COPELAND™
CAPITAL MANAGEMENT, LLC
Dividend Growth Investing

THE COPELAND REVIEW

SPRING 2012

"We believe that a company's dividend growth rate is the most significant driver of its total return."

Taxman

If you drive a car, I'll tax the street,
If you try to sit, I'll tax your seat,
If you get too cold, I'll tax the heat,
If you take a walk, I'll tax your feet.

"Taxman"
The Beatles, 1966

It's hard to imagine that a band which was once accused of harboring Communist leanings, and which famously penned the progressive rallying song, "Revolution," could so clearly express the conservative angst over profligate government spending, funded primarily by taxing only a miniscule sliver of the population. Still, at some point even the most starry-eyed idealist can turn abruptly pragmatic when he finds out he's on the hook for an ever-increasing tab by virtue of his elected officials who have been spending like drunken sailors, with little to show for it. For George Harrison, the breaking point came in 1965 when he realized that the Beatles' success would soon subject him to Britain's "Super Tax" with an astronomical top marginal rate of 95%![1]

While a return to such outrageous rates of confiscation (US tax rates peaked at 94% in 1944[2]) seems improbable at this moment, we believe that it is reasonable to expect, sadly, that taxation rates on dividends will rise over the next several years from their current favorable level. That sets up a very important question for investors: how will the securities of dividend payers and dividend growers perform relative to the market as investors are forced to share a larger portion of their income with their government?

Why Tax Rates on Dividends Don't Affect Performance

With tax rates on dividends declining fairly steadily for nearly 50 years, historical examples from which to extrapolate return expectations in a rising tax rate environment are rare. Still, relatively recently, we can look at 1990 through 1993, when the top marginal rate rose from 28.0% to 39.6%.[2] If tax rates really drive investing decisions, we would expect dividend strategies to have underperformed the market during this period. To determine whether or not this was the case, we created two hypothetical, capitalization-weighted portfolios, reconstituted each year, and compared their total returns to those of the S&P 500 Index (the "Index"). Sector weightings within the portfolios were aligned with those of the Index in order to remove any sector bias. One portfolio, "dividend payers," was comprised of all US traded companies with market capitalizations above $1 billion that paid a dividend in the prior year. The second portfolio, "dividend growers," was constructed analogous to Copeland's traditional investable universe, including all US traded companies with market capitalizations greater than $1 billion that had increased their dividends in each of the preceding five years.

This period was particularly interesting to study given the varied market environments included therein. Equity market returns began weakly, as recessionary pressures were compounded by concerns related to the first Gulf War, quickly recovered when interest rates and energy prices fell, and ultimately finished with two years of fairly normal returns (see Table 1). Traditionally, absent any concerns about taxes, in a weak period one might expect outperformance from dividend stocks due to the relative stability in their business models. By contrast, it sometimes proves difficult for them to keep pace in aggressive rallies as investors opt to take on additional risk. Remarkably though, the portfolio of dividend payers outperformed in all four years, posting an annualized return of 12.0%, while the portfolio of dividend growers outperformed in three of the four years, posting an even more impressive 13.6% annualized return for the full period.[3]

Alternatively, we also looked at the performance of dividend payers and dividend growers in 2002 and 2003, as the top tax rate on dividends fell from 35% to 15% in the latter year.[2] If tax rates drove the relative performance of dividend strategies, we would expect them to have outperformed significantly in light of such a favorable change. Like 1990-1991, 2002-2003 was also a period that began very weakly, followed by strong performance as the economy recovered (the Index fell -22.3% in 2002, then rallied 28.7% in 2003), resulting in flat performance for the full period. Again, results for dividend

Table 1.

The total returns of both dividend payers and dividend growers consistently outpaced the S&P 500 Index even as tax rates rose from 1990 through 1993 [2,3]

	Dividend Payers	Dividend Growers	S&P 500 Index	Highest Marginal Tax Rate
1990	-1.4%	4.0%	-3.4%	28.0%
1991	31.0%	35.7%	31.0%	31.0%
1992	10.2%	9.8%	7.6%	31.0%
1993	10.7%	7.4%	10.2%	39.6%
Full Period Annualized	12.0%	13.6%	10.7%	

Disclosure: The compilation of the Dividend Payers and Dividend Growers information presented in Table 1 is described in the text above. This is not the performance of the firm and there is no guarantee that investors will experience the type of performance reflected in this table. Total return is calculated assuming reinvestment of all dividends, interest and capital gains. Please refer to the back page for additional disclosures.

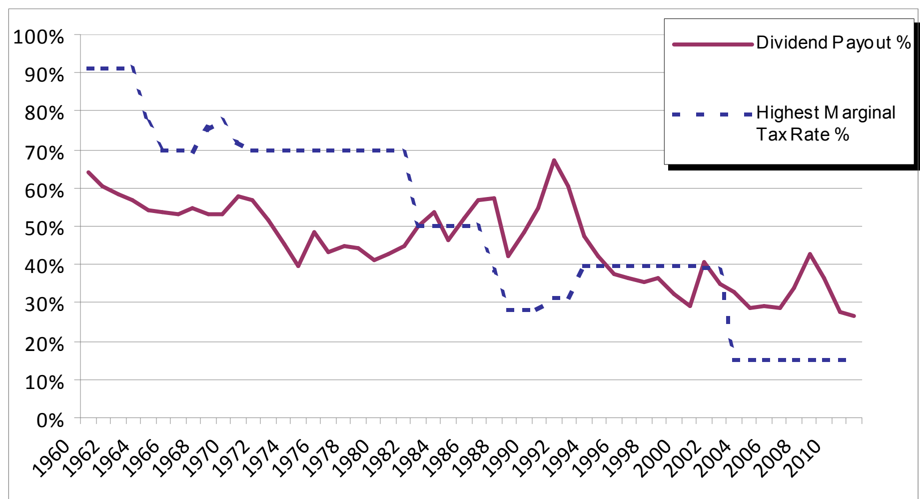
strategies showed little correlation with tax rate changes. While dividend payers, down -18.3% and dividend growers down -18.6%, both beat the Index in 2002, only dividend payers (up 28.50%) kept pace during the 2003 recovery; dividend growers rose 22.1%.[3] This highlights the cyclical, rather than tax policy driven, nature of performance over the period.

Collectively, these results increase our comfort that the performance of dividend-oriented strategies – including our dividend growth approach – are not likely to be driven by tax rate changes. Instead, we expect that returns for dividend growth stocks will be driven by the economic cycle, outperforming in all periods but the early acceleration phase, which occurs after a cyclical downturn and is generally characterized by outperformance of lower quality names with weak balance sheets and highly cyclical business models.

Nonetheless, there is a second equally critical question for dividend investors as tax rates change: will corporate management teams opt for other uses of cash as rates rise? At Copeland, due to the stringent requirements of our selection process, this is not merely an academic concern. Indeed, it is no good to say that dividend growth stocks can outperform regardless of tax policy if our investable universe of consistent dividend growers is about to be thinned dramatically.

Fortunately, similar to what we observed in terms of return patterns, corporate dividend policy appears to have little to do with personal income tax rates. Surprisingly, while the top tax rate on dividends has fallen from 91% in 1960 to 15% today, the dividend payout of the S&P 500 Index, as a percentage of S&P 500 earnings, has also consistently declined from almost 64% to a record low of 27% in 2011 (see Chart 1).[2,4] While this is disappointing, in light of our strong belief that <u>*a company's dividend growth rate is the most significant driver of its total return,*</u> we are nonetheless heartened by five factors. First, in dollar terms, total dividends paid by S&P 500 companies still grew at a 5.2% annualized rate over the period.[4] Second, the growth was fairly consistent, with dividends rising in 44 of the last 51 years, including 1991 and 1993, and falling only when earnings were under pressure.[4] Third, the breadth of participation has been expanding recently, with 298 names from the S&P 500 raising their dividends at least once in 2011, the largest number in 22 years, and nearly double the number seen during the recession of 2009.[5] Fourth, corporate balance sheets are collectively flush with cash.[6] And finally, within our universe of potential investments, with shareholders now accustomed to dividend increases, management teams treat dividend growth as a philosophical decision, driven not by tax policy, but by the belief that returning a growing income stream sends a perpetual message of confidence in their business models to shareholders. Holding the payout flat or reducing it would undermine that confidence.

Chart 1.



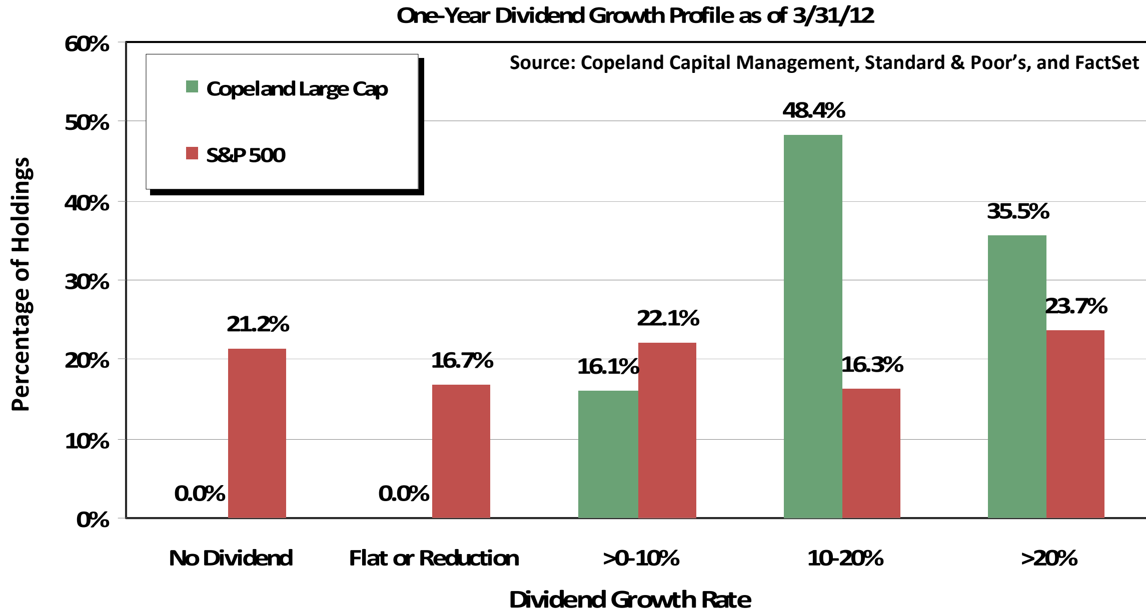
Recently, in light of the persistent low yields available in most fixed income instruments and the relatively tepid pace of the global recovery, an increasing number of managers have emerged that claim to be focused on dividends and dividend growth. While we welcome the competition, we offer a word of caution, too. Upon "looking under the hood" of these portfolios, we've found that some are littered with companies that either don't pay dividends or have no history of increasing their dividends, despite fund names that might lead one to believe otherwise. At Copeland, we pride ourselves on rigorous adherence to our dividend growth philosophy when constructing portfolios. At times, when lower quality names are in favor, this may present a short-term challenge to our relative performance. Under those circumstances, competitors with looser guidelines may tout their superior results. However, during the course of a full economic cycle, we believe that companies which consistently grow their dividends will outperform the market, and that Copeland's selection process, emphasizing strong profitability and strong dividend growth and security, will be additive to those results.

[1]http://en.wikipedia.org/wiki/Taxman; "How the Budget affects you: The public give their verdict". WalesOnline. 23 April 2009.
[2]http://www.taxfoundation.org/publications/show/151.html
[3]Copeland Capital Management (data from FactSet)
[4]Copeland Capital Management (data from http://w4.stern.nyu.edu/~adamodar/New_Home_Page/datafile/spearn.htm)
[5]Ned Davis Research
[6]http://articles.businessinsider.com/2012-03-21/markets/31218667_1_corporations-cash-flows-record-high-profit-margins

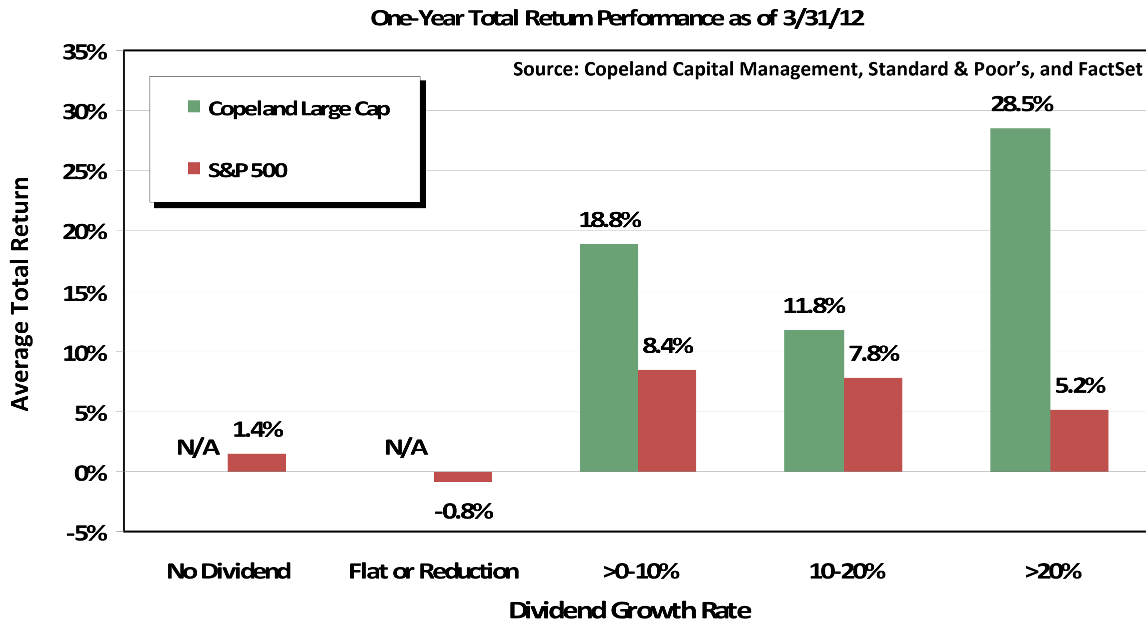
April 1, 2012

The Copeland Philosophy At Work

At Copeland, *we believe that a company's dividend growth rate is the most significant driver of its total return.* As a result, our portfolios are positioned to benefit from above average dividend growth. For our Large Cap Dividend Growth Strategy, nearly 84% of current holdings increased their dividends at a double-digit pace for the year ended 3/31/12. This feat compares favorably to the S&P 500 Index, in which only 40% of the constituents achieved the same milestone.



Over the last year, the average returns of all three dividend growth buckets within the S&P 500 Index outpaced the average returns of non-dividend payers and non-dividend growers, demonstrating the logic behind our philosophy. Within each dividend growth bucket, however, Copeland's corresponding average returns bested those of the Index, indicating the strength of Copeland's stock ranking model and fundamental analysis.



Disclosures:

The information presented above is intended to illustrate the performance of S&P 500 stocks according to their dividend policy. The data quoted above represents the past performance of one Copeland product against the S&P 500 over a limited time frame and does not indicate future returns. Gross returns include transaction costs but do not include Copeland's management fees. Total return is calculated assuming reinvestment of all dividends, interest and capital gains. After-tax results will vary from the returns presented here for those accounts that are subject to taxation. Please refer to the next page for additional disclosures.

Copeland Capital Management's Strategies

Dividend Growth Strategies

Large Cap Dividend Growth
30-40 stocks, with market capitalizations of $2 billion and above, restricted to companies that have increased their dividends for at least five consecutive years.

Mid Cap Dividend Growth
30-40 stocks, with market capitalizations of $1billion - $15 billion, focused on companies that have consistently increased their dividends.

Small Cap Dividend Growth
30-45 stocks, with market capitalizations of $250 million - $2 billion, focused on companies that have consistently increased their dividends.

Risk Managed Dividend Growth
Generally 30 to 45 stocks with market capitalizations of $250 million and above, restricted to companies that have increased their dividends for at least five consecutive years. The strategy also employs a tactical sector weighting methodology where we have the ability to completely avoid certain sectors and raise cash based on quantitative signals.

Relative Value Strategies

Large Cap Equity Relative Value
30-40 stocks, with market cap $5 billion and above, restricted to companies trading at a discount to their historical average relative valuation.

Concentrated All Cap Equity Relative Value
25-30 stocks, with a market cap $250 million and above, restricted to companies trading at a discount to their historical average relative valuation.

Fixed Income/Balanced

Approximately 15-20 issues of investment grade securities, with an intermediate term focus. Balanced allocation flexible based on market activity and client objectives.

About Copeland Capital Management

Copeland Capital Management is an employee owned, registered investment adviser with offices in Conshohocken PA and Wellesley MA. The firm specializes in managing dividend growth and relative value equity strategies for both institutions and high net worth individuals. For more information, please contact Chuck Barrett, Director of Sales and Marketing at (484) 351-3665 or cbarrett@copelandcapital.com.

Disclosures:

The data quoted in this presentation represents past performance and does not indicate future returns. Returns for periods of greater than one year are annualized. Gross returns include transaction costs but do not include Copeland's management fees. Total return is calculated assuming reinvestment of all dividends, interest and capital gains. After-tax results will vary from the returns presented here for those accounts that are subject to taxation.

S&P 500 Index consists of 500 stocks chosen for market size, liquidity and industry group representation. It is a market value weighted Index with each stock's weight in the Index proportionate to its market value. Standard and Poor's is the owner of the trademark service marks and copyrights of the S&P 500 Index. You cannot invest directly in an Index.

The material in this letter is for informational purposes only. 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 primary basis for 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.