Most Profitable Move of 2016

August 2016 Client Letter

MOST PROFITABLE MOVE OF 2016

One of the most profitable investing moves of 2016 involved no research, no trading and actually no work at all. While it now seems like a distant memory, you may recall the nosedive that stocks took to begin the year. Just 10 trading days into

January, U.S. stock markets recorded their worst start to a year on record. Making matters worse, the bad days did not end quickly. Stocks continued lower into the first part of February. An *Economist* article asked, “Is this really 2008 all over again?”

By the time February 11 rolled along, the S&P 500 was down 10% and the NASDAQ had tumbled 14%. For some, this was an alarming environment. Markets had experienced few corrections dating back to 2009. Had the day of reckoning arrived? A decision needed to be made. Should I abandon ship and cut losses, or ride it out and hope for the best?

Fortunately, most of our clients made the decision to stay the course. This decision turned out to be the right move as the markets rallied and reached new highs. When looking back, it's easy to see what a blow it would have been to dump one's equities and head to cash. Those who chose to make no move experienced a dramatic difference in portfolio returns compared to those who sold out.

The table below shows the total returns from various asset classes since February 11.

Index / Sector	2/11/16 to 8/29/16
S&P 500	+20.6%
MSCI All Country World	+20.4%
S&P 500 Consumer Staples	+11.9%
S&P 500 Materials	+27.6%
S&P 500 Energy	+28.9%

In just over six months' time markets made impressive gains. Investors who completely sold their equities in January or February missed the boat on future returns. Selling an asset on the basis of performance is a strategy that can sabotage portfolio returns. As I wrote in April, market research firm Dalbar has shown over and over that when investors sell in despair and buy on euphoria, they sacrifice returns. The result of this emotionally charged approach to portfolio management has been dismal. Dalbar's data shows that for the 30-year period ending in 2014, the S&P 500 would have compounded investors' money at an annual rate of over 11%, but the actual return of the average equity-fund investor was

only 3.8%. The same is true of bonds. Dalbar reports a 30-year return of 7.4% for the Barclay's Aggregate Bond Index, but only 0.72%
for the average fixed-income fund investor.

EASIER WITH A PLAN

Avoiding panic and staying calm through market declines is easier with an investment plan in place. Clients at Richard C. Young & Co., Ltd. understand that much of our plan centers on higher-quality security selection with a focus on dividends and interest. Additionally, most portfolios are balanced between fixed-income securities, gold, and stocks. When stocks declined, as they did earlier in the year, the fixed-income and gold component held their values or even increased in value, helping to reduce portfolio volatility. Obviously, the reduced volatility added a degree of comfort, helping clients to remain patient and calm.

WHICH ALLOCATION IS BEST?

In determining the right balance between stocks and bonds, you need to weigh several considerations. These include personal risk tolerance to volatility, past experiences, and personal financial situations. By example, investors who have successfully ridden out Black Monday, the dot-com crash, and the 2008 financial crisis may accept that markets do not always go up. Corrections, while not pleasant, are part of the investing landscape. Historically, time has healed market wounds. Investors in this camp may have no problem with a heavier allocation to stocks.

PHASE OF LIFE

Other investors, while also accepting the potentially volatile nature of the markets, find themselves in a different phase of life compared to the dot-com crash and financial crisis years. Those now fully retired, with health concerns, or with thoughts of a surviving spouse may not wish to have the added concern of portfolio volatility. At this point in life, sleepless nights are a bad investment. Investors with this type of risk profile can still invest in stocks but may prefer less exposure than they tolerated in earlier years.

SAFE EUROPEAN STOCKS

With interest rates still nailed to the floor, investors are seeking additional yield from stocks. Income stocks are also enjoying a nice rally this year, further increasing investors' desires to own these shares. In fact, The Vanguard Group recently closed its popular Dividend

Growth Fund (VDIGX) to new investors. Due to its popularity and to the strong cash flows into the fund, management felt the need to stem further growth. Owners of VDIGX know that, despite the word Dividend in its name, the fund is more focused on companies with a commitment to grow their dividends over time than on companies with relatively higher yields. As of August 23, 2016, VDIGX offered a 1.91% yield. This is probably on the lower side for investors looking for additional cash flow.

To achieve a higher-yielding equity portfolio, it can be effective to invest in individual stocks as opposed to the fund route. The August 13 issue of

Barron's featured an article profiling "5 Safe European Stocks With Yields Up to 5%." Three of the featured stocks, National Grid, Nestle, and Vodafone, are ones we purchase for clients. *Barron's* made the case that income seekers are neglecting Europe, which is one of the more promising places for dividends. European companies tend to favor dividends over stock buybacks, and some European shares have not kept pace with U.S. equities offering potential upside in capital appreciation.

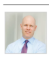
A few other European names in our client portfolios that perhaps could have made the *Barron's* list include Unilever, Anheuser Busch InBev (Bud), British American Tobacco, and Siemens. Unilever, Bud, and British American Tobacco are all powerhouse global, branded-consumer-staples companies.

Unilever sold $60 billion worth of soaps, detergents, deodorants, foods, and beverages in 2016. Almost two-thirds of the company's business is done in the fast-growing emerging markets. According to the IMF, emerging market economies are expected to grow at more than twice the rate of developed economies for the balance of the decade. Long-term, Unilever's position is a winner. Some of Unilever's more recognizable U.S. brands include Dove, Hellman's, Vaseline, Ben & Jerry's, Country Crock, Klondike, Q-tips, and Suave.

Anheuser Busch is the world's leading beer company. Bud owns 19 $1-billion brands, including Budweiser, Bud Light, Corona, Stella Artois, and Michelob, among others. With the pending acquisition of SAB Miller, Bud will become an even more dominant force in the global beer market, enhancing the company's cost advantage cost advantage with larger scale.

British American Tobacco (BTI) is one of the world's largest tobacco companies with factories in 41 countries. British American Tobacco has paid annual dividends since at least 1928. Over the last five years, British American Tobacco has increased its dividend at an annual rate of 5.5%. A mid-single-digit dividend growth rate paired with BTI’s current yield of 3.4% makes for a decent prospective return in today’s ultra-low-return environment.

As I mentioned in my last client letter to you, we view Siemens as the GE of Europe. Siemens is a leader in automation, energy, healthcare, and building technologies. While Siemens is a more cyclically sensitive business than many of the consumer companies we



own, it is a global blue-chip that has been around for almost 170 years. It has survived many recessions, a few depressions, and even major wars.

As for *Barron's* implication that these companies may be safe, investors should note that safe is a subjective term and best interpreted relative to other equity investments. Nestle, National Grid, and, to a lesser extent, Vodafone all provide or produce essential goods and services. Their businesses are less susceptible to business cycle fluctuations than the average company, and all have the financial capacity to weather a recession. That does not mean that their share prices can't fluctuate substantially. I am sure *Barron's* would put Coca-Cola in the same safe category as Nestle, National Grid, and Vodafone, but being a safe stock didn't prevent Coke shares from falling almost 60% between July 1998 and March 2003.

In terms of strategy at Richard C. Young & Co., Ltd., we seek a mix of higher-yielding equities and companies that focus on dividend growth. Companies offering a heftier yield, include many of our above mentioned European holdings, our energy and MLP positions, and utilities. As with the Vanguard Dividend Growth Fund strategy, we also invest in companies with a commitment to grow their dividends over time. Examples of these companies would include CVS, Walgreens, and Johnson & Johnson. As I have stated before, annual dividend increases act as a pay raise. And this pay raise can occur regardless if the stock market is up or down. We all enjoy pay raises, as they are one of the few ways to keep pace with the nasty effects of inflation.

Have a good month. As always, please call us at (888) 456-5444 if your financial situation has changed or if you have questions about your investment portfolio.

Warm regards,

Matthew A. Young
President and Chief

Executive Officer

P.S. "If making money is a slow process, losing it is quickly done." Japanese poet Ihara Saikaku

P.P.S. Finding alternatives: Alternative investments are assets classes that do not move up and down in tandem with the stock market. Gold is considered an alternative and often moves out of sync with stocks. By example, on June 24, after the Brexit vote was announced, SPDR Gold Shares rose 4.9%, while the S&P 500 fell 3.6%. Obviously, the opposite can occur as well, where gold will underperform when stocks are doing well. But the strategy for including gold (and bonds) is to help smooth out portfolio returns and to reduce volatility.

P.P.P.S. Regardless of whether a security is domestic or international, dividends remain the heart of our investment strategy. Over time, dividends and the reinvestment of dividends make up most of the return of stocks. The percentage of return coming from dividends, of course, varies by period. From year-end 1999, dividends have accounted for about 54% of the return on the S&P 500.

The information contained in this letter is for informational and educational purposes only. It is not intended nor should it be considered investment advice or a *recommendation of securities. Past performance is not a guarantee of future results. It is possible to lose money by investing. You should carefully consider your investment objectives and risk tolerance before investing. Please contact our office directly with any questions regarding items appearing in the letter.*

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