The Copeland Review

Third Quarter 2017

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

"Everybody gets high… everybody gets low… every day is a winding road"

- Sheryl Crow
"Every Day is a Winding Road," 1996

The Winding Road

A pleasant surprise awaits many investors upon receipt of their September quarterly statements: at odds with the views of most market observers at the start of the year, the S&P 500 Index has delivered a total return of +14.2% through the first nine months of 2017. For those with international equity exposure, even better news is in store: the MSCI Europe, Australia, and Far East Index® (EAFE) has gained +20% year to date. As Chart 1 shows, the current US bull market (as defined by a market advance without a decline of at least 20%) is the second longest and largest of the post-World War II era, having lasted eight and a half years and generating a 272% return so far. At least in terms of duration, this puts it in range of the longest modern advance, which began in 1990, and lasted nearly nine and a half years before flaming out in March 2000, with the start of the Telecom-Media-Technology (TMT) Crisis.

Perhaps as striking is that the S&P 500 Index's current exceptional run has been achieved with substantially below average levels of volatility. In fact, volatility as measured by the CBOE Volatility Index® (VIX®, or otherwise known as the "fear gauge"), is currently sitting near 20-year lows and has been trending lower ever since the end of the Financial Crisis.[1] Given this extended period of benign conditions, one could be forgiven for wondering if Sheryl Crow's first blockbuster hit single, "Every Day is a Winding Road," no longer applies to the stock market.

Whither Quantitative Easing?

Following years of the United States Federal Reserve's ("the Fed") Quantitative Easing program, involving prodigious open-market purchases of bonds, investors are intently focused on the future direction of domestic monetary policy and what it might mean for economic growth and equity market returns. The latest commentary, as cited by Chair Yellen in September, indicated that in the fourth quarter of 2017, the Fed would begin to trim its massive balance sheet holdings, which have more than

Chart 1. The Six Longest S&P 500 Bull Markets (in months) as of 9/30/17

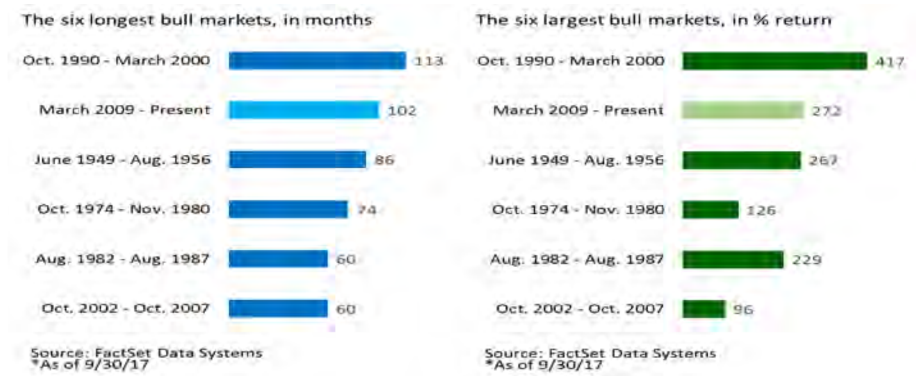
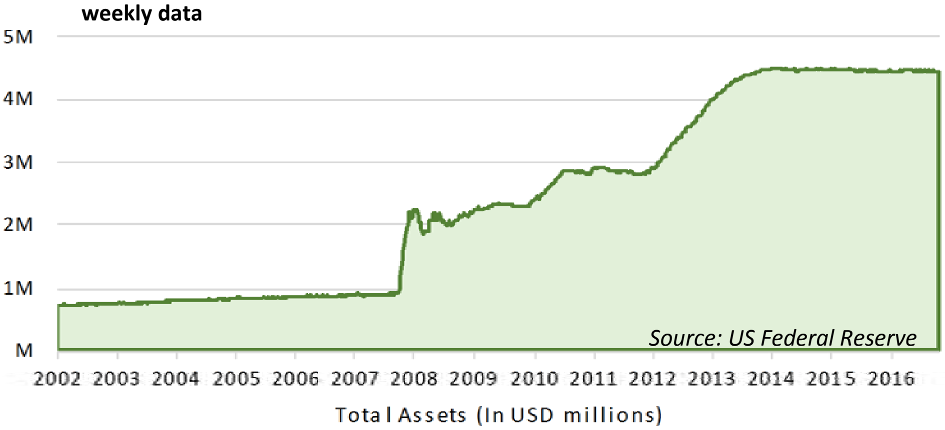


Chart 2 – US Federal Reserve Assets (USD millions) December 18, 2002 – September 30, 2017 weekly data



quadrupled to over $4.5 trillion since the end of the Financial Crisis in 2009 (Chart 2).

Should investors be concerned about the "Great Unwind," when the Fed begins to sell the bond holdings of its swollen balance sheet? Readers will recall that we touched on this topic in our last *Copeland Review* ("Punched Out!"). If done in an orderly fashion – and Yellen has indicated the Fed will initially be taking a measured approach over the next twelve months by simply not reinvesting maturing bonds – there seems to be no particular cause for alarm. Also, even if bond yields were to rise sharply due to more pronounced government selling pressure, certain segments of the global economy, such as the banking sector, may be poised to benefit from a more normalized yield curve structure. Of course, many market participants believe the valuation expansion of global equities in recent years is directly a function of the Fed's quantitative easing, as "easy money" pushed investors into risky assets. Reversing that flow of monetary support could just as easily pull the rug from under the market, they fear. Regardless of which side one takes, however, as long-time readers of the *Copeland Review* can attest, we neither own, nor are prone to seek, a crystal ball to divine the future direction of markets. Our mandate, in good times and bad, is to invest our client assets in a diversified portfolio of companies which we believe are able to sustainably grow their dividends at an above-market rate. By sticking to this mandate, we believe our strategies should deliver performance ahead of the benchmarks over a market cycle, regardless of where the winding road may take us in the short term.

Acknowledging, though, that all good things must eventually come to an end, including the second best bull market of our lifetimes, we would like to emphasize one of the most valuable features of Dividend Growth investing: the favorable risk attributes and potential to deliver meaningful downside protection. Chart 3 highlights the price behavior of US equities, by dividend policy, over roughly the past 35 years, from March 31, 1981 to December 31, 2016. As the data demonstrates, stocks that grow or initiate dividends have delivered substantially less volatility over time. The standard deviation of dividend growth stocks of 14.6% is well below the benchmark and other classes of stocks as defined by dividend policy. Further, dividend growth stocks delivered an enviable 79% downside capture during this time period, or in other words, reflected only 79% of the market decline during periods of falling share prices.

Importantly, as Chart 4 demonstrates, this protection from market downdrafts did not come at the expense of longer-term performance. Indeed, the material outperformance of dividend growth stocks vs. the market has been achieved in part due to their resilience in down markets.

Global Diversification

The merits of overseas diversification have been widely accepted by academics and investors due to the benefits of exposure to:

- a broader universe of companies;
- different underlying currencies;
- different capital market conditions; and
- correlation across markets < 1.

We would also propose that the opportunity to increase allocations to international dividend growth stocks is especially timely for US-based investors, given what we believe to be the:

- attractive relative valuations of foreign stocks;
- favorable risk/return attributes of international dividend growth stocks;
- more rapid improvement occurring in foreign economies; and
- lagging performance of foreign stock markets.

Chart 5 displays the longer-term performance of international equities, as reflected by the MSCI Europe, Australia, and Far East Index® (EAFE), compared with US equities, through September 2017. As one can see, US equities have dramatically outperformed the main non-US equity benchmark since September 2007, the approximate top of the last bull market. While the S&P 500 Index stands more than 62% above the prior high water mark in 2007, the EAFE Index has not yet even fully clawed back the losses of the Financial Crisis.

Rarely has the US/non-US equity divergence in performance, as highlighted in the chart below, been so pronounced for so long. A reversal in this trend, or reversion to the mean in Wall Street parlance, would not be surprising. A rapidly improving macroeconomic climate abroad is shown by the Manufacturing Purchasing Managers' Index (PMI) in Chart 6, even as the equivalent PMI for the United States has moderated over the past year. From May 2016 through September 2017, the US PMI increased 5% to 53.1, while the PMI readings for Europe and Japan rose more dramatically, up 13% to 58.1 and up 11% to 52.9, respectively. After years of below-trend economic growth overseas, a return to more typical growth seems quite likely to boost investor sentiment.

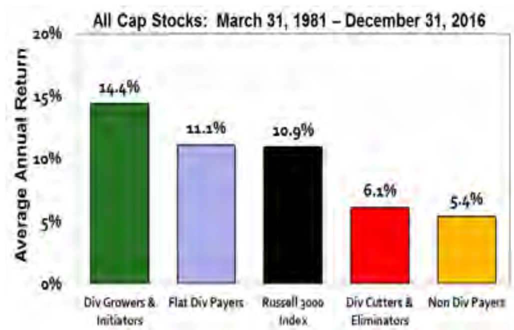
While perhaps not surprising after years of marked underperformance, non-US equities also provide favorable relative valuation today versus the domestic market. A number of key metrics favored by investors are provided in Chart 7. International equities currently trade at healthy discounts on the trailing twelve months Price/Earnings (TTM P/E) and Price/Book Value (P/BV) ratios, while also providing

Chart 3 – US Equity (All-Cap) Risk Statistics by Dividend Policy

3/31/81-12/31/16	Volatility (Std Dev)	Upside Capture	Downside Capture
Div Grower & Initiator	14.6%	96.9%	79.2%
Flat Div Payer	17.1%	100.8%	100.0%
Russell 3000	15.2%	100.0%	100.0%
Non Div Payer	24.8%	129.9%	149.6%
Div Cutter	21.7%	96.0%	117.3%

Source: Ned Davis Research, Copeland Capital Management

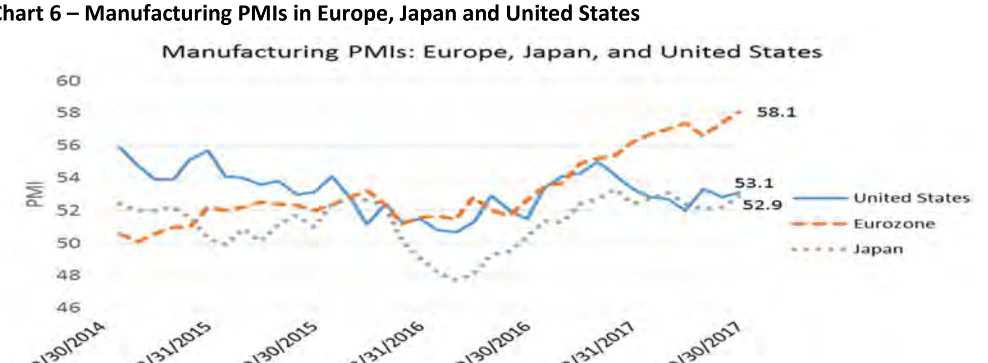
Chart 4 – US Equity Performance by Dividend Policy



Source: Ned Davis Research, Copeland Capital Management

Chart 5 – US vs. International Equity Returns

Chart 6 – Manufacturing PMIs in Europe, Japan and United States



Source: Bloomberg/Markit

a higher dividend yield. Although some of the valuation disparity is probably justified by the growth and leverage comparisons, we believe the investable valuation discount in overseas markets is worth trying to exploit.

Shifting to the risk/return characteristics of international equities, Chart 8 shows the favorable risk profile of Dividend Growth stocks overseas, reflected in a lower standard deviation and 79% of the downside capture of the EAFE Index.

Meanwhile, as Chart 9 demonstrates, the long-term returns of International Dividend Growth stocks are substantially higher than the international benchmark, and other classes of stocks as segregated by corporate dividend policy. The statistics, and our experience, have shown that by following the information provided by a dividend, we believe we can create an investing advantage and lower portfolio risk, regardless of region or (as discussed in prior reports) market capitalization. This phenomenon makes perfect sense to us. When a company announces a dividend action they signal their confidence, or lack thereof, in the upcoming performance of the business. Statistics that we monitor regarding dividend health signal whether the company has the financial strength to support a rising dividend, which also supports resilience during times of economic volatility.

Expecting an Upturn in Market Volatility?

So, for those investors who have a nostalgic fondness for Sheryl Crow's "Every day is a Winding Road," and expect market volatility to return sooner rather than later (or at least, some day), we believe the risk/return attributes of Dividend Growth investing in general, and International Dividend Growth investing specifically, are especially well suited for today's investment climate.

October, 2017

[1] *Source: Factset Data Systems, Inc. as of 9/30/17.*

Chart 7 – Market Characteristics: US vs. International Equity, as of 9/30/2017

	S&P 500	MSCI EAFE
TTM P/E	20.1x	18.8x
P/BV	3.0x	1.5x
Dividend Yield	1.7%	2.6%
1-Yr EPS Growth	11.0%	4.9%
1-Yr Div Growth	10.4%	11.6%
Net Debt to EBITDA	1.1x	1.4x

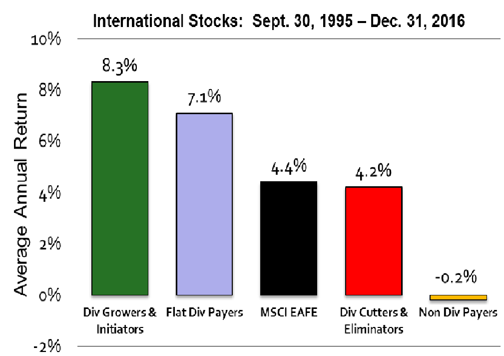
Source: MSCI, FactSet Data Systems, Copeland Capital Management

Chart 8 – International Equity (All-Cap) Risk Statistics by Dividend Policy

9/30/95-12/31/16	Volatility (Standard Deviation)	Upside Capture	Downside Capture
Div Grower & Initiator	16.3%	93.5%	79.3%
Flat Div Payer	16.6%	89.1%	80.3%
MSCI EAFE	16.5%	100.0%	100.0%
Non Div Payer	25.2%	121.3%	130.0%
Div Cutter	19.2%	93.8%	96.0%

Source: Ned Davis Research, Copeland Capital Management

Chart 9 – International Equity Performance by Dividend Policy



Source: Ned Davis Research, Copeland Capital Management

Disclosure Section:

The views expressed herein represent the opinions of Copeland Capital Management and are subject to change based on market, economic or other conditions. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. All data referenced is from sources deemed to be reliable, but cannot be guaranteed as to accuracy or completeness. All investments are subject to risk including possible loss of principal.

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 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.*

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

About Copeland Capital Management — Copeland Capital Management is an employee owned, registered investment adviser with offices in Conshohocken PA, Wellesley MA and Atlanta GA. The firm specializes in managing Dividend Growth strategies for both institutions and high net worth individuals. For more information, please contact Chuck Barrett, Senior Vice President - Director of Sales and Marketing at (484) 351-3665, cbarrett@copelandcapital.com or Robin Lane, Marketing Manager at (484) 351-3624, rlane@copelandcapital.com.

Disclosure Section (continued):

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.

*The Indexes mentioned are unmanaged, are not available for investment and do not incur expenses. The **MSCI EAFE® Index (Europe, Australasia, Far East)** is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada. The Index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 21 countries. 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 **CBOE Volatility Index® (VIX® Index®)** is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. The **Russell 3000® Index** measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.*

Definitions

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

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

***Earnings Per Share Growth (EPS)** illustrates the growth of earnings per share over time.*

***EBITDA stands for Earnings Before Interest, Taxes, Depreciation, and Amortization** and is a metric used to evaluate a company's operating performance. It can be seen as a proxy for cash flow from the entire company's operations. The metric is a variation of the operating income (EBIT) because it excludes non-operating expenses and certain non-cash expenses. The purpose of these deductions is to remove the factors that business owners have discretion over such as debt financing, capital structure, methods of depreciation, and taxes (to some extent). EBITDA then focuses on the operating decisions of a business because it looks at the business' profitability from its core operations before the impact of capital structure, leverage and non-cash items like depreciation are taken into account.*

***The Price-to-Earnings (P/E) 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. The P/E ratio is calculated as a stock's current share price divided by its earnings per share (EPS) for a twelve-month period (usually the last 12 months, or trailing twelve months (TTM)). Most of the P/E ratios for publicly-traded stocks are an expression of the stock's current price compared against its previous twelve months' earnings.*

***The Price-to-Earnings Growth (PEG) Ratio** is a valuation metric for determining the relative trade-off between the price of a stock, the earnings generated per share (EPS), and the company's expected growth.*

***Price-to-book value (P/B)** is the ratio of market price of a company's shares (share price) over its book value of equity. The book value of equity, in turn, is the value of a company's assets expressed on the balance sheet. This number is defined as the difference between the book value of assets and the book value of liabilities.*

***The Purchasing Managers' Index (PMI)** is an indicator of the economic health of the manufacturing sector. The PMI is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.*

Risks

***Emerging Markets Risk:** The risks associated with foreign investments are heightened when investing in developing or emerging markets. The governments and economies of emerging market countries feature greater instability than those of more developed countries. Such investments tend to fluctuate in price more widely and to be less liquid than other foreign investments.*

***Foreign Investing Risk:** Investments in foreign countries are subject to country-specific risks such as political, diplomatic, regional conflicts, terrorism, war, social and economic instability and policies that have the effect of decreasing the value of foreign securities. Foreign investments may experience greater volatility than U.S. investments.*

Copeland's fees can be found in our ADV Part 2 which is available by calling (484) 351-3700 and requesting a copy, or on our website at www.copelandcapital.com.

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