Convergence Dividend Growth Commentary

Q3-2019

The Convergence Dividend Growth outperformed the Russell 1000 Value by over 100 basis points in the third quarter of 2019, net of fees. It was a jumpy quarter where most indexes finished up with small single digit returns. For example, despite large intra-month differences, growth and value finished nearly equal at 1.5% and 1.4%, respectively, as measured by the Russell 1000 Growth and Value Indexes. For the quarter the Convergence Dividend Growth strategy finished up a noteworthy 2.51%. Since inception and over the trailing 3-, 5- and 10- year periods our Dividend Growth Strategy has outperformed the Russell 1000 Value index, net of fees. We believe that our process helps to provide a competitive edge for delivering superior risk adjusted returns by focusing on attractive relative valuations, strong cash flow generation and robust earnings and sales growth.

Why Dividends?

Dividends are genuine. In terms of equity investing, there are not many things more authentic than a dividend payment. Earnings are restated, guidance is missed, acquisitions are dilutive and self-serving, unforced errors are prevalent, but once the dividend is paid there's no getting it back. In addition to enhancing and stabilizing returns, dividends can be viewed as a signal from company management regarding the company's long-term prospects and sustainability.

Why Dividend Growth?

While traditional "high yield" stocks have delivered strong performance recently, some of these names have become quite expensive in terms of most valuation metrics. Companies in sectors such as Utilities or Real Estate Investment Trusts (REITS) have been stretched to the upper end of their historical valuation range, as some market participants have engaged in chasing yield. Conveniently, the recent low-interest-rate environment allowed many these companies to pile on debt to expand their operations, while continuing to pay elevated dividends. Therefore, if rates were to tick up, many of these companies could come under pressure.

Conversely, stocks with a history of strong and consistent dividend growth, present a compelling opportunity in an environment of heightened volatility or if interest rates were to rise in the future. A portfolio of companies with both sustainable and growing dividends should provide exposure to high-quality stocks with greater income over time, which should better weather market volatility and the risk of rising rates, than a portfolio focused solely on yield.

Why Convergence? Experience. Income. Returns.

David Abitz, our founder, President and Chief Investment Officer has been managing dividend-focused strategies for over 25 years. The Convergence Dividend Growth strategy has a 176 month-long track record. A period over which we have not only outperformed our benchmark, (net of fees) but also remained true to our philosophy and approach: a focus on both dividend income and growth. Our portfolio yield is quite high at 3.47% when compared to the Russell

1000 Index yield of 1.92%, as of quarter end. Over the past 5 years the names in our portfolio have grown their dividends by 10.7%, much higher than our Russell 1000 Value benchmark, with a 6.7% five-year dividend growth rate. Finally, over the past decade, we have been able to deliver outperformance (13.28% vs. Russell 1000 Value 11.46%) with lower market risk (0.85 Realized Beta vs. the Russell 1000 Value).

Performance Review:

For the third quarter of 2019, the strategy benefited the most from stock selection within Energy, Retailing and the Pharmaceuticals groups. Blue chip names with strong cash flows provided strong relative returns within the portfolio. Groups that detracted most from relative performance for the year included Insurance, Food & Beverage and Semiconductors. The following table summarizes attribution effects of the Dividend Growth strategy versus the Russell 1000 Value Index.

Convergence Dividend Growth: YTD Attribution 6/30/2019 (vs Russell 1000 Value)			
	Stock Selection Effect (%)	Allocation Effect (%)	Total Variance (%)
Automobiles & Components	0	0.048	0.048
Banks	0.038	-0.038	0
Capital Goods	0.133	0	0.133
Consumer Durables & Apprl	0.014	0.006	0.02
Comm & Prof Services	0	0.004	0.004
Diversified Financials	0.04	0.037	0.076
Energy	0.607	0.08	0.687
Food Beverage & Tobacco	-0.297	-0.014	-0.312
Food & Staples Retailing	-0.054	0.101	0.047
Health Care Eqpt & Srvcs	-0.028	-0.027	-0.055
Household & Prsnl Prods	0.003	-0.007	-0.004
Consumer Services	0.143	0	0.143
Tech Hardware & Equipment	0.024	-0.156	-0.132
Insurance	-0.309	-0.022	-0.331
Materials	0.035	0.074	0.109
Media & Entertainment	0.038	0.074	0.112
Pharmaceuticals & Biotech	0.198	-0.1	0.097
Real Estate	-0.033	0.085	0.052
Retailing	0.262	0.089	0.351
Software & Services	0.169	-0.049	0.12
Semiconductors & Semi Eq	-0.126	0.097	-0.029
Telecomm Services	0.023	0.248	0.271
Transportation	0.034	-0.003	0.03
Utilities	0.013	-0.122	-0.109

Source: Wilshire Analytics

Our guiding mission for the strategy is to seek out companies with strong and improving cash flows which are supportive of rewarding shareholders with growing dividend payments. If history is any guide, companies with such shareholder-friendly dividend policies built from solid business models that are generating strong cash flow, should continue to perform well.

Data as of 09/30/2019

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.

The results portrayed relate only to the adviser's clients invested in the portfolio that meet the criteria for inclusion in composite performance. Strategy returns are presented after actual standard management fees and all trading expenses. The inception date is 2/2005 and period ended 9/30/2019. Returns have been compared to the Russell 1000® Value Index and Russell 1000 Index. The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 30000 and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe with lower price-to-book ratios and lower expected growth values. You cannot invest directly in an index. Comparison is for illustrative purposes only and the volatility of the benchmarks may be materially different from the volatility of the Composite due to varying degrees of diversification and / or other factors.

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Source of market data: Bloomberg