

Enhanced Dividend for Income

MARKET COMMENTARY BY JIM O'SHAUGHNESSY: SEPTEMBER 8, 2010



"FOLLOW THE COURSE OPPOSITE TO CUSTOM AND YOU WILL ALMOST ALWAYS DO WELL."

JEAN-JACQUES ROUSSEAU

It is axiomatic in the financial planning canon that investors searching for a steady source of income should rely heavily on bonds. Stocks are for capital appreciation and bonds for income. The practice is so ingrained, that I have not heard of many advisors who would make the case for using an equity portfolio to generate income. Bonds also appeal to advisors because of their inherent principal protection advantage. As a bond owner, you are a creditor, not an owner. If you buy relatively riskless securities like 10-year Treasury notes from the U.S. Government, you face an almost 100 percent chance that your principal will be returned to you in ten years. Of course, riskier bonds with lower ratings ("junk" bonds) are available with much higher yields, but with these instruments, you face a much greater risk that you could lose a good portion of your principal if the bond defaults.

For me, the problem with fixed income investments is that they are *fixed*. Once you lock in a yield—if you hold the bond to maturity—you will receive the same coupon payment for the remainder of the bond's life. While that might work fine in a stable economic environment with low inflation, it becomes a big problem if inflation is consistently reducing the

purchasing power of your annual earnings. Since the early 1970s, the inflation rate in the United States has been 4.45 percent. That means that something that cost one dollar in 1970 now costs \$5.75! Someone who put their entire savings in U.S. Treasury bonds hoping to live off the income would find themselves unable to do so because of the savage effects of inflation over the period. Since, if you consume the income generated by the bonds, you always get back just what you invested, with no principal growth in the value of your portfolio, you have no way to make up for what is being lost to inflation. With current government deficits and debt running amok, expecting inflation rates to remain low is wishful thinking—indeed, given current trends, it is more likely that inflation will be significantly higher over the next ten to 20 years than it was from 1970 until now.

I believe that investors and financial advisors should shift their focus from bonds to finding an investment that could continually grow income over time. That is why I decided to turn orthodoxy on its head and look primarily at the income benefits of our Enhanced Dividend strategy. Rather than focus on what happens to the total value of a portfolio from year to year, I decided to look at what happens

to just the income portion to see if we could see a pattern. And oh boy, did we find a nice pattern! Starting on December 31, 1962 (where our access to monthly data begins), what would happen to an investor's annual income if they simply invested in the stocks that qualified as of that date; consumed all of the dividend income over the following year and then rebalanced their portfolio to hold the new names that qualified as dividend champs? Before we look at the results in Table 1, let me enumerate some simple assumptions:

- I assume a lump-sum investment similar to what you have by rolling over a 401(k) into an IRA;
- I assume the vehicle we are using to invest is similar to a Roth IRA for individuals or a charitable or similar tax-free institution for institutional investors;
- I assume that all trading is done on December 31 each year and that the investor receives a payout which equals the indicated dividend yield of the portfolio as of December 31. Obviously, dividends can go up or be cut, and in the real world we would take actions around the dividend cut, but for our illustration here, we assume we get the indicated dividend yield and consume it entirely over the course of the year. I also present the results on a gross basis that ignores transaction costs and fees.

Table 1: Portfolio & Income Growth

Period Ending:	Indicated Yield	Portfolio Value	Portfolio Appreciation	Cash Consumed	% Change Income	Rolling 10-year % Increase in Income
12/31/1962	4.44%	\$250,000	—	—	—	—
12/31/1963	4.04%	\$295,168	18.07%	\$11,102	—	—
12/31/1964	3.92%	\$344,404	16.68%	\$11,915	7.33%	—
12/31/1965	3.77%	\$376,191	9.23%	\$13,506	13.35%	—
12/30/1966	5.58%	\$324,004	-13.87%	\$14,201	5.14%	—
12/29/1967	5.13%	\$390,243	20.44%	\$18,078	27.30%	—
12/31/1968	4.64%	\$466,715	19.60%	\$20,031	10.80%	—
12/31/1969	6.13%	\$357,107	-23.48%	\$21,640	8.03%	—
12/31/1970	6.27%	\$369,117	3.36%	\$21,896	1.18%	—
12/31/1971	5.73%	\$380,567	3.10%	\$23,145	5.70%	—
12/29/1972	5.69%	\$407,921	7.19%	\$21,794	-5.84%	—
12/31/1973	7.38%	\$381,049	-6.59%	\$23,203	6.47%	109.00%
12/31/1974	10.07%	\$303,240	-20.42%	\$28,116	21.18%	135.96%
12/31/1975	6.91%	\$428,642	41.35%	\$30,544	8.63%	126.15%
12/31/1976	5.64%	\$568,352	32.59%	\$29,608	-3.06%	108.49%
12/30/1977	6.81%	\$519,932	-8.52%	\$32,044	8.23%	77.25%
12/29/1978	7.50%	\$511,493	-1.62%	\$35,392	10.45%	76.69%
12/31/1979	7.98%	\$604,243	18.13%	\$38,355	8.37%	77.24%
12/31/1980	7.46%	\$681,245	12.74%	\$48,222	25.73%	120.23%
12/31/1981	8.05%	\$710,680	4.32%	\$50,846	5.44%	119.68%
12/31/1982	8.01%	\$867,403	22.05%	\$57,225	12.55%	162.58%
12/30/1983	6.57%	\$1,084,532	25.03%	\$69,449	21.36%	199.32%
12/31/1984	6.67%	\$1,143,122	5.40%	\$71,249	2.59%	153.41%
12/31/1985	6.10%	\$1,465,015	28.16%	\$76,226	6.99%	149.56%
12/31/1986	5.51%	\$1,747,774	19.30%	\$89,410	17.30%	201.98%
12/31/1987	5.61%	\$1,951,358	11.65%	\$96,326	7.73%	200.60%
12/30/1988	5.65%	\$2,289,726	17.34%	\$109,453	13.63%	209.26%
12/29/1989	4.17%	\$2,857,196	24.78%	\$129,406	18.23%	237.39%
12/31/1990	4.96%	\$2,626,044	-8.09%	\$119,283	-7.82%	147.36%
12/31/1991	4.43%	\$3,006,772	14.50%	\$130,290	9.23%	156.25%
12/31/1992	4.60%	\$3,142,215	4.50%	\$133,220	2.25%	132.80%
12/31/1993	4.39%	\$3,515,481	11.88%	\$144,402	8.39%	107.93%
12/30/1994	4.21%	\$3,417,473	-2.79%	\$154,438	6.95%	116.76%
12/29/1995	3.30%	\$4,580,515	34.03%	\$144,016	-6.75%	88.93%
12/31/1996	4.04%	\$5,539,103	20.93%	\$151,069	4.90%	68.96%
12/31/1997	3.43%	\$6,841,720	23.52%	\$223,887	48.20%	132.43%
12/31/1998	3.56%	\$7,380,976	7.88%	\$234,586	4.78%	114.32%
12/31/1999	3.87%	\$7,455,701	1.01%	\$262,972	12.10%	103.21%
12/29/2000	3.50%	\$7,815,171	4.82%	\$288,592	9.74%	141.94%
12/31/2001	3.38%	\$8,229,025	5.30%	\$273,527	-5.22%	109.94%
12/31/2002	4.74%	\$7,350,618	-10.67%	\$278,252	1.73%	108.87%
12/31/2003	4.21%	\$9,687,251	31.79%	\$348,775	25.35%	141.53%
12/31/2004	4.56%	\$10,853,083	12.03%	\$407,582	16.86%	163.91%
12/30/2005	5.03%	\$11,065,514	1.96%	\$495,176	21.49%	243.83%
12/29/2006	4.91%	\$13,936,938	25.95%	\$556,103	12.30%	268.11%
12/31/2007	4.80%	\$16,759,778	20.25%	\$684,721	23.13%	205.83%
12/31/2008	8.34%	\$9,767,822	-41.72%	\$804,705	17.52%	243.03%
12/31/2009	5.65%	\$14,094,124	44.29%	\$814,770	1.25%	209.83%
Total Income Consumed				\$7,842,748		
Total Income Increase from Start				\$803,668		
Average Annual Increase in Income					10.24%	147.85%
Cumulative Increase in Income					7,239.12%	
Cumulative Increase in Portfolio Value					5,537.65%	

Past performance is no guarantee of future results. Please see important information at the end of this presentation.

As you can see in Table 1, by implementing the Enhanced Dividend strategy and simply looking at **what is happening to your annual income**, you see that, on average, the strategy generates a 10 percent pay raise year after year. Between 1963 and 2009, there were only five occasions (highlighted in red) when your income declined from the previous year. What's more, this consistent increase occurred despite the fact that the principal value of your portfolio declined in ten of the 47 years covered (shaded blue/gray in the table). Interestingly, income declined only *once* when the value of the portfolio also declined! Look at what happened over the entire period— income generated by the portfolio starts at a modest \$11,102 in 1962, but *soars* to \$814,770 by 2009! There are eight years where income increases by more than 20 percent, yet the single largest decline in income was a drop of 7.82 percent in 1990. If you look at the rolling ten-year increase in annual income, you see that the *lowest* ten-year increase was 69 percent for the ten years ending 1996. On average, ten-year annual income increased nearly 148 percent over all rolling ten-year periods.

The reason this works so well is because of a similar phenomena we see with bonds—when bond yields go up, bond prices decline. With stocks, when stock prices decline, dividend yields go up. But since stock prices generally go up (approximately 70 percent of the time since the founding of the New York Stock Exchange in the late 1700s) you have the added advantage of growing your principal as well as your income over time. Indeed, we see that even with the worst decade for stocks in 110 years, the value of the portfolio—with a starting value of

\$250,000 in 1962—grew to \$14.1 million at the end of 2009. And since we are consuming all of the income from the portfolio, nearly all of that \$14.1 million was from capital appreciation alone.

Compare these results with those featured in Table 2 where an investor simply bought and held to maturity a 10-year Treasury note over the same 1962 to 2009 time period. While it is

Table 2: Income From Treasuries

Period Ending:	Initial Investment	Yield on 10-Year Treasury*	Annual Income Consumed	Growth in Income
12/31/1962	\$250,000	—	—	—
12/31/1963	\$250,000	3.95%	\$9,875	0.00%
12/31/1964	\$250,000	3.95%	\$9,875	0.00%
12/31/1965	\$250,000	3.95%	\$9,875	0.00%
12/31/1966	\$250,000	3.95%	\$9,875	0.00%
12/31/1967	\$250,000	3.95%	\$9,875	0.00%
12/31/1968	\$250,000	3.95%	\$9,875	0.00%
12/31/1969	\$250,000	3.95%	\$9,875	0.00%
12/31/1970	\$250,000	3.95%	\$9,875	0.00%
12/31/1971	\$250,000	3.95%	\$9,875	0.00%
12/31/1972	\$250,000	3.95%	\$9,875	0.00%
12/31/1973	\$250,000	6.16%	\$15,400	55.95%
12/31/1974	\$250,000	6.16%	\$15,400	0.00%
12/31/1975	\$250,000	6.16%	\$15,400	0.00%
12/31/1976	\$250,000	6.16%	\$15,400	0.00%
12/31/1977	\$250,000	6.16%	\$15,400	0.00%
12/31/1978	\$250,000	6.16%	\$15,400	0.00%
12/31/1979	\$250,000	6.16%	\$15,400	0.00%
12/31/1980	\$250,000	6.16%	\$15,400	0.00%
12/31/1981	\$250,000	6.16%	\$15,400	0.00%
12/31/1982	\$250,000	6.16%	\$15,400	0.00%
12/31/1983	\$250,000	13.92%	\$34,800	125.97%
12/31/1984	\$250,000	13.92%	\$34,800	0.00%
12/31/1985	\$250,000	13.92%	\$34,800	0.00%
12/31/1986	\$250,000	13.92%	\$34,800	0.00%
12/31/1987	\$250,000	13.92%	\$34,800	0.00%
12/31/1988	\$250,000	13.92%	\$34,800	0.00%
12/31/1989	\$250,000	13.92%	\$34,800	0.00%
12/31/1990	\$250,000	13.92%	\$34,800	0.00%
12/31/1991	\$250,000	13.92%	\$34,800	0.00%
12/31/1992	\$250,000	13.92%	\$34,800	0.00%
12/31/1993	\$250,000	7.86%	\$19,650	-43.53%
12/31/1994	\$250,000	7.86%	\$19,650	0.00%
12/31/1995	\$250,000	7.86%	\$19,650	0.00%
12/31/1996	\$250,000	7.86%	\$19,650	0.00%
12/31/1997	\$250,000	7.86%	\$19,650	0.00%
12/31/1998	\$250,000	7.86%	\$19,650	0.00%
12/31/1999	\$250,000	7.86%	\$19,650	0.00%
12/31/2000	\$250,000	7.86%	\$19,650	0.00%
12/31/2001	\$250,000	7.86%	\$19,650	0.00%
12/31/2002	\$250,000	7.86%	\$19,650	0.00%
12/31/2003	\$250,000	5.20%	\$13,000	-33.84%
12/31/2004	\$250,000	5.20%	\$13,000	0.00%
12/31/2005	\$250,000	5.20%	\$13,000	0.00%
12/31/2006	\$250,000	5.20%	\$13,000	0.00%
12/31/2007	\$250,000	5.20%	\$13,000	0.00%
12/31/2008	\$250,000	5.20%	\$13,000	0.00%
12/31/2009	\$250,000	5.20%	\$13,000	0.00%
Total Income Consumed			\$888,250	
Total Income Increase from Start			\$13,000	
Average Annual Increase in Income				0.60%
Cumulative Increase in Income				31.65%
Cumulative Increase in Portfolio Value				0.00%

* Rates source: Federal Reserve website (http://www.federalreserve.gov/releases/h15/data/Annual/H15_TCMNOM_Y10.txt)

unlikely that an individual investor would simply buy and hold a 10-year Treasury, other strategies tested yielded similar or lesser results over the total period. Bond total returns are heavily reliant on income reinvestment; therefore, no matter what bond strategy you choose, consuming the income erodes purchasing power and income growth over time.

Because your principal is returned to you when the bond matures, your base \$250,000 investment never changes or grows. What does change is the *value* of that \$250,000—for your \$250,000 investment to have the same purchasing power in 2009 as it did in 1962, it would have to grow to \$1,777,213! By simply using bonds to generate income, your nest egg is still worth just \$250,000 and that generates a mere \$13,000 annual income, hardly the type of income that leads to a life of leisure.

Look at the differences in total income consumed and total cumulative increase in income since 1962: with the Enhanced Dividend strategy, you would have consumed \$7,842,748 over the period and seen your total annual income increase by 5,538 percent since 1962. With the 10-year Treasury approach, you would have consumed \$888,250 in total income and seen your annual income increase by just 31.65 percent since December 31, 1962. What's more, as inflation raged on you would have had to endure income declines of 44 percent in 1993 and 34 percent in 2003 as rates on the 10-year Treasury dropped.

Now, many might argue that people investing in fixed income don't invest in a vacuum—what if, when the yield on long-term U.S. Treasury bonds increased to 14.82 percent in September 1981, our hypothetical investor

locked in those much higher long-term rates? Not counting the loss of principal he would have to take by selling his 10-year Treasury notes at below face value because rates had been skyrocketing, he would not be that much better off—his total consumed wealth would increase to \$1,274,750 and his annual income from the investment would still be a paltry \$37,050. Clearly, despite the more volatile nature of stocks, they offer a much more consistent approach to growing both income and principal.

If you are an investment advisor, you might be wondering how you could have stopped clients from panicking in 2008. Had you positioned an investment in the Enhanced Dividend strategy by focusing on the income it generates, and making that the primary objective, you probably wouldn't have to be talking clients off the ledge. You could remind your clients that in one of the worst years for stocks since the 1930s, their income from that investment had actually *gone up*. Rather than the \$804,705 they got to spend in 2008, they could look forward to spending \$814,770 in 2009. Granted, it is an increase of just 1.25 percent, but an *increase* of anything in that horrible year would feel like a very good thing. And why did income increase? Quite simply, income from Enhanced Dividend went up because dividend yields climbed as the market fell.

What if the client argues that the value of their portfolio plunged from \$16.75 million to \$9.76 million? You give the same answer—the principal value of the portfolio is not its primary objective—growing your annual income at a consistent rate is the objective, and it achieved this primary objective in a horrible year for stocks.

By changing what your client is focusing on, you will have a much easier time keeping them in the program. And by that reasoning, this is a strategy that achieved its primary objective of increasing annual income in 42 of the 47 years of the study, and when it did fail to increase income, it was, on average, a small decline of just 5.74 percent.

Of course, you might also argue that while it's great to see how this strategy performed since 1962, your clients do not have the time advantage of 47 years of compounding. Say you have a 65-year-old client who needs to live off his income over the next ten years, how might things look for him? On the following page, Table 3 answers that question by assuming that your client will have to live through another decade that was as bad as the last one. We start with the same \$250,000 investment on December 31, 1999 and run it for the ten years ending December 31, 2009. Remembering that the last decade was the worst for stocks in 110 years, this should provide a nice “worst-case scenario.” In this worst-case decade, total income earned by the portfolio increases, on average, by 13 percent a year, and only has one year where income declines—by five percent in 2001. Even so, the cumulative increase in income from December 31, 1999 to December 31, 2009 is 182 percent! Thus, you would have successfully achieved your primary objective of increasing your client's income in nine out of ten years during the worst decade for stocks in 110 years. Imagine what you might be able to achieve for your client if returns over the next ten years prove to be better than those in the previous ten.

Compare the Table 3 results with those of another hypothetical client who had elected to follow the Treasury strategy who would have invested \$250,000 in a 10-year Treasury on 12/31/99 yielding 6.45 percent. That unfortunate investor would have seen his annual income decline from the \$16,125 a year he would have earned between 2000 and 2009 to just \$9,625 a year because of a decline in interest rates in 2009 that forced our investor to roll his 10-year Treasury note at a rate of just 3.85 percent. Adding insult to injury, his principal value would have remained at \$250,000 whereas your Enhanced Dividend client's would have increased to \$472,648. **All during the worst decade for stocks in 110 years!**

A Great Strategy for Charitable Trusts and Foundations

Imagine how well this strategy would work for a wealthy client setting up a Charitable Remainder Trust (CRT) or a Charitable Lead Trust. With a Charitable Remainder Trust the beneficiaries receive the income from the trust for a pre-specified period of time and then the principal value of the trust is claimed by the charity that received the donation. Table 4 looks at the effect of setting up a CRT with a \$10 million gift. Your client gets to deduct the gift and yet the income that the beneficiaries of the trust receive over the next 21 years amounts to \$29.6 million and the principal the charity gets to use is \$61.6 million!

With a Charitable Lead Trust, it would be the charity that enjoyed the benefits of the \$29.6 million in income and your heirs the \$61.6 million in principal value at the end of the trust's life. In each case, there are multiple benefits

Table 3: Income Growth from 2000 to 2009

Period Ending:	Indicated Yield	Portfolio Value	Portfolio Appreciation	Cash Consumed	% Change Income
12/31/1999	—	\$250,000	—	—	—
12/31/2000	3.87%	\$262,050	4.82%	\$9,677	—
12/31/2001	3.50%	\$275,886	5.28%	\$9,172	-5.22%
12/31/2002	3.81%	\$246,477	-10.66%	\$10,521	14.71%
12/31/2003	4.74%	\$324,856	31.80%	\$11,695	11.16%
12/31/2004	4.21%	\$363,969	12.04%	\$13,668	16.87%
12/31/2005	4.56%	\$371,103	1.96%	\$16,606	21.50%
12/31/2006	5.03%	\$467,441	25.96%	\$18,650	12.31%
12/31/2007	4.91%	\$562,098	20.25%	\$22,965	23.14%
12/31/2008	4.80%	\$327,591	-41.72%	\$26,989	17.52%
12/31/2009	8.34%	\$472,648	44.28%	\$27,326	1.25%
Total Income Consumed				\$167,268	
Total Income Increase from Start				\$17,649	
Average Annual Increase in Income					12.58%
Cumulative Increase in Income					182.38%
Cumulative Increase in Portfolio Value					89.06%

Table 4: Portfolio & Income Growth for Charitable Trust or Foundation

Portfolio Formed on:	Indicated Annual Yield*	Portfolio Value	Price-Only Portfolio Appreciation	Cash Consumed	% Change Income
12/30/1988	5.65%	\$10,000,000	—	—	—
12/29/1989	4.17%	\$12,478,332	24.78%	\$565,161	—
12/31/1990	4.96%	\$11,468,814	-8.09%	\$520,950	-7.82%
12/31/1991	4.43%	\$13,131,580	14.50%	\$569,020	9.23%
12/31/1992	4.60%	\$13,723,105	4.50%	\$581,818	2.25%
12/31/1993	4.39%	\$15,353,283	11.88%	\$630,653	8.39%
12/30/1994	4.21%	\$14,925,247	-2.79%	\$674,480	6.95%
12/29/1995	3.30%	\$20,004,644	34.03%	\$628,967	-6.75%
12/31/1996	4.04%	\$24,191,115	20.93%	\$659,769	4.90%
12/31/1997	3.43%	\$29,880,080	23.52%	\$977,788	48.20%
12/31/1998	3.56%	\$32,235,191	7.88%	\$1,024,514	4.78%
12/31/1999	3.87%	\$32,561,541	1.01%	\$1,148,486	12.10%
12/29/2000	3.50%	\$34,131,469	4.82%	\$1,260,380	9.74%
12/31/2001	3.38%	\$35,938,907	5.30%	\$1,194,586	-5.22%
12/31/2002	4.74%	\$32,102,607	-10.67%	\$1,215,218	1.73%
12/31/2003	4.21%	\$42,307,467	31.79%	\$1,523,218	25.35%
12/31/2004	4.56%	\$47,399,047	12.03%	\$1,780,046	16.86%
12/30/2005	5.03%	\$48,326,803	1.96%	\$2,162,601	21.49%
12/29/2006	4.91%	\$60,867,273	25.95%	\$2,428,688	12.30%
12/31/2007	4.80%	\$73,192,896	20.25%	\$2,990,408	23.13%
12/31/2008	8.34%	\$42,657,795	-41.72%	\$3,514,287	17.52%
12/31/2009	5.65%	\$61,551,516	44.29%	\$3,558,242	1.25%
Total Cash Consumed				\$29,609,281	
Total Income Increase from Start				\$2,993,081	
Percentage Increase in Income from Start				529.60%	
Average Annual Increase in Income					10.32%

* Calculated by annualizing the most recent dividend payment, may differ from realized yield over the course of the year.

to the donor, his or her charity of choice and the beneficiaries of the donor. Slicing out a portion of a

Foundation's investments and following this approach would have equally beneficial effects.

What About Taxable Investors?

We generally use the simplifying assumption (as stated above) that investments are being made in a tax-free vehicle, since everyone faces different tax rates. Yet I also think this strategy is appropriate for taxable accounts, so we also looked at returns for an investor in the top projected tax rate (please see Table 5, page 7). (The maximum expected dividend tax rate for 2011 and after is 39.6 percent, with capital gains tax expected to be 20 percent. We retroactively applied these rates to the portfolio starting on December 31, 1962 for both the Enhanced Dividend strategy and the strategy of buying 10-year Treasury notes; holding them to maturity and then rolling into the new 10-year note.)

For the entire period December 31, 1962 through December 31, 2009, an investor using the 10-year Treasury notes and paying tax on the income would consume—after tax—a total of \$536,503 in income. His after-tax income in 2009 would be a paltry \$7,852. Obviously, because there was no capital appreciation, the value of his portfolio would remain \$250,000, a fraction of the \$1,777,213 he would need it to be to just break even with inflation. His 2009 total after-tax income was just \$1,887.50 higher than what he earned in 1963 and he paid a total of \$351,747 in income tax.

Once again, an investor using the Enhanced Dividend strategy for income found himself in a much better financial position. After paying *both* capital gains taxes and 39.6 percent on his dividend income, he would have consumed \$2,623,528 in total income and the principal value of his portfolio—again, after tax—would be \$6,428,566. His annual after-tax income would have increased by 3,247 percent to \$224,465 in 2009. The annual increase in after-tax income would have been 8.36 percent and the average ten-year increase would have been 109 percent. By adding taxes to the equation, the number of years where income declined went up by just one occurrence—to six years out of 46; thus, after-tax income increased in 40 of the 46 years. The maximum drop in annual income went up to -11.48 percent in 1990 and the average drop in the six years that income declined was -5.79 percent. His total after-tax income of \$224,465 in 2009 was \$217,759 higher than the \$6,705 he earned in 1963. An investor following this strategy would have paid a total of \$1,848,604 in capital gains taxes and \$1,720,061 in income taxes on dividends, for a total of \$3,568,665 in taxes to Uncle Sam.

Clearly, even taking taxes into account, the strategy still offers a tremendous return and consistent way to increase income year after year and a vastly better return on the principal of the portfolio.

The key element in letting a strategy like this work is getting your client to focus on the primary goal: increasing annual income from the investment. If you can achieve that, clients will be far less likely to panic when the market declines in value, since for the most part, their income from the investment will not. Point to what happened after the 2008 collapse—income increased. Stress that you are working to endow their future with ample income to pursue the passions and avocations that they have developed over a lifetime of successful work. Goethe said that “Many people take no care of their money till they come nearly to the end of it, and others do just the same with their time.” Convince your clients that using this strategy will help them with both.

Past performance is no guarantee of future results. Please see important information at the end of this presentation.

Table 5: After-Tax Portfolio and Income Growth*

Period Ending:	Indicated Yield	After-Tax Portfolio Value	Portfolio Appreciation	Dividend	Tax on Dividends	Cash Consumed	% Change Income	Rolling 10-year % Increase in Income
12/31/1962	4.44%	\$250,000	—	—	—	—	—	—
12/31/1963	4.04%	\$286,134	14.45%	\$11,102	\$4,396	\$6,705	—	—
12/31/1964	3.92%	\$324,318	13.34%	\$11,551	\$4,574	\$6,977	4.05%	—
12/31/1965	3.77%	\$348,264	7.38%	\$12,718	\$5,037	\$7,682	10.11%	—
12/30/1966	5.58%	\$299,951	-13.87%	\$13,147	\$5,206	\$7,941	3.37%	—
12/29/1967	5.13%	\$358,671	19.58%	\$16,736	\$6,628	\$10,109	27.30%	—
12/31/1968	4.64%	\$414,900	15.68%	\$18,410	\$7,290	\$11,120	10.00%	—
12/31/1969	6.13%	\$317,461	-23.48%	\$19,237	\$7,618	\$11,619	4.49%	—
12/31/1970	6.27%	\$328,137	3.36%	\$19,465	\$7,708	\$11,757	1.18%	—
12/31/1971	5.73%	\$338,316	3.10%	\$20,575	\$8,148	\$12,428	5.70%	—
12/29/1972	5.69%	\$362,633	7.19%	\$19,374	\$7,672	\$11,702	-5.84%	—
12/31/1973	7.38%	\$338,744	-6.59%	\$20,627	\$8,168	\$12,458	6.47%	85.80%
12/31/1974	10.07%	\$269,573	-20.42%	\$24,995	\$9,898	\$15,097	21.18%	116.39%
12/31/1975	6.91%	\$381,054	41.35%	\$27,153	\$10,753	\$16,400	8.63%	113.49%
12/31/1976	5.64%	\$487,182	27.85%	\$26,321	\$10,423	\$15,898	-3.06%	100.21%
12/30/1977	6.81%	\$445,677	-8.52%	\$27,468	\$10,877	\$16,590	4.36%	64.12%
12/29/1978	7.50%	\$438,444	-1.62%	\$30,338	\$12,014	\$18,324	10.45%	64.79%
12/31/1979	7.98%	\$511,794	16.73%	\$32,877	\$13,019	\$19,858	8.37%	70.90%
12/31/1980	7.46%	\$563,970	10.19%	\$40,844	\$16,174	\$24,670	24.23%	109.83%
12/31/1981	8.05%	\$583,465	3.46%	\$42,093	\$16,669	\$25,424	3.06%	104.58%
12/31/1982	8.01%	\$686,400	17.64%	\$46,981	\$18,605	\$28,377	11.61%	142.50%
12/30/1983	6.57%	\$823,856	20.03%	\$54,957	\$21,763	\$33,194	16.98%	166.44%
12/31/1984	6.67%	\$859,462	4.32%	\$54,124	\$21,433	\$32,691	-1.52%	116.54%
12/31/1985	6.10%	\$1,053,076	22.53%	\$57,311	\$22,695	\$34,616	5.89%	111.07%
12/31/1986	5.51%	\$1,215,677	15.44%	\$64,269	\$25,451	\$38,819	12.14%	144.18%
12/31/1987	5.61%	\$1,328,960	9.32%	\$67,000	\$26,532	\$40,468	4.25%	143.92%
12/30/1988	5.65%	\$1,513,315	13.87%	\$74,542	\$29,519	\$45,024	11.26%	145.71%
12/29/1989	4.17%	\$1,813,355	19.83%	\$85,527	\$33,869	\$51,658	14.74%	160.14%
12/31/1990	4.96%	\$1,666,651	-8.09%	\$75,705	\$29,979	\$45,726	-11.48%	85.35%
12/31/1991	4.43%	\$1,889,299	13.36%	\$82,690	\$32,745	\$49,945	9.23%	96.45%
12/31/1992	4.60%	\$1,957,383	3.60%	\$83,709	\$33,149	\$50,560	1.23%	78.18%
12/31/1993	4.39%	\$2,143,398	9.50%	\$89,953	\$35,621	\$54,331	7.46%	63.68%
12/30/1994	4.21%	\$2,083,642	-2.79%	\$94,161	\$37,288	\$56,873	4.68%	73.97%
12/29/1995	3.30%	\$2,662,882	27.80%	\$87,807	\$34,772	\$53,035	-6.75%	53.21%
12/31/1996	4.04%	\$3,108,701	16.74%	\$87,824	\$34,778	\$53,046	0.02%	36.65%
12/31/1997	3.43%	\$3,693,554	18.81%	\$125,652	\$49,758	\$75,894	43.07%	87.54%
12/31/1998	3.56%	\$3,926,451	6.31%	\$126,643	\$50,151	\$76,492	0.79%	69.89%
12/31/1999	3.87%	\$3,958,252	0.81%	\$139,893	\$55,398	\$84,495	10.46%	63.57%
12/29/2000	3.50%	\$4,110,927	3.86%	\$153,215	\$60,673	\$92,542	9.52%	102.38%
12/31/2001	3.38%	\$4,285,083	4.24%	\$143,881	\$56,977	\$86,904	-6.09%	74.00%
12/31/2002	4.74%	\$3,827,672	-10.67%	\$144,893	\$57,378	\$87,516	0.70%	73.09%
12/31/2003	4.21%	\$4,892,554	27.82%	\$181,617	\$71,920	\$109,697	25.35%	101.90%
12/31/2004	4.56%	\$5,363,598	9.63%	\$205,849	\$81,516	\$124,333	13.34%	118.61%
12/30/2005	5.03%	\$5,447,585	1.57%	\$244,716	\$96,908	\$147,809	18.88%	178.70%
12/29/2006	4.91%	\$6,578,473	20.76%	\$273,771	\$108,413	\$165,358	11.87%	211.73%
12/31/2007	4.80%	\$7,644,416	16.20%	\$323,200	\$127,987	\$195,213	18.05%	157.22%
12/31/2008	8.34%	\$4,455,267	-41.72%	\$367,039	\$145,348	\$221,692	13.56%	189.82%
12/31/2009	5.65%	\$6,428,566	44.29%	\$371,630	\$147,166	\$224,465	1.25%	165.65%
Total Income Consumed						\$2,623,528		
Total Income Increase from Start						\$217,759		
Average Annual Increase in Income							8.36%	109.25%
Cumulative Increase in Income							3,247.49%	
Cumulative Increase in Portfolio Value							2,471.43%	
Total Gains Tax						\$1,848,604		
Total Income Tax						\$1,720,061		

* Assumes 20% capital gains tax and 39.6% income tax on dividends.

General Legal Disclosure/Disclaimer and Backtested Results

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The hypothetical backtested performance does not represent the results of actual trading using client assets nor decision-making during the period and does not and is not intended to indicate the past performance or future performance of any account or investment strategy managed by OSAM. If actual accounts had been managed throughout the period, ongoing research might have resulted in changes to the strategy which might have altered returns. The performance of any account or investment strategy managed by OSAM will differ from the hypothetical backtested performance results for each factor shown herein for a number of reasons, including without limitation the following:

- Although OSAM may consider from time to time one or more of the factors noted herein in managing any account, it may not consider all or any of such factors. OSAM may (and will) from time to time consider factors in addition to those noted herein in managing any account.
- OSAM may rebalance an account more frequently or less frequently than annually and at times other than presented herein.
- OSAM may from time to time manage an account by using non-quantitative, subjective investment management methodologies in conjunction with the application of factors.
- The hypothetical backtested performance results assume full investment, whereas an account managed by OSAM may have a positive cash position upon rebalance. Had the hypothetical backtested performance results included a positive cash position, the results would have been different and generally would have been lower.
- The hypothetical backtested performance results for each factor do not reflect any transaction costs of buying and selling securities, investment management fees (including without limitation management fees and performance fees), custody and other costs, or taxes – all of which would be incurred by an investor in any account managed by OSAM. If such costs and fees were reflected, the hypothetical backtested performance results would be lower.
- The hypothetical performance does not reflect the reinvestment of dividends and distributions therefrom, interest, capital gains and withholding taxes.
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