



During the two years since the Dividend Equity Strategy was launched, the stock market has witnessed two very distinct environments. In 2008, investors suffered from a collapse in the credit markets, an economic recession with growing unemployment, and a rapid decline in share prices. The Government was forced to pump more than a trillion dollars into the financial industry to prevent a total collapse in our banking system. As the first quarter of 2009 came to end, investors finally saw the light at the end of the tunnel and grew more confident. The combination of higher investor sentiment and billions of dollars in new liquidity launched a rally in stock prices that began in March and continued through the rest of the year.

The fallout in the credit markets hit investors with more than just declining stock prices. Investors were also hit with a sharp decline in dividend income. In 2009, more than 800 publicly traded companies reduced or eliminated its quarterly dividend and cost investors roughly \$58 billion in lost income (Standard and Poor's). The majority of these dividend reductions came from the financial sector as banks and insurance companies were forced by new Government legislation to increase their capital base.

Other companies reduced or maintained their dividend at current levels as the focus turned away from rewarding shareholders and toward building a higher cash balance. The collapse in the credit markets brought fears that corporations would not be able to refinance their maturing debt and dividend investors suffered as a result. It was the worst year for dividends since 1955 and was reflected in dividend-focused benchmarks.

On a positive note, the slow recovery in the credit markets should bring an improved outlook for dividends in 2010. With large cash balances and healthy cash flows, many publicly traded companies have the capacity to significantly increase its quarterly payout. The question that remains is whether Board Members have the confidence to increase its dividend while the health of the U.S. economy is still up for debate.

In 2008, we focused on avoiding potential land mines to the portfolio even though many stocks looked attractive based on historic valuations. This allowed the Strategy to escape most of the fallout in the financial sector as names like AIG, Bear Sterns, Wachovia, Fannie Mae, and Lehman Brothers were never held within the portfolio. The focus changed in 2009, however, as the bulk of the Strategy remained intact throughout the year. With only one new addition and two deletions to the Strategy, the turnover rate fell below 10%. That does not mean that the Strategy was dormant during the year. Due to the significant rally in certain market sectors, the portfolio was rebalanced on three occasions to prevent concentrations from developing in individual holdings and to realize large capital gains.

For 2010, we admit that the outlook for the markets is cloudy. History would tell us that the market rally needs to digest its recent gains before resuming its upward movement. However, S&P 500 quarterly earnings have yet to match 1Q2005 when the market was trading just below 10,500. Corporate earnings for the 4th Quarter of 2009 will post sizable growth but it is compared to a considerably weak 4th Quarter of 2008. Revenue growth for the S&P 500 is a more telling story. Ignoring the Financial sector, year-over-year revenue growth is estimated at only 2% and indicates that the consumer remains very cautious and capital spending has yet to pick up. As a result, we are holding our current positions until we sense a change in consumer sentiment and business investment activity.