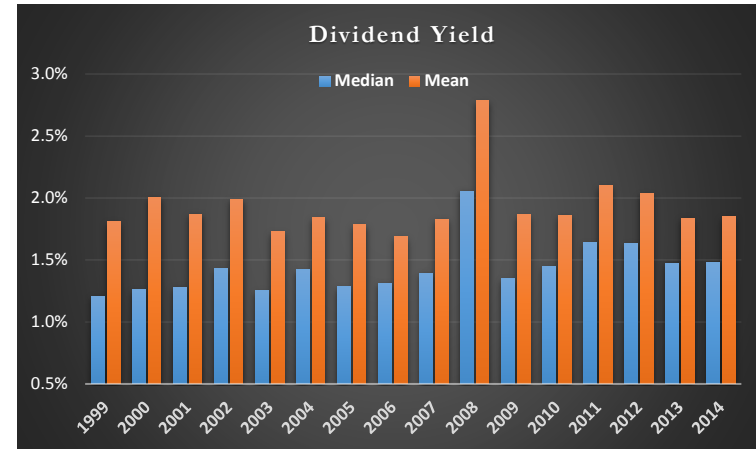
- ▶ Global universe of 13000 stocks (GF 13000) subdivided by market capitalization
 - ▶ GF 1000 (largest 1000 global companies by market capitalization in USD)
 - ▶ GF 2000 (next 2000 largest companies)
 - ▶ GF 3000 (next 3000 largest companies)
 - ▶ GF 4000 (next largest 4000 companies)
 - ▶ GF MINI (smallest 3000 companies in our universe)
- ▶ Created portfolio deciles depending on stock characteristics
 - ▶ Dividend yield & Dividend growth
 - ▶ Valuations
 - ▶ Growth & Profitability
 - ▶ Leverage and ability to sustain dividends
 - ▶ Volatility
- ▶ Examined the fundamental characteristics of the two primary strategies employed by investors seeking yield
 - ▶ High Dividend Yield
 - ▶ High Dividend Growth

Decile 1 contains the most attractive stocks

Decile 10 contains the least attractive stocks

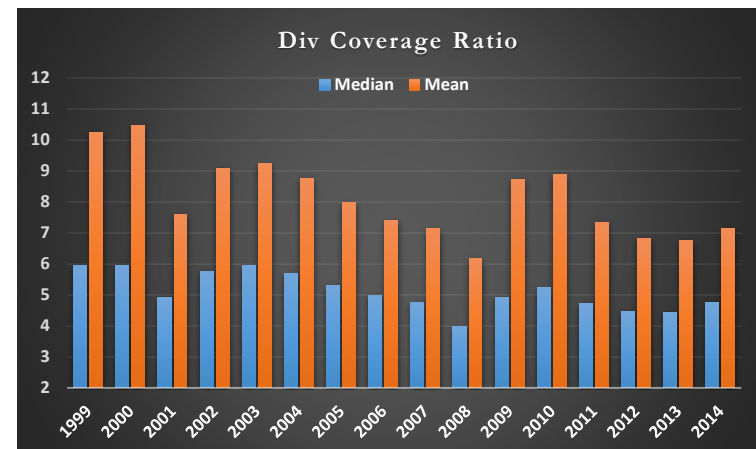
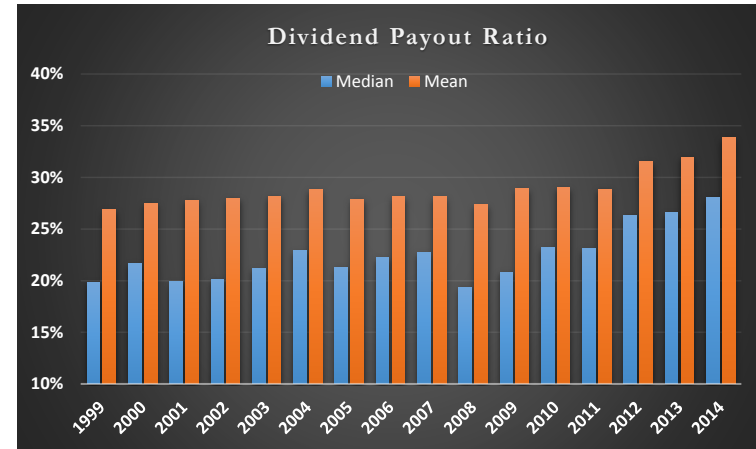
Average Dividend Yields have been pretty steady but dividend growth has been volatile and in line with EPS growth

- ▶ Except for a brief spike up in 2008 dividend yields for our global universe have been fairly steady
 - ▶ Median yields have trended up as more companies have started paying a dividend
- ▶ Dividend growth rates closely mimic EPS growth profiles
 - ▶ Year to year there is a lot of variability
 - ▶ Since the Financial Crisis dividend growth has been more subdued
 - ▶ The likely reason are dividend cuts by large Cap Financials



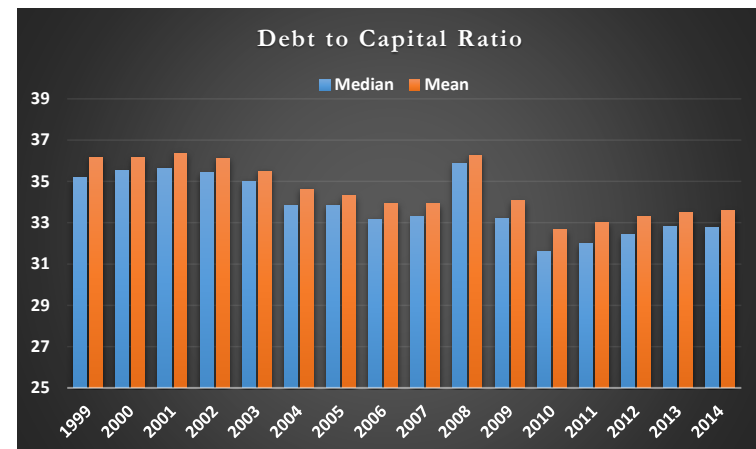
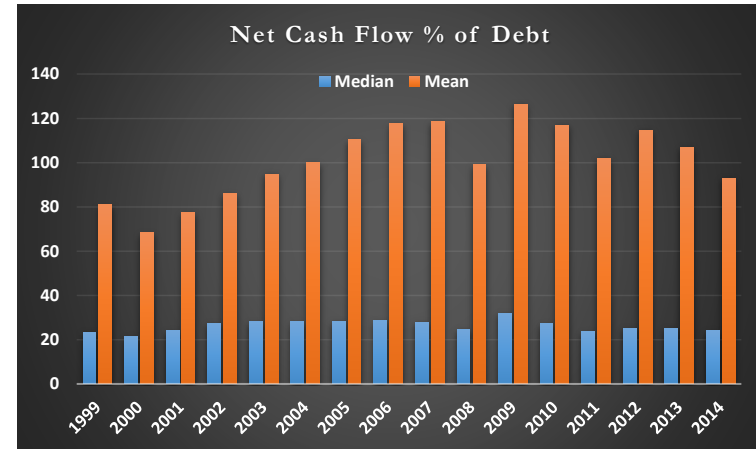
Dividend Payouts have been steadily rising reflecting a greater sensitivity to the wishes of investors seeking yield

- ▶ Average dividend payouts have been increasing steadily over the last 15 years
 - ▶ As the demand for yield has gone up company management teams have been accommodative
- ▶ Not surprisingly, as dividends have grown the dividend coverage ratio has been slowly falling
- ▶ The drop in the dividend coverage ratio does not cause us concern as companies have been enjoying health cash flows



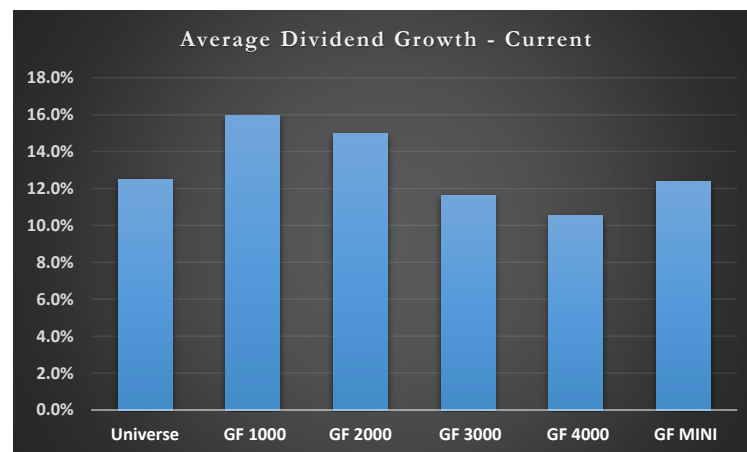
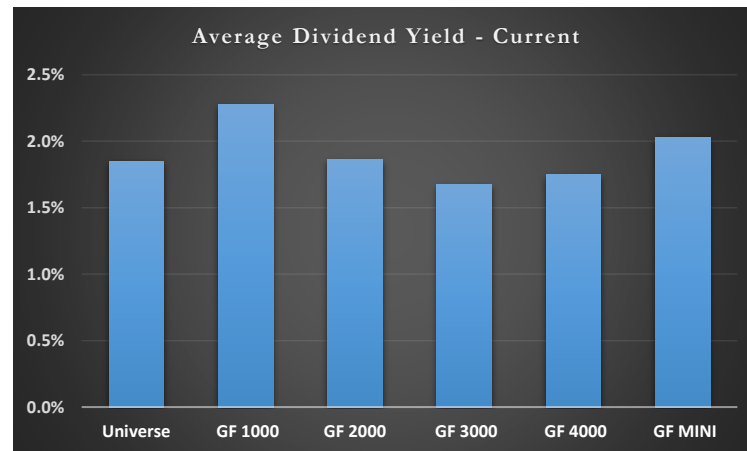
Global companies have become less levered over the last 15 years and cash flow to debt appears exhibits a healthy margin

- ▶ The average company in our universe has become less levered in the last 15 years, but we have had a slight uptick in the last 5 years probably due to the record low interest rates
- ▶ Similarly, the cash flow as a proportion of debt has been falling since the end of the Financial Crisis
- ▶ In general, the growth of dividends has not come at the expense of further balance sheet leverage or an impairment of debt servicing capacity



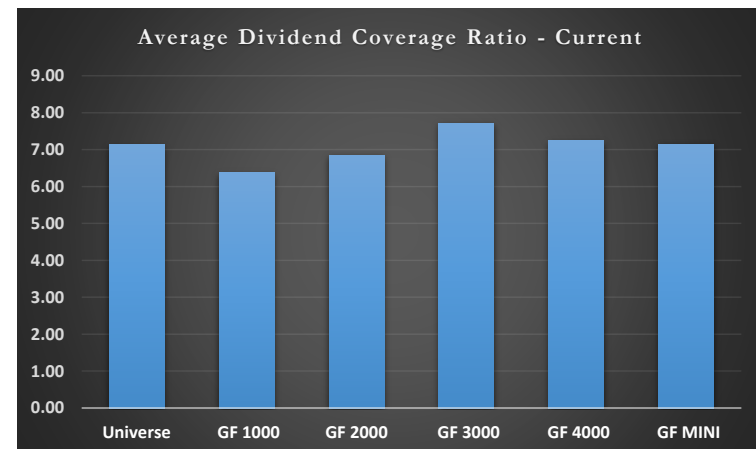
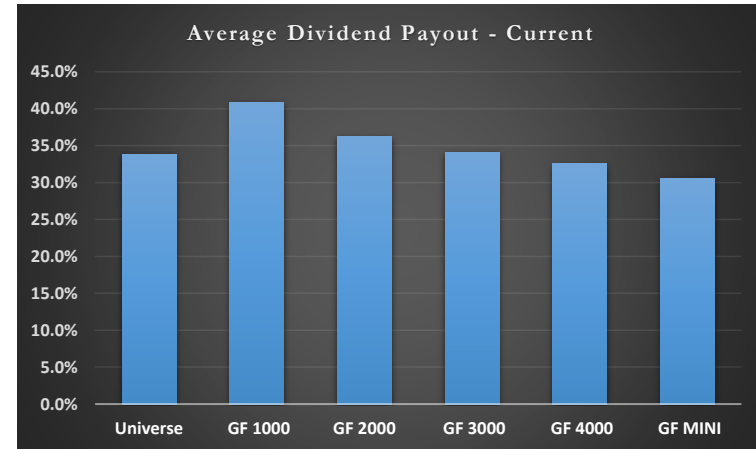
The largest market cap companies (GF 1000 index) enjoy the highest average yields as well as dividend growth rates

- ▶ Current dividend yields are highest, on average, for the largest market cap companies (GF 1000)
- ▶ The second highest average dividend yields occur in the smallest market cap segment (GF MINI)
- ▶ The largest market companies are also growing their dividends at a faster clip than smaller cap companies



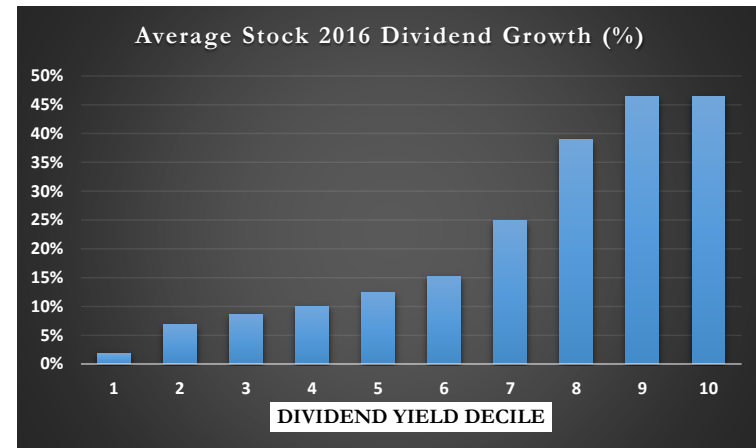
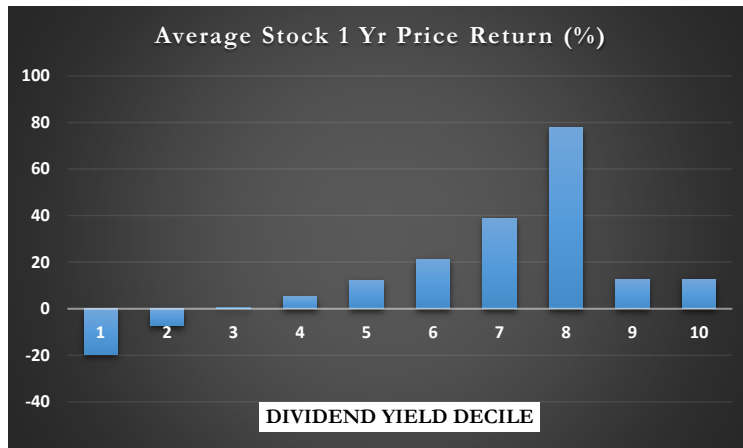
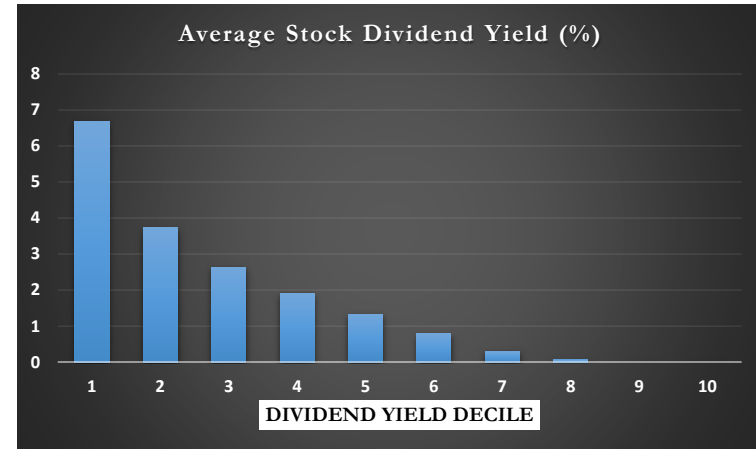
Dividend Payouts decrease with market cap while dividend coverage ratios are pretty uniform across company size

- ▶ The GF 1000 (largest market cap) companies exhibit, on average, the highest payout ratios
- ▶ There is a pretty consistent decrease in payout ratios with lower market cap tiers
- ▶ In terms of current dividend coverage ratios we do not seem to be much distinction among capitalization tiers
- ▶ Moreover, current dividend coverage ratios appear healthy with companies in a position of maintaining or raising their dividend payments if desired

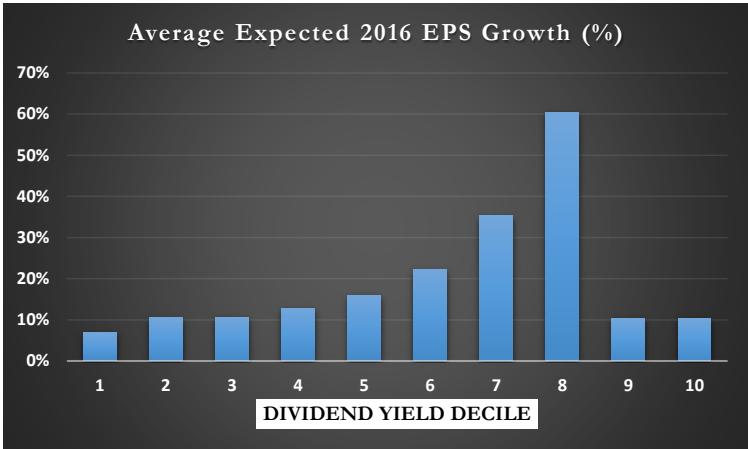
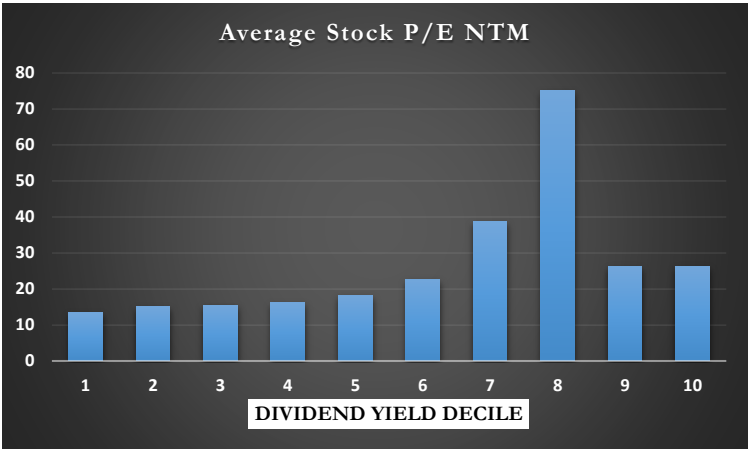
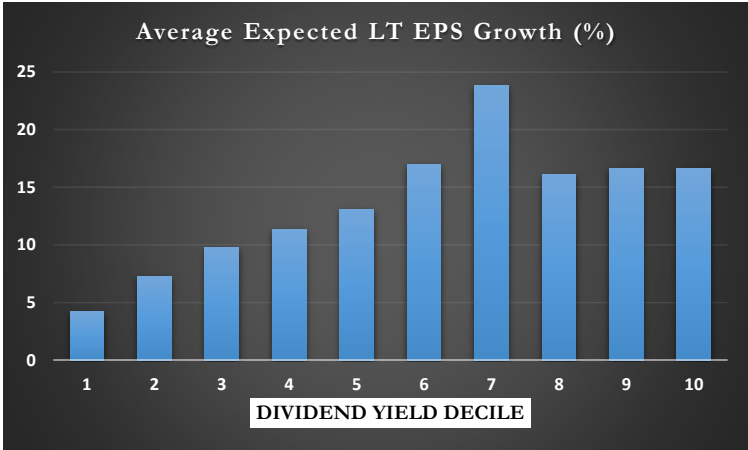
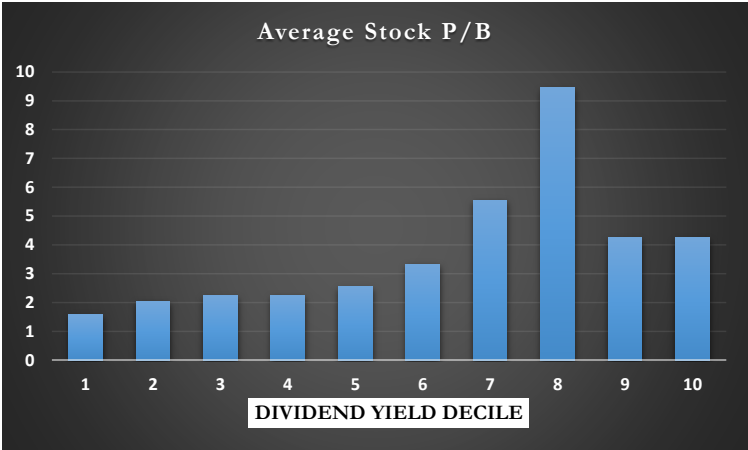


Fundamentals of Dividend Yield Strategies

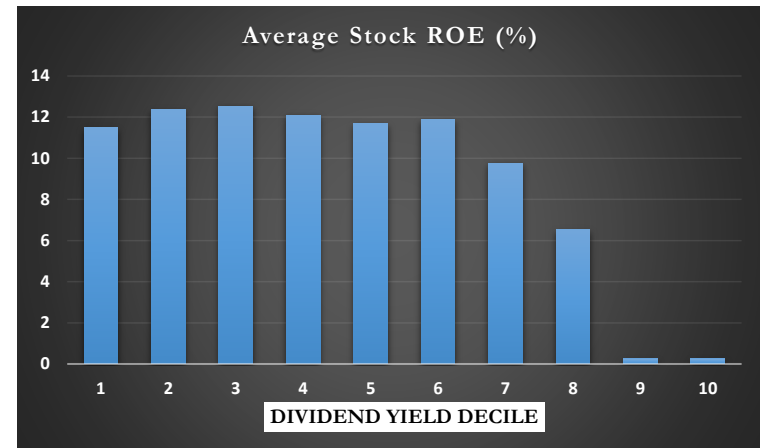
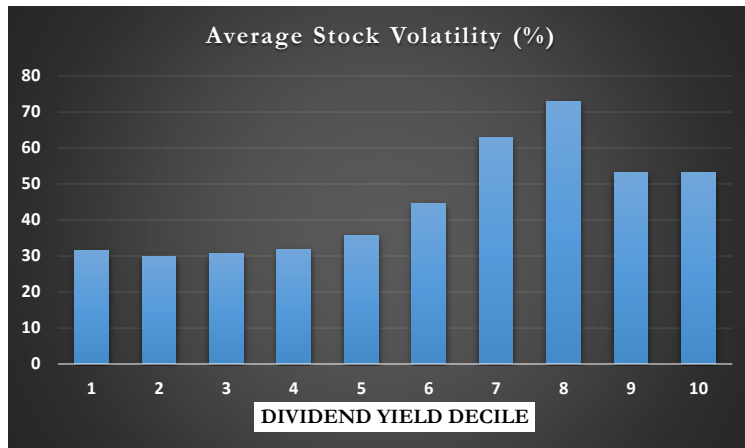
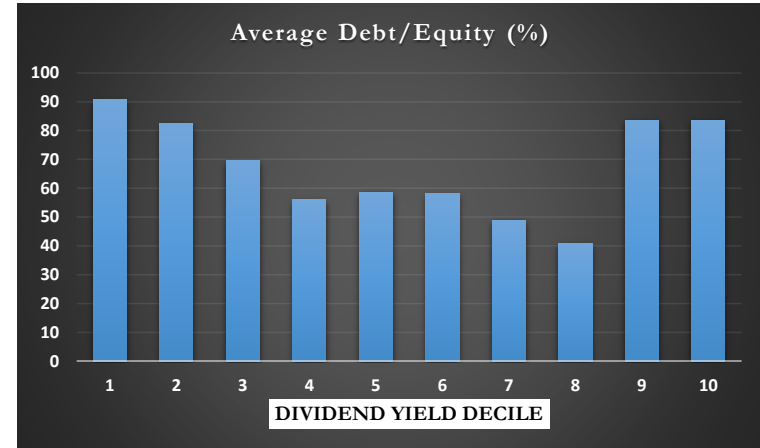
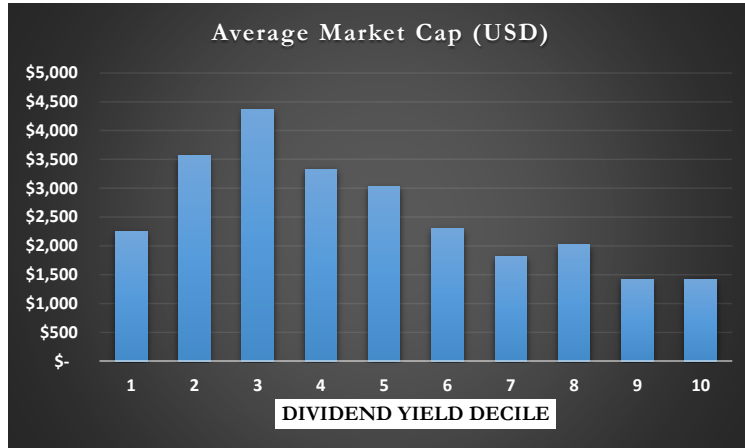
- ▶ The top decile(1) yields over 6.5% dropping sharply thereafter
 - ▶ Deciles 9 and 10 correspond to non-dividend stocks
- ▶ High dividend yield deciles have under-performed in the last year
- ▶ High yield stocks exhibit the lowest rate of expected 2016 income growth



High yield stocks exhibit among the most attractive relative valuations (Decile 1 has the lowest average P/B and P/E ratios) but suffer from a lack of prospective EPS growth. Low dividend yield stocks (Deciles 7 and 8) are expected to grow the fastest both long-term as well as in 2016 but carry the highest valuations as well

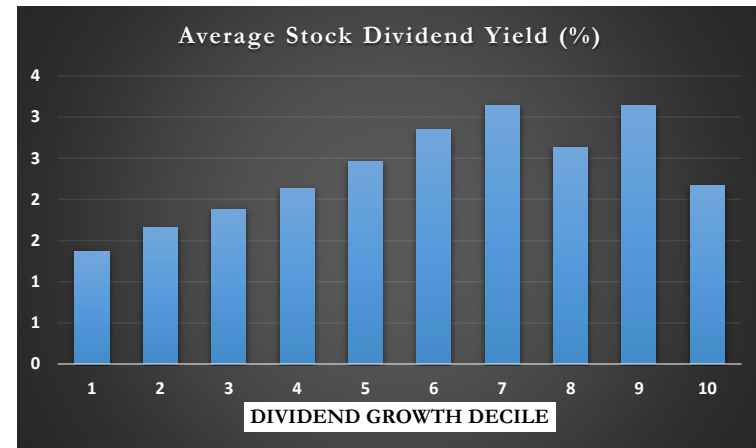
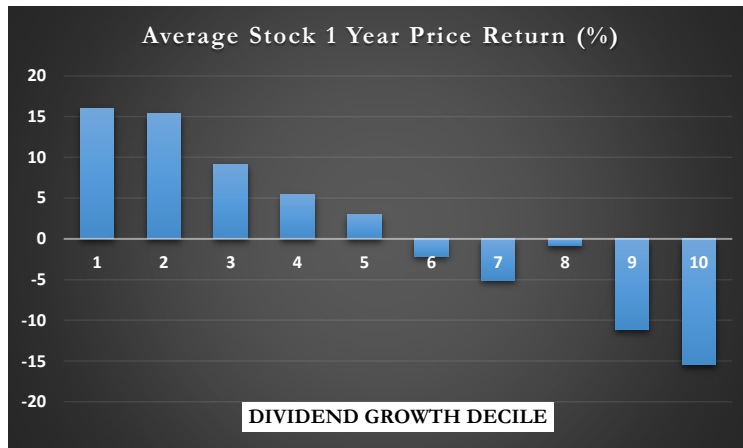
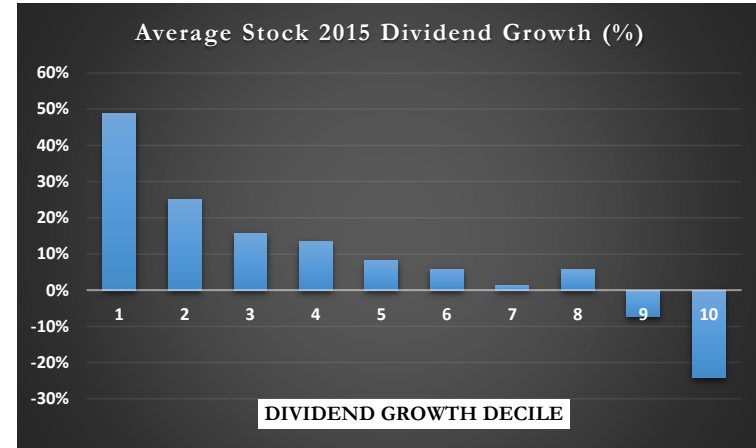


High yield stocks possess middle of the road capitalizations but above average balance sheet leverage. Dividends seem to dampen stock volatility as there appears to be a negative correlation between yield and volatility. In terms of ROE's there does not seem to be much distinction among yield deciles, but note the very low level of profitability of non-dividend payers (Deciles 9 and 10)

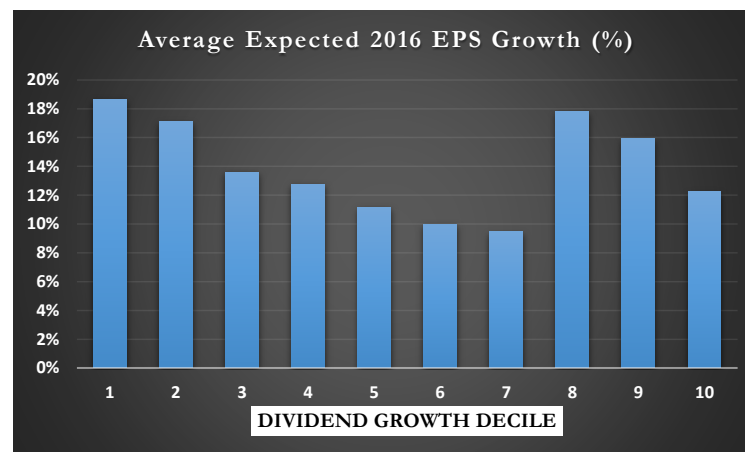
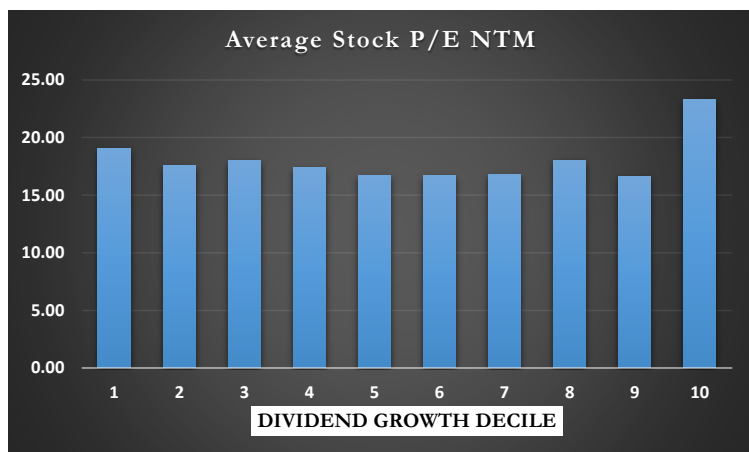
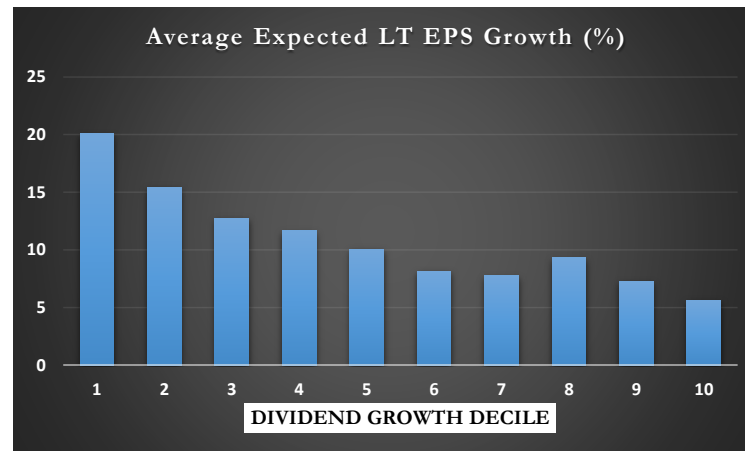
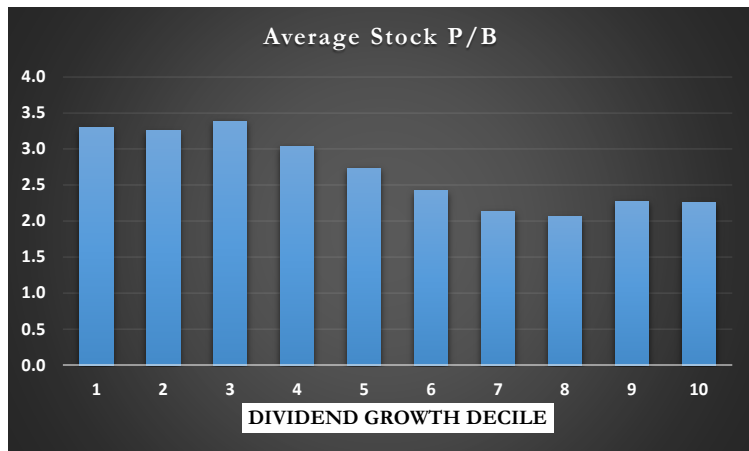


Fundamentals of Dividend Growth Strategies

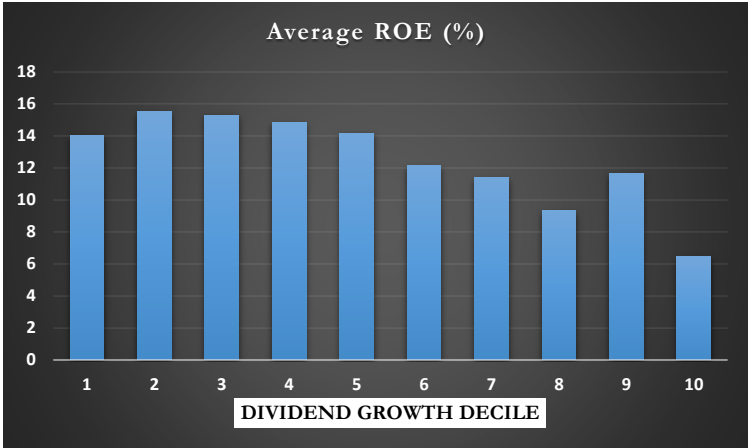
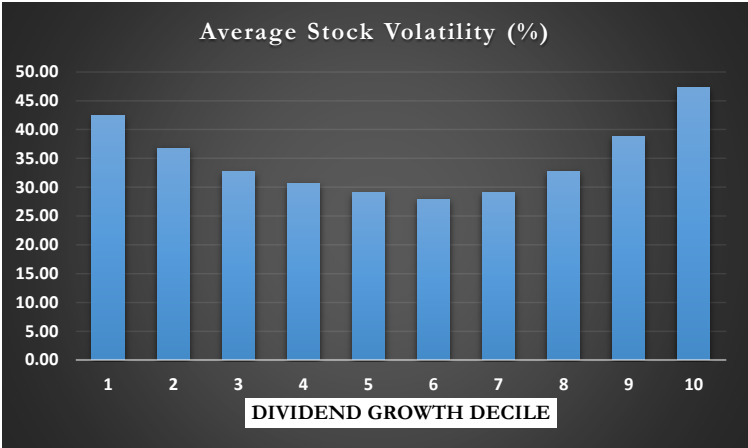
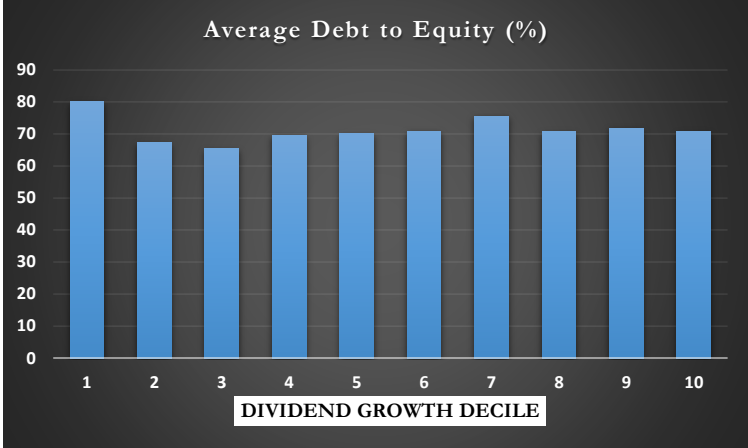
- ▶ Dividend growth has been associated with positive one year performance (2015)
- ▶ The highest dividend growth stocks tend to offer the lowest yields
 - ▶ Companies with a long history of paying dividends tend to operate in more mature sectors



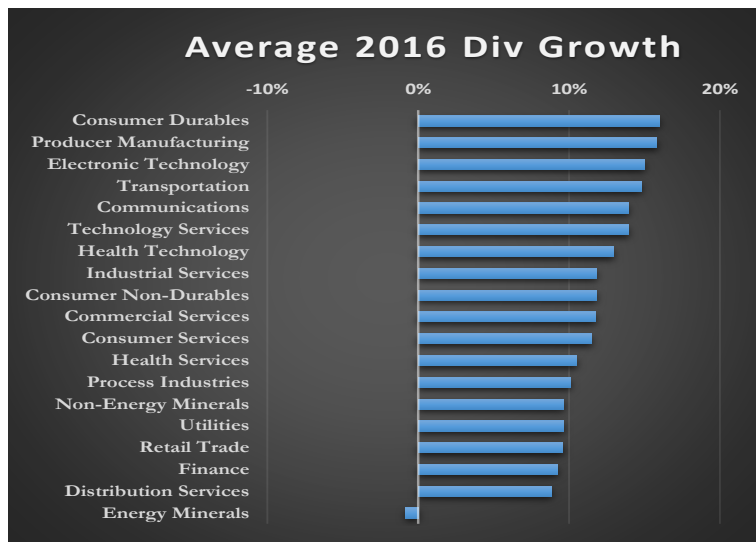
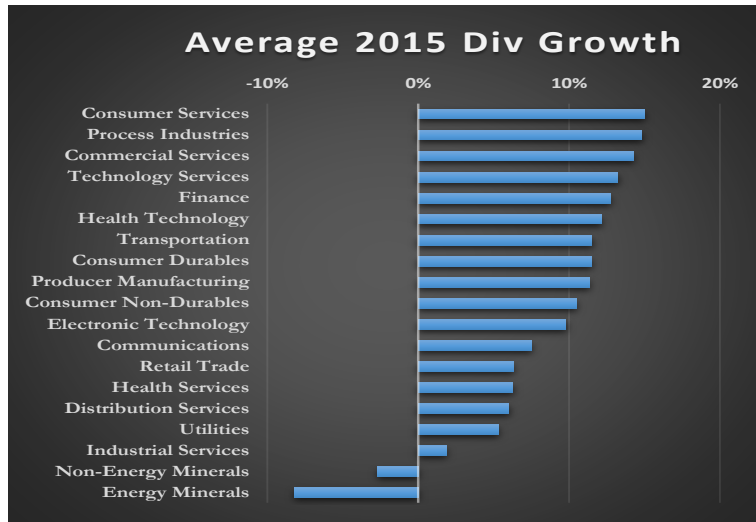
The highest dividend growth stocks appear to be only slightly more expensive in terms of P/B and P/E's but are expected to grow EPS at the fastest rate over the long-term as well as over 2016. The slightly higher valuations of the highest dividend growers seems justified in light of their expected EPS growth profile



The highest dividend growth stocks reside in the middle of the market cap distribution (Deciles 4,5,6 and 7). These mid-cap companies also have the lowest level of stock volatility. Except for the fastest dividend growing companies (Decile 1) there appears to be little distinction in balance sheet leverage across growth profiles. Interestingly, faster dividend growth companies tend to exhibit higher average ROE's

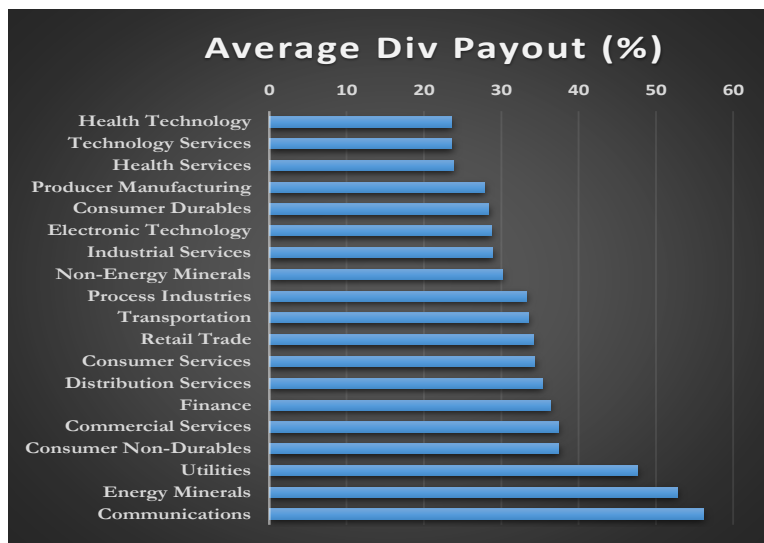
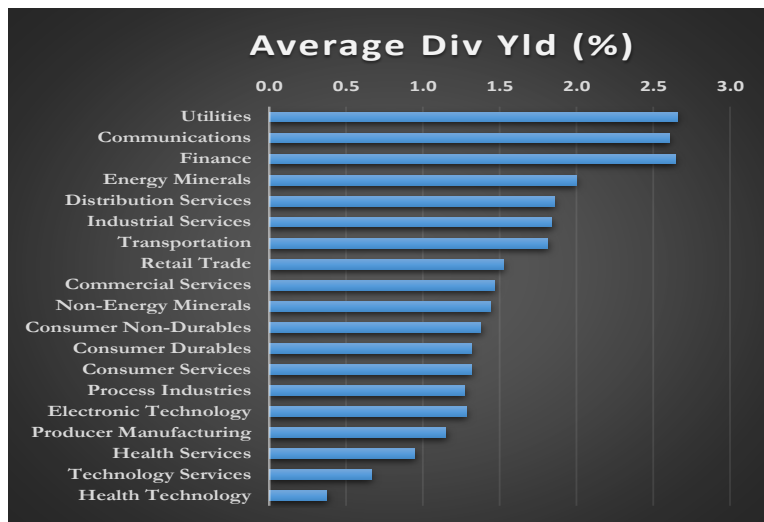


Dividend Growth - A Sector View



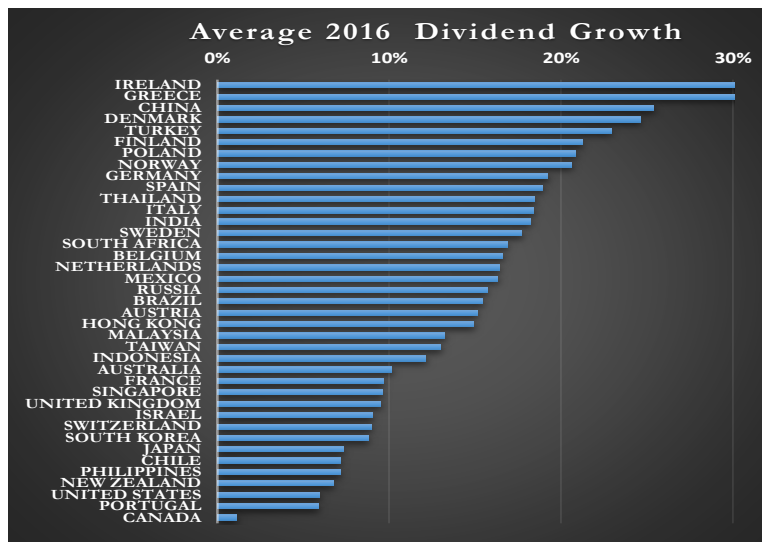
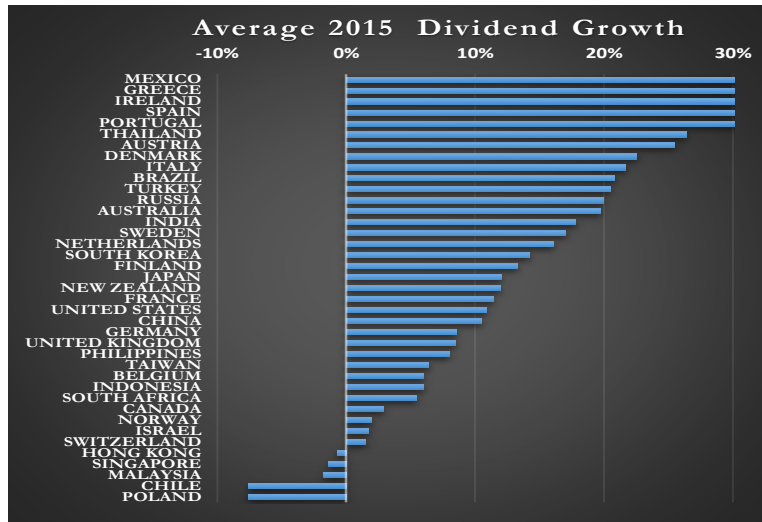
- ▶ Not surprisingly given the commodity bust of 2015 resource-oriented stocks have, on average, instituted cuts in dividends
- ▶ For 2016 analysts expect further cuts by Energy companies
- ▶ In our opinion energy companies will have no choice but to significantly cut their dividend programs
- ▶ In general, we view 2016 analyst dividend growth expectations as too optimistic

Dividend Yield – A Sector View



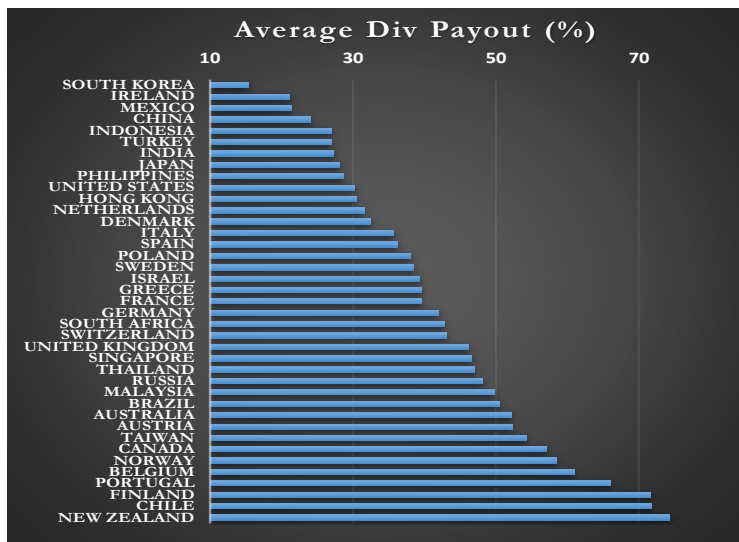
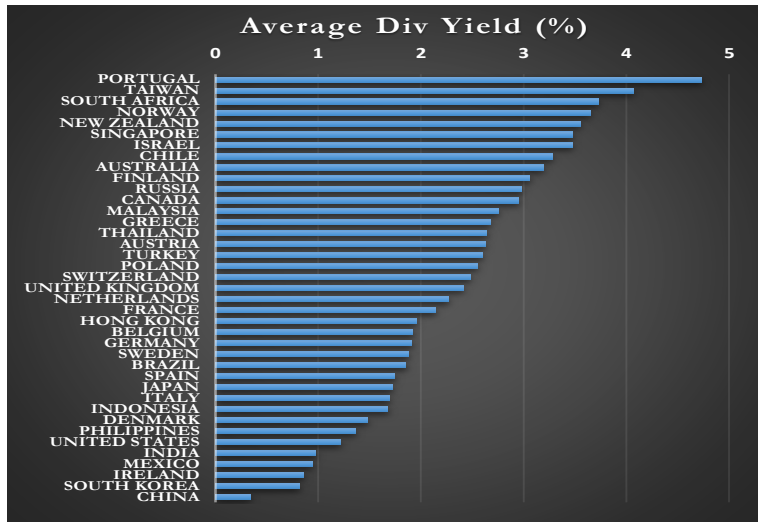
- ▶ The highest yielding companies are in mature sectors such as Telecom, Utilities, Finance and Energy
- ▶ The lowest yields are paid out in more growth-oriented sectors such as Tech and Health Care
- ▶ Given our view that commodity markets are over-supplied and global growth will again be slow in 2016 we identify energy company dividend programs as high risk for income generation
- ▶ A less risky place to focus for income generation are Financials, a sector highly rated by our sector allocation fundamental models

Dividend Growth – A Country View



- ▶ In terms of dividend growth the US ranks in the middle of our country sample
- ▶ Superior dividend growth opportunities are expected to arise in smaller capitalization markets such as Ireland and Spain
- ▶ For 2016 analysts expect strong dividend growth from Chinese companies
- ▶ Our view is that income generation programs should target specific companies and economic sectors regardless of geographic location

Dividend Yield – A Country View



- ▶ Chinese companies exhibit, on average, the lowest dividend yields but have the ability to significantly expand their dividend programs (low payout ratios)
- ▶ Some of the highest yields are observed in resource-oriented countries
 - ▶ We expect significant dividend cuts in 2016 for companies in the energy and materials sectors so buyer beware
- ▶ US stocks, on average, rank low in terms of dividend yields

Stock Ideas - Attractive Current Yield Plays

NAME	MKT CAP	COUNTRY	INDUSTRY	VOL	DY	DIV PAYOUT	2016 DIV GRW
Apple Inc.	\$521,135	UNITED STATES	ELECTRONICS	27.31	2.21	21.65	10.09
Toyota Motor Corp.	\$153,639	JAPAN	AUTOMOTIVE	25.10	3.50	25.53	6.51
Home Depot, Inc.	\$147,480	UNITED STATES	RETAILERS	21.38	2.03	39.87	12.46
Cisco Systems, Inc.	\$127,460	UNITED STATES	ELECTRONICS	24.49	4.14	45.50	10.52
Taiwan Semiconductor Manufacturing Co., Ltd.	\$113,680	TAIWAN	ELECTRONICS	27.61	4.11	38.06	13.95
CVS Health Corporation	\$105,301	UNITED STATES	RETAILERS	20.63	1.77	30.30	23.43
NIKE, Inc. Class B	\$86,119	UNITED STATES	APPAREL	24.26	1.13	27.47	13.14
Walgreens Boots Alliance Inc	\$83,150	UNITED STATES	RETAILERS	28.48	1.87	32.80	7.21
Starbucks Corporation	\$82,567	UNITED STATES	RETAILERS	23.93	1.43	33.68	23.26
Nippon Telegraph and Telephone Corporation	\$78,482	JAPAN	UTILITIES	30.02	2.39	38.56	9.47
Deutsche Telekom AG	\$75,468	GERMANY	UTILITIES	28.85	3.43	44.12	9.32
Ping An Insurance (Group) Company of China, Ltd. Class B	\$71,813	HONG KONG	FINANCIAL	35.55	1.75	9.07	5.03
American International Group, Inc.	\$65,562	UNITED STATES	FINANCIAL	21.62	2.42	9.46	48.04
BT Group plc	\$64,557	UNITED KINGDOM	UTILITIES	24.65	2.88	43.28	12.47
Reckitt Benckiser Group plc	\$60,935	UNITED KINGDOM	CHEMICALS	20.16	2.17	30.65	9.00
KDDI Corporation	\$60,396	JAPAN	UTILITIES	33.09	2.39	29.26	13.19
Accenture Plc	\$59,463	UNITED STATES	MISCELLANEOUS	22.09	2.32	44.32	8.25
Lowe's Companies, Inc.	\$59,363	UNITED STATES	RETAILERS	22.31	1.73	30.65	14.89
AIA Group Limited	\$57,617	HONG KONG	FINANCIAL	29.36	1.42	19.97	15.78
Mitsubishi UFJ Financial Group, Inc.	\$55,038	JAPAN	FINANCIAL	32.44	4.03	25.54	10.50
AXA SA	\$52,336	FRANCE	FINANCIAL	27.80	4.91	47.37	6.74
Bank of Nova Scotia	\$46,777	CANADA	FINANCIAL	23.02	5.18	49.38	5.88
CK Hutchison Holdings Ltd	\$45,562	HONG KONG	DIVERSIFIED	34.17	4.04	0.00	12.12
Honda Motor Co., Ltd.	\$43,742	JAPAN	AUTOMOTIVE	29.97	3.22	31.13	18.13
Prudential plc	\$43,049	UNITED KINGDOM	FINANCIAL	31.13	3.29	40.39	10.43
Reliance Industries Limited	\$43,048	INDIA	OIL, GAS, COAL & RELATED SERVICES	29.92	1.10	13.87	6.19
General Motors Company	\$42,798	UNITED STATES	MACHINERY & EQUIPMENT	24.19	5.49	23.14	6.06
Industrial Bank Co., Ltd. Class A	\$41,820	CHINA	FINANCIAL	43.43	3.95	18.59	5.76
China Merchants Bank Co., Ltd. Class H	\$41,573	HONG KONG	FINANCIAL	44.86	6.62	28.00	6.46
General Dynamics Corporation	\$40,507	UNITED STATES	DIVERSIFIED	19.64	2.12	29.44	9.11

The table contains the largest market cap stocks in our universe rated as Attractive by our overall stock selection methodology as well as with favorable expectations of dividend growth in 2016

Stock Ideas - Unattractive Current Yield Plays

NAME	MKT CAP	COUNTRY	INDUSTRY	VOL	DY	DIV PAYOUT	2016 DIV GRW
BHP Billiton Limited	\$56,890	AUSTRALIA	METAL PRODUCERS	38.66	11.17	340.21	-52.00
Telefonica SA	\$48,758	SPAIN	UTILITIES	27.17	6.88	77.57	0.55
Advanced Info Service Public Co., Ltd.	\$27,841	THAILAND	UTILITIES	36.27	7.80	94.61	-13.93
Sands China Ltd.	\$25,640	HONG KONG	RECREATION	47.41	8.04	102.09	-1.17
A.P. Moller - Maersk A/S Class B	\$25,635	DENMARK	DIVERSIFIED	30.63	3.78	776.36	-0.51
Glencore plc	\$20,490	UNITED KINGDOM	OIL, GAS, COAL & RELATED SERVICES	77.22	12.65	97.23	-99.11
FirstEnergy Corp.	\$13,910	UNITED STATES	UTILITIES	22.20	4.38	202.01	0.27
Ecopetrol SA	\$12,843	COLOMBIA	OIL, GAS, COAL & RELATED SERVICES	45.71	12.49	167.21	-2.22
Philippine Long Distance Telephone Co.	\$9,861	PHILIPPINES	UTILITIES	27.11	5.81	117.24	-8.12
Coach, Inc.	\$9,582	UNITED STATES	DIVERSIFIED	31.48	3.91	92.40	0.72
Bank Pekao SA	\$9,517	POLAND	FINANCIAL	31.38	6.12	114.49	-10.30
Pearson PLC	\$9,039	UNITED KINGDOM	PRINTING & PUBLISHING	36.33	6.83	84.29	0.32
OMV AG	\$8,605	AUSTRIA	OIL, GAS, COAL & RELATED SERVICES	32.97	5.33	128.29	-6.21
Pepco Holdings, Inc.	\$6,744	UNITED STATES	UTILITIES	22.15	4.06	112.40	0.00
Quanta Computer Inc.	\$6,088	TAIWAN	ELECTRONICS	28.51	7.60	84.31	0.18
Japan Retail Fund Investment Corporation	\$5,507	JAPAN	FINANCIAL	24.79	3.45	94.34	0.07
BTS Group Holdings Public Co. Ltd.	\$5,358	THAILAND	TRANSPORTATION	19.28	7.95	204.76	-69.42
Crescent Point Energy Corp.	\$5,241	CANADA	OIL, GAS, COAL & RELATED SERVICES	56.32	8.32	164.03	-44.38
Casino, Guichard-Perrachon SA	\$5,108	FRANCE	RETAILERS	38.13	7.77	152.81	-2.43
Frontier Communications Corporation Class B	\$4,953	UNITED STATES	UTILITIES	40.44	9.91	308.73	0.00
MGM China Holdings Limited	\$4,347	HONG KONG	RECREATION	48.64	4.50	103.88	-35.93
Equity One, Inc.	\$3,773	UNITED STATES	FINANCIAL	20.34	3.29	226.27	0.97
SJM Holdings Limited	\$3,733	HONG KONG	RECREATION	39.26	14.01	85.71	-30.27
Fortescue Metals Group Ltd	\$3,572	AUSTRALIA	METAL PRODUCT MANUFACTURERS	69.61	3.09	108.20	-34.05
Retail Properties of America, Inc. Class A	\$3,478	UNITED STATES	FINANCIAL	21.62	4.52	494.11	0.33
Senior Housing Properties Trust	\$3,282	UNITED STATES	FINANCIAL	23.41	11.29	192.75	0.17
First Capital Realty Inc.	\$3,100	CANADA	FINANCIAL	20.32	4.50	90.41	0.19
Advance Residence Investment Corporation	\$3,062	JAPAN	FINANCIAL	21.56	3.41	93.76	0.84
Hokuriku Electric Power Company	\$2,997	JAPAN	UTILITIES	25.24	3.09	116.26	0.00
Gramercy Property Trust	\$2,909	UNITED STATES	FINANCIAL	24.51	3.57	641.98	-15.17

The table contains the largest market cap stocks in our universe rated as Unattractive by our overall stock selection methodology as well as with unfavorable expectations of dividend growth in 2016

Dividend Strategies - Conclusions

- ▶ We expect the search for yield to continue for the foreseeable future
 - ▶ The strategy for capturing income becomes critically important especially as we expect capital market volatility to revert back to higher historical norms
- ▶ Our research shows an adequate margin of safety in terms of the capacity of companies to sustain their dividend programs
 - ▶ Clearly pockets are at greater risk given the collapse in commodity markets but for our universe as a whole the financials appear in good shape
- ▶ Investors seeking the highest stock yields have been penalized in 2015 while dividend growth investors have been rewarded
 - ▶ To a large extent this is related to the poor growth and profitability of resource-oriented sectors

Dividend Strategies - Conclusions

- ▶ High Dividend Yield stocks tend to be inexpensive but lacking in growth and historically have been members of distressed categories
- ▶ High Dividend Growth stocks are only slightly more expensive than their lower growth peers but exhibit much higher rates of prospective earnings growth as well as superior profitability
- ▶ Our overall conclusion is that High Dividend Growth stocks are not materially over-valued versus lower growth companies and that there is an adequate margin of safety to fund dividends out of earnings growth
- ▶ We **strongly suggest employing dividend growth strategies** as the preferred way to implement income generation programs
 - ▶ We also believe that significant dividend growth opportunities exist outside of the major equity markets so a global perspective is recommended
 - ▶ Finally, priority should be given to the analysis of company fundamentals in terms of their ability to increase dividends in a financially responsible manner while also allowing the investor a margin of principal (price) protection

Who We Are



Eric Jose Weigel began his career with the Federal Reserve Bank of Dallas in the economic research department providing econometric support and general research assistance. He subsequently worked at Russell Investments in the capital market research group focusing on the development of global tactical asset allocation strategies, macro-based risk models, and derivative pricing models.

After leaving Russell he has headed up a variety of senior portfolio and research efforts within established firms such as MFS, Pioneer, Chancellor/LGT and Invesco as well as entrepreneurial hedge fund ventures such as Milestone International, LongPoint Partners and Windsor Re.

In addition to his extensive exposure to a variety of long-only equity strategies, he has significant experience in running long/short strategies and was one of the early practitioners in the field of global tactical asset allocation.

Mr. Weigel has published numerous articles in professional and academic investment journals including the Journal of Portfolio Management, the Financial Analysts Journal, Journal of Investing and Management Science.

Mr. Weigel received an M.B.A degree in Finance (1988) from the University of Chicago, where he was the recipient of the Dart & Kraft Fellowship Award. He also has a M.S. degree in Applied Economics & Statistics from the University of Minnesota (1984) and graduated from Iowa State University with a B.S. in 1982.



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