Convergence Dividend Growth Commentary

Q2-2020

The Convergence Dividend Growth strategy generated a 16.71% return, net of fees, in the second quarter of 2020. The strategy outperformed the Russell 1000 Value Index by 2.42% for the quarter.

The strategy delivered in the first half of 2020, outperforming the Russell 1000 Value, net of fees, during despite the onset of a global pandemic and unprecedented central bank intervention. The U.S. Federal Reserve actions included cutting rates to zero, $2.3 Trillion in lending, and an open-ended promise to buy securities, "in the amounts needed to support smooth market functioning and effective transmission of monetary policy to broader financial conditions."[1] In the second quarter of 2020, the Fed's portfolio of securities held outright grew from $3.9 trillion to $6.1 trillion. We are clearly in a period of unparalleled influence from a colossal player in the markets.

The Convergence process guides us to create a portfolio of reasonably-valued companies with high, growing, and sustainable dividends . Our portfolio delivered strong relative returns for the first half of 2020. The strategy holdings outperformed in five of the six months, with particularly strong relative returns in March and June. As the global pandemic swept across the globe, corporate fundamentals provided a positive differentiator between winners and losers. This period of heightened volatility proved a good environment for the Convergence Dividend Growth strategy.

Our portfolio construction process is built on the principle that companies with strong and growing dividends tend to outperform over the long haul. Central to our selection process is the premise that a given company's profits should be sustainable enough to weather economic slowdowns. This becomes evident when analyzing the past performance of companies with moderate payout ratios, strong cash flow and sustained dividend growth. Historically, these companies have fared better in times of economic turmoil.

As our long-term investors are aware, our three core tenets have remained steadfast since the strategy's inception.

- Competitive, long-term returns
- Below market volatility
- Above market level dividend yield

The pillars of our philosophy are reflected in our portfolio statistics. Our portfolio yield has been consistently higher than the market averages since inception, and the portfolio dividend growth rate is nearly double that of the market. Using the price-to-earnings ratio as a proxy for valuation, we can observe that our portfolio is comprised of names that the market is currently undervaluing. Restated, one could say that we are buying strong dividend growth and dividend payments at a discount to the broader market.

[1] https://www.federalreserve.gov; Press Release 03/23/2020

Past performance is not indicative of future results.

	Current Yield	5 Year Div. Growth	Trailing P/E Ratio
Convergence Dividend Growth Strategy	4.09%	10.8%	19.7
Russell 1000 Value Index	2.61%	7.7%	19.8
Russell 1000 Index	1.76%	7.5%	26.6

Source: Wilshire Analytics: as of 6/30/2020

With the Federal Reserve's unprecedented intervention, Treasury and corporate bond yields have plunged. With average portfolio yield on the Convergence Dividend Growth strategy above 4% and the 10 Year U.S. Treasury yield at 0.66%, (as of June 30), our strategy presents a very compelling opportunity for investors seeking a certain level of income. The table below shows the amount of principal or initial investment required to generate that same level of income as a 4% yield strategy.

Investment	Principal	Yield	Income
Convergence Dividend Growth	$1,000,000	4.00%	$40,000
BBB Corp. Debt (5 year)	$2,730,748	1.46%	$40,000
A Corp. Debt (5 year)	$4,208,754	0.95%	$40,000
AAA Corp. Debt (5 year)	$6,408,202	0.62%	$40,000
Treasuries (5 year)	$13,860,014	0.29%	$40,000

Yields as of 6/30/2020: Source: Bloomberg

The above table clearly shows that when locking up your capital for 5 years, it takes a significantly larger amount of initial investment to generate $40,000 of income. While this is unsurprising given today's historically low yields, demonstrating this with numbers helps convey the idea that there is a compelling opportunity in dividend paying equities. It is shocking to note that when investing in 5-year Treasuries, an investor would be required to purchase over $13M to generate a mere $40,000 in income. Taking the above example to a 10-year lock up reduces the initial investment, but it remains significant. The table below compares a 4% yield to the same fixed income offerings.

Investment	Principal	Yield	Income
Convergence Dividend Growth	$1,000,000	4.00%	$40,000
BBB Corp. Debt (10 year)	$1,682,864	2.38%	$40,000
A Corp. Debt (10 year)	$2,228,785	1.79%	$40,000
AAA Corp. Debt (10 year)	$2,816,505	1.42%	$40,000
Treasuries (10 year)	$6,089,207	0.66%	$40,000

Yields as of 6/30/2020: Source: Bloomberg

After reviewing the above table, it remains obvious that an incredible amount of initial capital is required to generate $40,000 of income from Treasuries. Furthermore, given the continued deterioration of corporate debt quality, one would be required to consider lending money to nearly junk rated corporations to meet a $40,000 income requirement. Also, a portfolio of high-quality dividend paying companies with strong balance sheets and cash flow can pay dividends that increase over time, unlike the fixed payments from most bonds. In conclusion, income sensitive clients should consider the Convergence Dividend Growth strategy for their portfolios as we have delivered an average yield of 3.77% (gross) since 2009, and with current yield in excess of 4.0%, the tumultuous environment of 2020 presents an exciting opportunity.

Performance.

The Convergence Dividend Growth delivered a 16.71% return, net of fees in the second quarter of 2020. The strategy outperformed the Russell 1000 Value index by 2.75% in the first half of 2020 and it outperformed the Value Index by 2.42% in the second quarter of 2020. For the second quarter, Dividend Growth was helped by solid stock selection in Diversified Financials, Pharmaceuticals and Energy. Our industry groups allocations helped with Utilities and Retailing. Industry groups that detracted most from relative performance for the quarter included Media, Telecom and Materials. The following table summarizes attribution effects of the Dividend Growth strategy vs. the Russell 1000 Value Index.

Convergence Dividend Growth: 3 Month Attribution as of 6/30/2020 (vs Russell 1000 Value)

	Stock Selection Effect (%)	Allocation Effect (%)	Total Variance (%)
Automobiles & Components	-0.078	-0.111	-0.189
Banks	0.025	0.087	0.112
Capital Goods	-0.021	-0.030	-0.051
Consumer Durables & Apprl	0.064	0.045	0.109
Comm & Prof Services	0.000	-0.047	-0.047
Diversified Financials	0.942	0.093	1.035
Energy	0.340	0.139	0.479
Food Beverage & Tobacco	0.016	0.064	0.080
Food & Staples Retailing	-0.168	-0.072	-0.240
Health Care Eqpt & Srvcs	0.000	0.036	0.036
Household & Prsnl Prods	-0.006	-0.002	-0.008
Consumer Services	0.002	-0.005	-0.003
Tech Hardware & Equipment	0.143	0.068	0.211
Insurance	0.304	0.039	0.343
Materials	0.052	-0.207	-0.155
Media & Entertainment	-0.312	-0.124	-0.436
Pharmaceuticals & Biotech	0.671	-0.040	0.631
Real Estate	0.164	0.031	0.195
Retailing	0.097	0.296	0.393
Software & Services	0.042	0.139	0.181
Semiconductors & Semi Eq	0.204	0.046	0.250
Telecomm Services	-0.035	-0.238	-0.273
Transportation	-0.180	0.016	-0.164
Utilities	-0.114	0.346	0.232

Source: Wilshire Analytics

As we look forward to the remainder of the year, in the words of Michael Goldstein from Empirical Research, "nobody knows nuttin'." Trying to predict the direction of the markets, will be a fruitless exercise even for the most seasoned market strategists. However, there are sound investing principles that astute investors can lean on. Periods of economic uncertainty, can create opportunities for shrewd and discerning market participants who invest in fundamentally sound companies with strong growth characteristics. In the words of Michael Wilson, the senior equity strategist at Morgan Stanley, the upcoming earnings reports will show a lot of stock specific dispersion, which can create some terrific stock selection opportunities for active managers. As always, our guiding mission will be to continue to focus on companies with proven dividend-paying records, supported by strong financial health. If history is any guide, companies with shareholder-friendly dividend policies built from solid business models that are generating strong cash flow, should continue to perform well.

Data as of June 30, 2020

Past performance is not indicative of future results. Dividends represent past performance. There is no assurance they will continue to be paid in the future. Holdings are subject to change and should not be considered a recommendation to buy or sell any security.

Source of market data: Wilshire Analytics and Bloomberg LLC