Second Quarter 2020

The Copeland Review

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

(Don't) Press Your Luck!

"Today, these three players are after Big Bucks, but they'll have to avoid the Whammy, as they play the most exciting game of their lives! Big bucks, big bucks, no Whammies, come on!"

- Press Your Luck, 1980s, 2019 and '20 Game Show

One quarter ago, both the S&P 500 Index and the MSCI World Ex US Index were down -20% year-to-date, on a total return basis, while the Nasdaq Composite Index was down -14%. Now, having staged a remarkable rebound, the S&P 500 Index finds itself down only -4% and the MSCI World Ex US Index is off only -10% as of the end of June. Even more incredible, the Nasdaq Composite Index rallied into positive territory and now stands up +13% as of June 30! We have journeyed into the abyss and back, all while facing a very serious global pandemic and a deep recession.

With the benefit of hindsight, the sharp market downswing and speedy recovery that followed, tracked a familiar, though compressed, market psychology pattern: an initial period of investor shock transitions to a period of realization, then to a period of acceptance. Yet, much like the game show, investors seeking "big bucks" from here may be haphazardly pressing their luck and hoping that another Whammy is not just around the corner.

In this Review, we emphasize three key points supporting the continuity, discipline, and strength of Copeland's dividend growth investment philosophy:

1. Despite a deep, COVID-induced recession, our investable dividend growth universe suffered only modest impairment. We believe that our remaining sizable opportunity set confirms reason for optimism.

2. Contrary to some pundits espousing that dividends do not really matter,[1] we submit that dividends remain more relevant than ever. At Copeland, we don't press our luck, or stray from our investment approach, relying instead on dividend activity to help identify winners and losers. Companies raising dividends now – during a period of extreme economic stress – provide us with a higher level of confidence in a company's future return prospects.

3. The early stages of any recession rebound are frequently driven by the most impaired, lowest quality, highest risk stocks. So far, this category has done well, along with thematic biotech and technology stocks, many of which are not profitable. Going forward, we believe dividend growers can use their financial strength to win the next stage of recovery while also proving more resilient should things go south again, especially considering that the valuations of dividend growth stocks are currently near record relative lows.

Are we concerned about the size of the Global Dividend Growth Universe? *No!*

We closely monitor every dividend action around the world. Contrary to headlines about companies eliminating their dividends[2] and, in some cases, new government restrictions around shareholder returns,[3] the universe of dividend growers remains robust. In fact, many companies continue to raise their dividends, both in the US and abroad.

Indeed, at the beginning of March 2020, there were 1,038 small- to mid-capitalization US companies in our investable Smid Cap dividend growth universe, which we define as companies having market capitalizations up to approximately \$10 billion. Since that time, 16% of these companies – largely from the Consumer Discretionary and Energy sectors – have cut, suspended, or postponed their dividends. Still, 602 companies have announced higher year-over-year dividends, including 88 with sequential quarter-over-quarter dividend hikes. Another 208 companies have announced dividends that are higher on an annualized basis (See Chart 1). Combined, 810 Smid Cap companies remain in our investable universe.

Outside the US, while there is some variation across countries and sectors, overall dividend behavior has been similar (See Chart 2). At the beginning of March, there were 1,706 dividend growers in the ex-US developed market, small cap universe, which we define as companies having market capitalizations up to approximately \$7 billion. Since that time, 947 have

As our country works through this period, we would like to express our continued appreciation of everyone on the front lines dealing with COVID-19. Our hearts truly go out to you as well and to those individuals and families directly impacted by the virus.

Chart 1. US Smid Cap Dividend Actions Since March 1, 2020

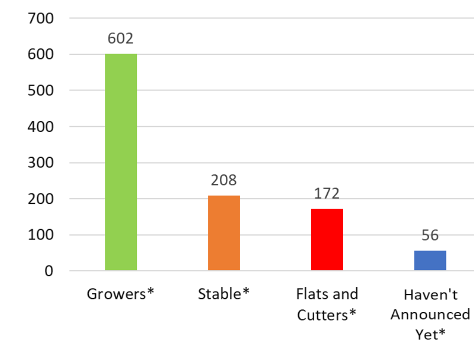
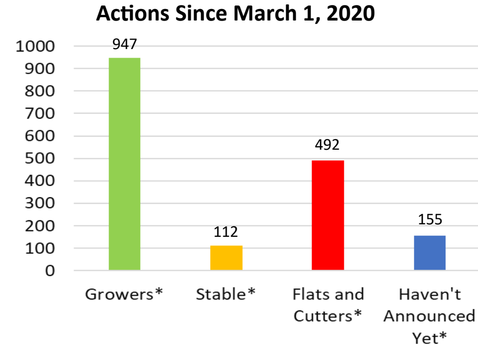


Chart 2. International Small Cap Dividend Actions Since March 1, 2020



1. ***As of 6/30/2020***. *The US Smid Cap Dividend Growth universe includes 1038 companies, while the International Small Cap Dividend Growth universe includes 1706 companies, that had grown their dividends for at least one year (as of March 1, 2020). Source: FactSet, CCM*
2. ***Growers*** *include announced dividends that are up year over year.*
3. ***Stable*** *includes companies with unchanged or – in international markets – reduced dividends, but which are still dividend growers on a fiscal year basis.*
4. ***Flats and Cutters*** *include dividend cuts, suspensions, and companies that announced a flat year over year dividend on a full fiscal year basis, due to timing.*
5. ***Haven't Announced Yet****: In international markets, this refers both to companies that have not announced their dividends yet and to companies that have postponed their dividend decisions until later this year.*

raised their dividends. Another 112 have sustained their prior dividend rate, with their annualized dividends remaining higher on a year-over-year basis. Accordingly, more than 1,000 companies remain investable currently, while another 155 have yet to specify their dividend intentions, but have NOT left the universe.

Resolved in our Focus, No Exceptions!

Regardless of economic conditions, Copeland's entire research effort is focused on owning only the best available dividend growth companies and avoiding those companies where we see potential for negative dividend actions. Our rationale remains unchanged: through complete market cycles, we believe companies with sustainable dividend growth consistently outperform the market with less risk.

The strong competitive advantages, balance sheets, and cash flows that are typical of these companies enable rapid adaptation to varied economic conditions, such as the recent sharp drop in customer demand driven by COVID-19. In fact, this environment should enable healthier dividend growth companies ample chances to win market share through opportunistic internal investment or acquisitions. Also, our experience suggests that management teams committed to a growing dividend are forced to pursue more intelligent capital allocation. That is, the rising dividend acts as a mitigating governor on possibly dilutive capital projects or acquisitions, when managers know a mistake could cause the end of a record of hikes and disappoint investors. The likely outcome is a less volatile return pattern for shareholders.

For these reasons, we treat a dividend cut much like the ultimate Whammy, to be avoided at all costs. For Copeland, a flat annualized dividend – or worse, a dividend cut – is not acceptable, even under extraordinary conditions. As such, though our preference is to sell long before such a situation arises, there is no wiggle-room when we are faced with rare examples of such negative dividend actions. Companies that hold flat on an annualized basis or, worse yet, which cut their dividends, are sold from our portfolios.

By contrast, a recent Barron's article featured a portfolio manager from another firm with a large cap dividend growth strategy.[4] In the interview, the manager spoke of possibly giving companies a pass on requiring a dividend increase due to the unprecedented impact of COVID-19. At Copeland, we will do no such thing. As noted above, we continue to require every company in our dividend growth strategies to pay a higher dividend each year.

Accordingly, during this challenging environment, we exited a handful of portfolio holdings with adverse dividend actions. In most cases, we swapped into shares of companies on Copeland's watch list that experienced sharp share price declines but whose dividend growth trajectories, we believe, remain intact. We believe that adherence to our dividend growth philosophy will help guide us through this very uncertain market environment.

"The Most Exciting Game" and Market Fancy

On one hand, the quick market resurgence we experienced in the second quarter makes sense as investors look forward to a recovery in economic activity and earnings power. The value of any business is based on underlying long-term cash flows and dividends to owners. In this context, a short-term hiccup in earnings power should not dramatically impact the long-term inherent value of a business, so long as the business is not fundamentally or permanently impaired. So, investors might correctly overlook near-term COVID-19 impacts and instead, focus on 2021 and beyond. This is sensible.

On the other hand, people love to play "the most exciting game of their lives," making the "market" extremely moody, driven by sporadic bouts of fear and greed. Sentiment can turn on a dime, be fickle and move in herd-like patterns, with money rushing into certain stocks and sectors without regard to underlying fundamentals or valuation. As examples, look no further than the recent surge of the Robinhood trading platform and the Biotech sector.

Thanks to COVID-19 shutdowns – including the closure of casinos and sports betting – a bevy of new "investors" joined the Robinhood platform and others to, among other things, bid up shares of bankrupt, troubled and/or speculative companies such as Hertz (HTZ) and Nikola (NKLA).[5] Barstool Sports blog founder Dave Portnoy even went so far as to say, 'The smart money is the Robinhood accounts and dumb money are billionaire hedge funds.'[6] This phenomenon and mindset is immediately reminiscent of the late 1990s day-trading boom, which did not end well.

Meanwhile, year-to-date through June, the Biotech sector, as represented by the iShares NASDAQ Biotechnology ETF (IBB), was up +14% while the S&P 500 Index was down -3%, both on a total return basis. Of course, at the behest of government leaders and for profit-seeking motivations, some biotech companies large and small are actively engaged in COVID-19 research. While this research effort is praiseworthy and likely to be profitable for a small number of players eventually, investors appear to have made little distinction between those companies that are most likely to succeed and those that aren't focused on this pernicious disease at all.

Amazingly, Biotechnology ETF (IBB) earnings estimates are -61% lower since year-end 2019 compared to estimates for the S&P 500 Index down only -22%! With strong year-to-date performance (+14%) and significant downward EPS revisions, IBB is now trading at 167x expected earnings over the next twelve (12) months (NTM), up from an already rich 90x at year-end. At the same time, the dividend growth universe is trading near record low relative valuations (Chart 3). Below we highlight the US Smid Cap space, given its relative underperformance this year and the significant impact of the factors above that have driven strong performance in the most speculative stocks.

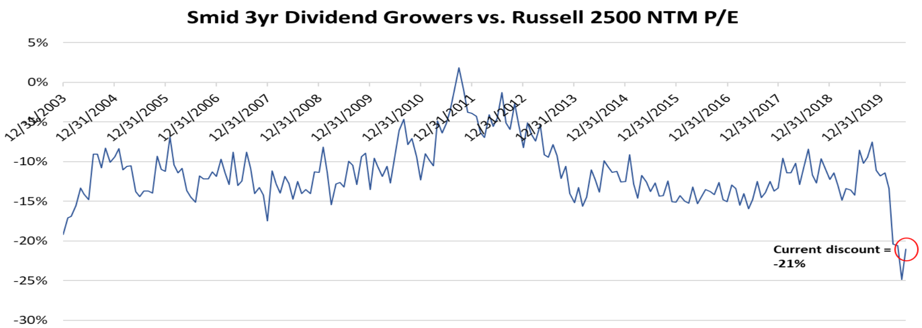
Winning Over Time

Our Dividend Growth strategies tend to perform well in most market environments, offering healthy participation in normal, upward trending markets and meaningful downside protection during market swoons. The scenario in which Dividend Growth may lag is a rapid rally off of a market bottom. The quarter ending June 30 was no exception. Pronounced speculative activity, as well as narrow leadership by a number of non-dividend paying technology companies, were performance headwinds.

Yet, while markets can be exceedingly enthusiastic about themes like these in the near-run – frequently without regard to underlying fundamentals -- we argue that they tend to be more rational in the long-run. Why? Again, the value of any business is based on underlying long-term cash flows and dividends to owners. Strong stock or sector performance is very difficult to sustain without underlying cash flows and growth. Even for those companies with such attributes, expectations may significantly exceed actual results, leading to disappointment and severe valuation Whammies.

The nature of our targeted Dividend Growth

Chart 3. Smid Cap Dividend Growers Trading Near Record Relative Lows



Source: FactSet. Valuation discounts or premiums do not guarantee future returns will be greater or lower than the benchmark. There is no guarantee that companies will declare dividends or, if declared, that they will remain at current levels or increase over time. Dividend Growers included stocks that raised their existing dividend or initiated a new dividend during the previous 12 months. You cannot invest directly in an Index.

approach minimizes these occurrences. Moreover, through time, share prices tend to follow rising dividends upward and do so with far less volatility than non-dividend growers, which lack this guidepost. Alas, the market is rational! Chart 4 is the proof point, highlighting the consistency of Dividend Growth in Smid Cap stocks over time. We see similar performance across all capitalization ranges and in international, as well.

No Need to Press Your Luck

The recent pace of events has been surprising and, we submit, impossible to predict. From here, the outlook remains unsettled. As we write, the number of new COVID-19 cases is surging across geographies that were initially less impacted and many states are widely reversing "reopening" plans. Nascent macroeconomic progress – including a burgeoning jobs recovery – is in jeopardy. Volatility, as measured by the CBOE Volatility Index (VIX) is off the extraordinary highs of March, but still elevated at more than double levels prior to the pandemic.[7]

Nonetheless, hope springs eternal and many investors appear to be pressing their luck, favoring higher risk, speculative stocks rather than dividend growth companies likely to deliver more consistent total returns over the long haul. Whammies could arrive, however, in the form of further detrimental COVID-19 impacts, a reversal or simply a curtailment of recent monetary and fiscal stimulus which has supported economic activity and kept fixed income markets functioning smoothly, political/civil unrest, geopolitical risk, trade risk, earnings disappointments, or heretofore unknown risks.

At Copeland, we are not pressing our luck. Our investable universe remains substantial across all capitalization ranges and geographies and we remain true to our strict dividend growth philosophy. While each cycle is different, we believe our commitment to owning only those companies with steadily rising dividends should continue to drive favorable total returns across our US and International Strategies.

July 20, 2020

Chart 4. Consistency of Dividend Growth in US Smid Cap

Data as of 12/31/2019	Initiation Date	Benchmark (total return)	One Year Rolling	Three Year Rolling	Five Year Rolling	Ten Year Rolling
Smid Cap Dividend Growers	**9/30/1982**	**Russell 2500® Index**	66%	78%	83%	94%
Smid Cap Flat Dividend Payers	9/30/1982	Russell 2500® Index	42%	33%	27%	35%
Smid Cap Non-Dividend Payers	9/30/1982	Russell 2500® Index	34%	20%	20%	10%
Smid Cap Dividend Cutters	9/30/1982	Russell 2500® Index	29%	15%	16%	15%

Source: Copyright 2019 Ned Davis Research, Inc. Further distribution prohibited without prior permission. All Rights Reserved. The information presented is intended to illustrate performance of Smid Cap stocks according to their dividend policy. Returns shown include dividends reinvested. 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. 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. Dividend growers included stocks that raised their existing dividend, or initiated a new dividend 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. Non Dividend Payers included stocks that have not paid a dividend during the previous 12 months. Dividend Cutters included stocks that lowered their existing dividend or eliminated their dividend during the previous 12 months. There is no guarantee that companies will declare dividends or, if declared, that they will remain at current levels or increase over time. You cannot invest directly in an Index.

1 *WSJ, Why Many People Misunderstand Dividends, And the Damage This Does https://www.wsj.com/articles/why-many-people-misunderstand-dividends-and-the-damage-this-does-11591454292*

2 *Kiplinger https://www.kiplinger.com/slideshow/investing/t018-s001-15-dividend-cuts-and-suspensions-coronavirus/index.html; Barron's https://www.barrons.com/articles/3-long-running-dividend-payouts-upended-by-coronavirus-51588933801*

3 *EURACTIV https://www.euractiv.com/section/economy-jobs/news/france-puts-dividends-payments-into-confinement-amid-covid-19-crisis/*

4 *Barron's https://www.barrons.com/articles/dividend-growth-funds-hold-their-own-in-an-era-of-payout-cuts-and-suspensions-51588257901?mod=past_editions*

5 *Investopedia https://www.investopedia.com/robinhood-and-its-merry-traders-steal-the-show-4847193*

6 *Fox Business https://www.foxbusiness.com/markets/barstool-sports-dave-portnoy-gamblers-trading-stocks*

7 *FactSet*

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

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