The Copeland Review

Second Quarter 2022

"We believe that stocks with sustainable dividend growth consistently outperform the market with less risk."

You've Lost that Lovin' Feeling

You lost that lovin' feelin'
Whoa, that lovin' feelin'
You lost that lovin' feelin'
Now it's gone, gone, gone, whoa-oh

- Righteous Brothers 1965

One year ago, we titled these pages, "Can't Stop the Feeling!" At the time, the chart-topping single by Justin Timberlake perfectly embodied the exceedingly optimistic market sentiment of the moment. Recall that, following a strong finish to 2020, the first half of 2021 saw equity indexes move consistently higher, global equity inflows reach record levels, and a surge in new US equity issuance that surpassed even the Dotcom bubble peak. Risk seeking behavior was at extremes.

Today, with financial markets in the doldrums and Tom Cruise back as "Maverick" in the long-awaited *Top Gun* sequel, the Righteous Brothers' song, "You've Lost that Lovin' Feelin'," comes to mind. Amazingly, a *Financial Times* article pointed out that the success of the original *Top Gun* movie made the ballad "the most played song of the 20th century on radio and television."[1] Maverick's 1986 rendition, however, initially didn't go over well. He was concerned about a "crash and burn" outcome, just like investors are amidst the current market rout.

Now, that "lovin' feelin'" is entirely "gone, gone, gone" as the inflation and interest rate "Pied Piper" is quickly squeezing consumers, as well as making market participants pay for past transgressions, some dearly. Sentiment has flipped from extreme optimism to extreme pessimism with expectations that a US recession is imminent, or perhaps, already happening.

In this context, we highlight the following:

1. The risk of a recession is high.
2. Risk/reward is usually more attractive after major market pullbacks - equity markets already reflect a substantial downturn in economic conditions and corporate earnings.
3. There are rarely better times to invest in dividend growers than today. Dividend growth stocks have delivered strong relative performance before and during recessions, and they are currently inexpensively valued.

Importantly, with strong business models and market positions, along with discounted valuations, we continue to believe that shares of dividend growth companies remain poised for favorable risk-adjusted performance, regardless of prolonged high inflation and/or a recession.

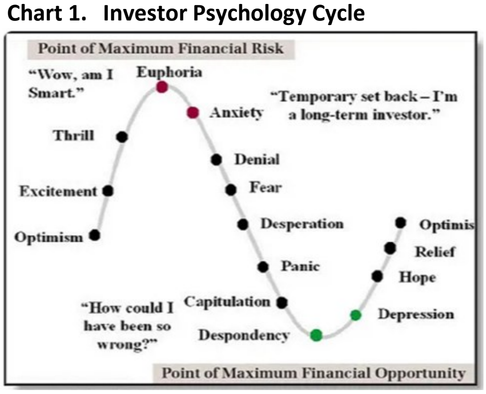
As the Pendulum Swings

While economic cycles may differ, investor psychology has historically followed a typical wave pattern. A year ago, egged on by more than a decade of easy money government policies – which were patently placed on steroids during the COVID-19 pandemic period – emotions were euphoric, carefree, and greedy. As markets reached new highs, extraordinary valuations were assigned to non-profitable companies, special purpose acquisition companies (SPACs), and numerous assets having esoteric, uncertain value. Speculation was rampant and risks widely ignored. Everyone felt "smart" as quick riches were feverishly sought, always expected, and sometimes made (Chart 1).

Today, the euphoria has evaporated. Equity and bond markets are down sharply as the Federal Reserve reverses "free" money policies in an arguably overdue bid to extinguish 1970s-like broad-based inflation. In June, the University of Michigan measure of consumer sentiment sank to an all-time low of 50.0, below even levels marked during the 1970s-80s, the Dotcom bust, the Great Financial Crisis (GFC), and the COVID-19 lockdowns (Chart 2). We may not yet be at "capitulation" or "despondency," but psychology seems well into the downslope of Chart 1. Valuations are also more palatable, although corporate margins and forward earnings estimates are clearly in question.

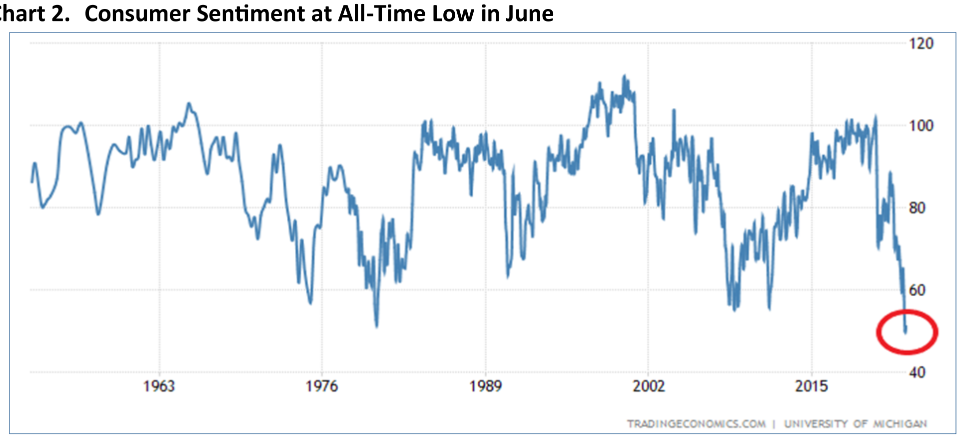
To the credit of gloomy consumers, their in-

Chart 1. Investor Psychology Cycle



Source: https://finance.yahoo.com/news/understanding-stock-market-cycles-184802038.html

Chart 2. Consumer Sentiment at All-Time Low in June

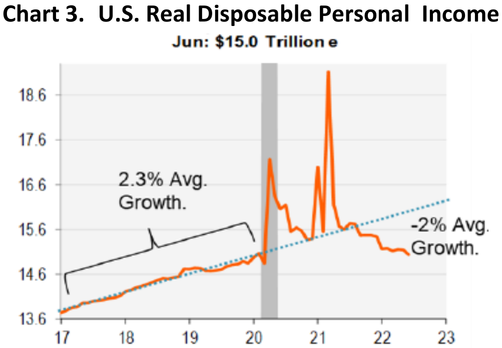


Source: https://tradingeconomics.com/united-states/consumer-confidence stinct about current conditions signaling a recession is likely correct, at least based on past periods of Federal Reserve tightening. With the exception of the unusual, short-lived, COVID-19-induced, recession, each of the prior three recessions – 1990-91, the Dotcom bust, and the GFC – followed a rate hiking cycle.[2] Interestingly though, the recessions didn't technically start until the Federal Reserve had begun cutting again, so economists tend to be late to "the party" with their actions, whether enabling or spoiling.

This time around, as we flagged in "Running Hot" (1Q 2021), markets were especially heated – and arguably distorted – thanks to unprecedented fiscal and monetary support. Rather than gradually dialing back stimulus last year as evidence of inflation mounted, the Federal Reserve is now effectively "ripping off the Band-Aid" to tamp out the highest levels of inflation experienced in 40 years.[3] As of mid-June, Federal Reserve member projections point to a median Federal Funds rate of 3.4% at year-end, up from the current level of 1.75% and 0% in January.[4] Meanwhile implied rates for year end 2023 via Bloomberg, reflecting investor expectations, are lower at 3.06%, implying rate cuts will be required after a recession takes hold.[5]

Dramatically higher borrowing costs for mortgages, car loans, and other debt are a meaningful, immediate headwind for consumer demand, which drives just over two-thirds of the US economy.[6] At the same time, elevated inflation is crimping budgets and may persist given higher housing costs that enter government data with a lag.[7] The cost of "Shelter" makes up approximately one-third of total inflation[8] and CoreLogic's latest report noted that its Single-Family Rent Index (SFRI) increased by 14% year over year, marking the "13th consecutive month of record-breaking annual gains."[9] The net result of broadly higher costs is that real personal incomes, after inflation, are shrinking (Chart 3).[10]

Chart 3. U.S. Real Disposable Personal Income



Source: Nancy Lazar, Piper Sandler Economics, July 17, 2022.

On the corporate side, borrowing costs are also rising. Short-term financing rates follow the Federal Funds rate upward and long-term rates track closely to the US 10-Year Treasury yield, which ended June at nearly 3.0%, approximately double the year-end 2021 level.[11]

Yet, Maverick Leads the Way and Risk/Reward Likely More Compelling

With nearly one-billion dollars in global gross box office receipts to-date, *Top Gun: Maverick* is driving a much-needed resurgence in attendance for theaters and production companies, many of which were given up for dead coming out of the pandemic.[12] The film's success is also a reminder that – notwithstanding dismal consumer sentiment and numerous economic challenges – positive offsets can always be found.

Namely, as we shared last quarter, supply chain bottlenecks are easing, employment and wage trends remain strong, and balance sheets – both consumer and corporate – are still flush.[13] Further, layoffs remain below historical levels while job openings remain plentiful at almost two times pre-pandemic levels.[14] Restaurant traffic is well above pandemic levels and now running flattish with 2019 levels.[15] Plus, a wide range of commodity prices are now easing – paradoxically on fears of reduced demand – with some prices having entirely reversed the spikes they experienced in response to the Ukraine invasion.[16]

In addition, Business Confidence – as measured by the ISM Manufacturing Purchasing Managers Index – although well off its peak, remains in positive territory, far above the low reached during the COVID market crash.[17] While confidence may track lower, US industrial supply chain replenishment and reconfiguration are expected to be ongoing, long-term investments. These actions may offset some consumer retrenchment.

Finally, we propose that the market opportunity is materially better after major pullbacks. While past performance is no indication of future results, we used benchmark data to study large cap and SMID cap performance following six-month declines of 20% or more, as we just experienced.

Year-to-date, through June 30th, the S&P 500 Index declined by 20.0% on a total return basis. A decline of this magnitude over such a short time frame is extremely rare, having occurred only seven other times since September 1981. Moreover, such periods have typically been followed by periods of strong performance. For example, following the seven prior declines of this magnitude, the median 12-month performance was +27.0%, far outpacing the median performance for all 12-month periods of only +14.6%. Notably, the Index was always higher one year following such declines.

Among the SMID caps, the Russell 2500 Index declined 21.8% through June 30th on a total return basis. Since September 1981, the Index experienced 17 six-month declines of 20% or more. However – as with the S&P 500 Index – the Russell 2500 Index was always higher one year later with a median return of 32.3%, performing far better than the 14.5% median performance for all 12-month periods during the study period.

Again, forecasting the near-term future is impossible and markets may still see further downside in the face of numerous pressures. Yet, past market experience suggests a more favorable set-up going forward, even if higher interest rates and stubbornly high inflation impair short run economic activity.

Durability of Dividend Growth Through Recessions

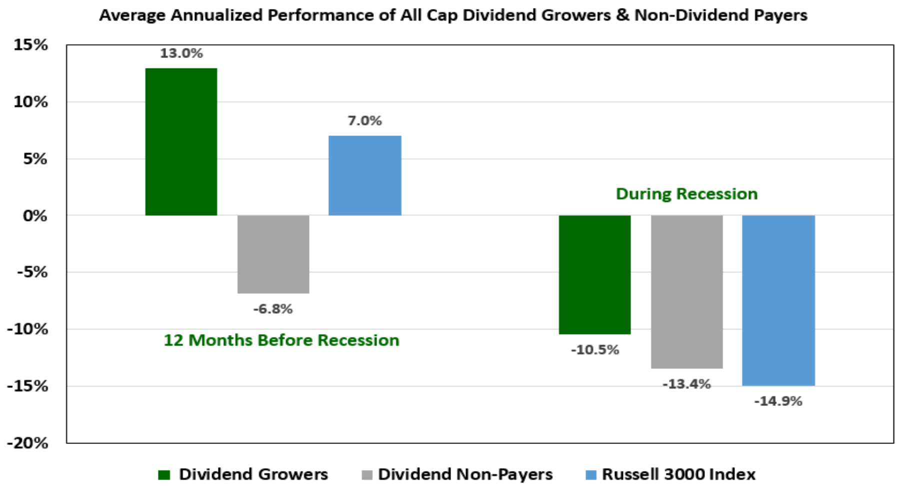
At Copeland, we often find good investment opportunities in these more volatile market periods, when we believe that our strategies have also proven to be resilient. In our view, the environment brings to bear the importance of understanding corporate business models, fundamentals, valuations, and risks when considering any investment. Yes, what was considered old-fashioned by some market participants just a year ago is vitally important. To

Chart 4. Lower Volatility and Downside Capture (SMID Cap)

9/30/1982 – 12/31/2021	Volatility (Standard Deviation)	Downside Capture
Dividend Grower & Initiator	15.3%	66.9%
Flat Dividend Payer	17.9%	88.2%
Russell 2500 Index	18.1%	100.0%
Non-Dividend Payer	24.4%	142.0%
Dividend Cutter	24.0%	116.8%

Source: Ned Davis Research. You cannot invest directly in an Index. The information presented is not the performance of any strategy overseen by Copeland and there is no guarantee that investors will experience the type of performance reflected in the information presented. Please see definitions and additional Disclosures below.

Chart 5. Dividend Growth Stocks Outperformed Immediately Prior to and During Recessionary Periods



Source: CCM, Ned Davis Research. You cannot invest directly in an Index. The information presented is not the performance of any strategy overseen by Copeland and there is no guarantee that investors will experience the type of performance reflected in the information presented. Please see definitions and additional Disclosures below.

Chart 6. Summary Portfolio Characteristics for Select Copeland Dividend Growth Strategies

Summary As of 06/30/22	Copeland Small Cap	Russell 2000 Index	Copeland SMID Cap	Russell 2500 Index	Copeland All Cap	Russell 3000 Index
One-Year Dividend Growth Rate (Median)	13.1%	3.7%	13.6%	4.5%	12.0%	5.6%
One-Year EPS Growth (Median)	19.8%	13.3%	23.1%	15.9%	21.4%	16.6%
NTM P/E Ratio	11.1x	13.8x	12.1x	13.2x	14.9x	15.6x
Dividend Yield (Weighted)	2.1%	1.3%	2.0%	1.4%	1.9%	1.5%

Source: FactSet, CCM.

the due diligence list, Copeland adds capital allocation – specifically, a company's willingness and ability to raise its dividend through both good times and bad.

Notably, the characteristics of dividend growth companies tend to make them more resilient and help investors avoid mistakes. As a result, when the going gets tough and equity markets decline, dividend growth stocks usually deliver far less "downside capture" relative to other investment approaches. As an example, SMID cap stocks are shown in Chart 4.

Further, using monthly data from Ned Davis Research dating back to September 1982, we calculated the average annualized performance of dividend growth stocks across the past four recessions (1990-91, post-dotcom, GFC, and COVID-19). Impressively, dividend growth stocks outperformed non-dividend payer stocks and the benchmark by a wide margin (Chart 5), both during the recession as well as during the 12 months immediately prior to the recession. This was the case across all capitalization dividend growth stocks as well as for small and SMID cap dividend growth stocks. We believe the historical results are indicative of the expected lower downside capture during market declines. The ultimate result should be favorable performance over full market cycles.

As outlined above, investors and consumers alike are working through some of the most difficult phases of the Investor Psychological Cycle. We are hopeful that our Dividend Growth strategies will help our clients weather the storm.

Our review of performance of dividend growth stocks through prior recessions provides reassurance that our style of investing is cycle-tested, tried, and true. By contrast, against a difficult macroeconomic backdrop, and as considerable geopolitical strife continues, we believe that speculative investment approaches may continue to struggle and encounter further downside risk.

Moreover, dividend growth stocks remain attractively valued and offer strong absolute and relative growth. Chart 6 illustrates growth, valuation, and yield profiles for Copeland's US Small Cap, Smid Cap, and All Cap Dividend Growth Strategies. Rarely have dividend growth stocks traded at such attractive levels, including an unusual valuation discount to respective benchmarks. Strong business models, coupled with healthy underlying earnings and dividend growth help mitigate downside risk and, we believe, position Copeland's strategies to shine through a tough economic environment.

Like Maverick evading numerous hazards to stay on target, we remain confident and disciplined in our investment approach, especially since the market's "lovin' feelin'" may remain elusive for some time.

July 26, 2022

[1] *Financial Times https://ig.ft.com/life-of-a-song/lovin-feelin.html*
[2] *Data derived from FactSet and Bloomberg with historical Federal Funds Rate based on start dates of each recession period.*
[3] *CNBC https://www.cnbc.com/2022/06/30/feds-preferred-inflation-measure-rose-4point7percent-in-may-near-40-year-high.html*
[4] *Federal Reserve https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20220615.pdf*
[5] *Bloomberg as of July 19, 2022*
[6] *BLS https://www.bls.gov/emp/tables/real-gdp-major-demand-category.htm*
[7] *Mickey Levy, Mahmoud Ghzalah, "Solid Growth, Persistent Inflation, Fed Hikes and Financial Markets," Berenberg Capital Markets, January 2022*
[8] *BLS https://www.bls.gov/news.release/cpi.t01.htm*
[9] *CoreLogic https://www.corelogic.com/intelligence/april-jump-in-us-rent-price-growth-puts-pressure-on-inflation-corelogic-reports/*
[10] *BEA https://www.bea.gov/news/2022/personal-income-and-outlays-may-2022*
[11] *FactSet*
[12] *Box Office Mojo https://www.boxofficemojo.com/release/rl2500036097/?ref_=bo_hm_rd*
[13] *FRED Economic Data https://fred.stlouisfed.org/series/DPSACBW027SBOG*
[14] *FRED Economic Data https://fred.stlouisfed.org/series/JTSLDL, https://fred.stlouisfed.org/series/JTSJOL*
[15] *OpenTable https://www.opentable.com/state-of-industry*
[16] *Trading Economics https://tradingeconomics.com/commodities*
[17] *Trading Economics https://tradingeconomics.com/united-states/business-confidence*

Disclosure Section:

The information herein is for informational purposes only and should not be construed as individualized recommendations or endorsements of any particular security, chart pattern or strategy. Any industries, sectors or securities presented herein should not be perceived as investment recommendations by Copeland. The views and opinions expressed herein represent the opinions of Copeland, are subject to change without notice, and are not intended as a forecast or guarantee of future results. Investing in stocks involves risk, including possible loss of principal. There is no assurance that the investment objective of the strategy will be achieved. All data referenced is from sources deemed to be reliable but cannot be guaranteed as to accuracy or completeness. Situations represented here may not be applicable to all investors. Holdings are for informational purposes only and should not be deemed a recommendation to buy the specific securities mentioned. Holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients. Please contact Copeland to obtain a list showing every holding's contribution to an overall strategy's performance during the period. Holdings are subject to change, may not be representative of current holdings, and are subject to risk. Individual financial situations and investment objectives will differ. Please consult with an investment professional before investing. **Unless otherwise specified or disclosed, the currency used for data in the report is US Dollar (USD).** Copeland's fees can be found in our ADV Part 2A which is available by calling 484-351-3700 and requesting a copy or on our website at www.copelandcapital.com.

The data presented herein represents past performance. Past performance is no guarantee of future results. There is no guarantee that companies will declare dividends or, if declared, that they will remain at current levels or increase over time. Returns for periods of greater than one year are annualized. The returns shown in the Charts herein include dividends reinvested. The historical data are for illustrative purposes only and do not represent the performance of any strategy overseen by Copeland or any particular investment, and there is no guarantee that investors will experience the type of performance reflected in the information presented. Strategies managed by Copeland's investment team are subject to transaction costs, management fees, trading fees or other expenses not represented in the information presented. A stock is classified as a **Dividend Payer** if it paid a cash dividend any time during the previous 12 months, a **Dividend Grower** if it initiated or raised its existing cash dividend at any time during the previous 12 months, and a **Non-Dividend Payer** if it did not pay a cash dividend at any time during the previous 12 months. **Flat Dividend Payers** included stocks that pay a dividend but have not raised or lowered their existing dividend during the previous 12 months. **Dividend Cutters** included stocks that lowered their existing dividend or eliminated their dividend during the previous 12 months. Periods of **Elevated Inflation** refer to months in which the annualized Personal Consumption Expenditures (PCE) Deflator was greater than 2.50%. The PCE Deflator can be found here: https://fred.stlouisfed.org/series/PCEPILFE

Currency - Unless otherwise specified or disclosed, the currency used for data in the report is US Dollar (USD).

Charts 4 & 5: © 2021 Ned Davis Research, Inc (NDR). Further distribution prohibited without prior permission. All Rights Reserved. See NDR Disclaimer at www.ndr.com/copyright.html. For data vendor disclaimers refer to www.ndr.com/vendorinfo/. Ned Davis Research adjusted the universe used for the domestic study as of December 31, 2017, from the Ned Davis Investable Universe to a universe based on the applicable Russell benchmarks. As a result, historical performance information may differ from previously disseminated performance information for stocks according to their dividend policy. **This is not the performance of Copeland and there is no guarantee that investors will experience the same type of performance.**

Charts 6: © FactSet Data Systems Inc. All Rights Reserved. FactSet is a company that offers financial industry analysis, financial data, analytics, and analytic software for investment professionals. The information contained herein: (1) is proprietary to FactSet Research Systems Inc. and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither FactSet Research Systems Inc. nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. **This is not the performance of any strategy overseen by Copeland and there is no guarantee that investors will experience the type of performance reflected in the information presented.**

The Indexes mentioned are unmanaged, are not available for investment and do not incur expenses. With respect to the comparison of the Copeland strategies to their comparative benchmarks, the number of holdings and volatility of an unmanaged Index is different from that of an actively managed portfolio of Dividend Growth stocks. The **S&P 500® Index** is a market-capitalization-weighted index of the stocks of 500 leading companies in major industries of the U.S. economy. The **Russell 2000® Index** is comprised of the smallest 2000 companies in the Russell 3000® Index. The **Russell 2500® Index** is comprised of the bottom 2500 companies in the Russell 3000® Index. The **Russell 3000® Index** measures the performance of the 3000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market. The **ISM Manufacturing Index**, commonly known as the ISM Manufacturing Purchasing Managers Index (ISM PMI), is a monthly gauge of the level of economic activity in the manufacturing sector in the United States versus the previous month.

Definitions

Dividend Growth Rate - The annualized percentage rate of growth that a particular stock's dividend undergoes over a period of time.

Dividend Yield - The company's total annual dividend payments divided by its market capitalization, or the dividend per share, divided by the price per share.

EPS Growth – Earnings Per Share Growth illustrates the growth of earnings per share over time.

NTM P/E Ratio - The Next Twelve Months Price-to-Earnings Ratio of a stock is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share.

SPAC - A special purpose acquisition company (SPAC) is a "blank check" shell corporation designed to take companies public without going through the traditional IPO process. SPACs allow retail investors to invest in private equity type transactions, particularly leveraged buyouts.

Copeland does not provide tax, legal or accounting advice. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. It represents an assessment of the market environment at a specific point in time and is intended neither to be a guarantee of future events nor as a basis for any investment decisions. It should also not be construed as advice meeting the particular needs of any investor. Neither the information presented, nor any opinion expressed constitutes a solicitation for the purchase or sale of any security. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

Copeland Capital Management, LLC

www.CopelandCapital.com www.CopelandFunds.com

Corporate Headquarters
161 Washington St., Suite 1325
Conshohocken, PA 19428
484-351-3700

Boston Regional Office
62 Walnut St., Fl 3
Wellesley, MA 02481