SUMMER 2020 | VOL. 28 | NO. 3
QUARTERLY PERSPECTIVE

DVI
DAVID VAUGHAN INVESTMENTS

1. *The Report of the Death of Dividends has been Greatly Exaggerated*
2. *ZIRP*
3. *ZIRP (cont.) | IRS Provides RMD...*
4. *Our Plan for New Normal Begins... The Report of the Death...(cont.)*

**Will Williams** *Chairman, President & CEO*

Mark Twain once famously remarked, "The report of my death has been greatly exaggerated." This was Twain's response to rumors in the press that he had taken ill while visiting his brother in London and had suddenly passed away. As I reflect upon the state of the equity markets today, now that the second quarter has come to an end, it appears that dividend paying stocks are facing a similar fate of misinformation and disdain. In my opinion, several factors are contributing to their current unpopularity.

## Headline Risk

Not a day goes by in which the financial press does not take advantage of their opportunity to "accentuate the negative." Many large, well-known companies are cutting or suspending their dividend payments to maintain as much cash as possible on their balance sheets to weather the unprecedented challenges caused by the pandemic. In the eyes of investors, dividend payments that were a year ago viewed as safe and secure are now considered to be at risk.

What history would suggest is dividend adjustments during trying economic times tend not to be levied across the board among all market sectors but focused specifically on a narrow group of companies that are in the cross hairs of the recession. This time around, industries that are directly impacted by social distancing represent a large percentage of the companies that have elected to lower or omit their dividend payments. Airlines, hotels, cruise lines, theme parks, restaurants, and casinos have all been the hardest hit. Energy companies have also suffered, but beyond the negative demand impact of COVID-19, other OPEC related factors are at play in their current challenges.

## 2020 Projected Corporate Earnings

It is highly anticipated that earnings per share (EPS) for the S&P 500 will decline between 25 and 35 percent in 2020 from prior-year levels. Wall Street analysts would be in mutual agreement that this forecast is really a shot in the dark as nearly 40% of S&P Companies have elected to no longer provide earnings guidance for the year. The message really is, even senior management does not have a full understanding of the impact of the pandemic on their bottom line. In this black hole of information, Wall Street firms have begun to forecast dividends per share (DPS) for 2020 at levels 25% lower than dividend amounts paid in 2019. Obviously, if dividends were to contract at this rate, dividend cuts would have to expand far beyond just a handful of economic sectors and become more widespread and begin to occur within financials, industrials and consumer discretionary sectors as well.

**HISTORY OF DIVIDED REDUCTIONS DURING RECESSIONS**

| AVG FOR 8 RECESSIONS SINCE 1955 | EARNINGS | DIVIDENDS |
|---|---|---|
| Peak-to-trough decline (%) | 20.1% | 9.9% |
| From peak to trough (#Qs ) | 5 | 2 |
| Rebound to previous peak (# Qs ) | 6 | 3 |

*Source: Bloomberg, NBER, Epoch Investment Partners*

An almost dollar for dollar reduction in DPS in lockstep with EPS would be a very unusual occurrence in market history. During recessions, dividends tend not to decline at the same rate as earnings but decline approximately half as much. Because of the material level of uncertainty, I believe analysts have overshot their forecasts on the downside. They really do not know what they do not know.

## The Appeal of Mega-Cap Technology

The long-standing positive attribute of dividend paying stocks has been their very low downside participation rate. When the market declined during market corrections and bear markets, these stocks as a class would typically decline far less. In the current investing climate, that attribute has been far more pronounced in mega-cap technology companies that in many instances pay no dividends at all. For the most part, it is viewed that these companies are immune to economic cycles and might even benefit when the world is becoming far more virtual. So as investors become more defensive, rather than focusing on low

*Continued on page 4*

**Brian Christensen,** CFA
*Senior Vice President & CIO*

# ZIRP

The Federal Reserve reiterated a Zero Interest Rate Policy (ZIRP) at its last Federal Open Market Committee meeting on June 10. What does this mean and what are the implications for financial markets?

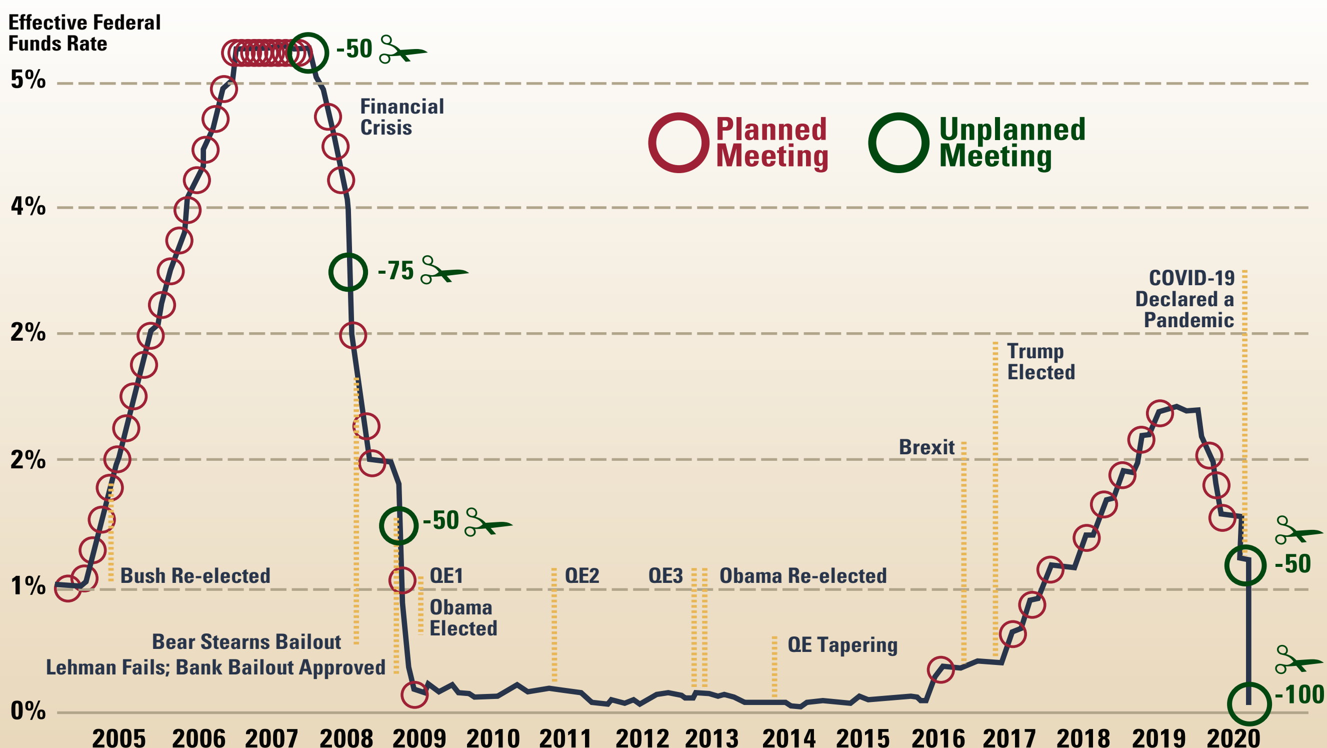
The Federal Reserve (Fed) is the central bank of the United States and performs five general functions to promote the effective operation of the U.S. economy. Those five functions include:

1. Conducts the nation's monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy
2. Promotes the stability of the financial system and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad
3. Promotes the safety and soundness of individual financial institutions and monitors their impact on the financial system as a whole
4. Fosters payment and settlement system safety and efficiency through services to the banking industry and the U.S. government that facilitate U.S.-dollar transactions and payments
5. Promotes consumer protection and community development through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations

In seeking to execute its responsibilities for item one, the Fed sets interest rate policy. The Federal Funds Rate, the interest rate at which banks lend to each other on an overnight basis at the Federal Reserve bank, is the foundation from where all other interest rates are determined. Currently, the Fed Funds target rate is 0% - 0.25% or effectively zero. In its June 10th press release, the Fed indicated they expected this benchmark interest rate would remain near zero through 2022. While the Fed has no direct influence on the interest rates banks will pay you on your savings deposits, they are normally closely tied. According to the Federal Deposit Insurance Corp (FDIC), for the week of June 29, 2020, the National average interest rate paid on savings deposits was 0.06% and for money market funds was 0.04%. Effectively zero. ZIRP is intended to spur borrowing, encourage individuals and corporations to invest, and ultimately stimulate the economy.

The chart below provides a 15-year historical view of the Fed Funds rate. The last time we experienced ZIRP began in 2009 at the bottom of the financial crisis and ended in 2016 as the economy began to grow at a more accelerated pace.

Japan has had "near zero" interest rates since February 1999 when the Bank of Japan cut its key lending rate to zero. Since that time, rates in Japan have been no higher than 0.5% and are currently negative at -0.1%. Japan's experience is the only historical data available to evaluate how different asset classes performed under ZIRP.



CONTINUED FROM PAGE 2

| JAPANESE ASSET CLASS RETURNS 2/26/99 - 2/26/20 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | STOCKS | | | | BONDS | | OTHER | |
| | Small Cap Value | Large Cap Value | Large Cap Growth | Small Cap Growth | Government Bonds | Corporate Bonds | Commodities | Real Estate |
| Annual Rate of Return | 7.1% | 4.0% | 0.8% | 3.6% | 2.1% | 1.5% | 0.4% | 5.2% |
| Annual Volatility | 20.8% | 21.6% | 36.1% | 25.3% | 1.7% | 1.4% | 30.0% | 31.5% |
| Maximum Drawdown | -53% | -54% | -80% | -63% | -4% | -2% | -77% | -73% |

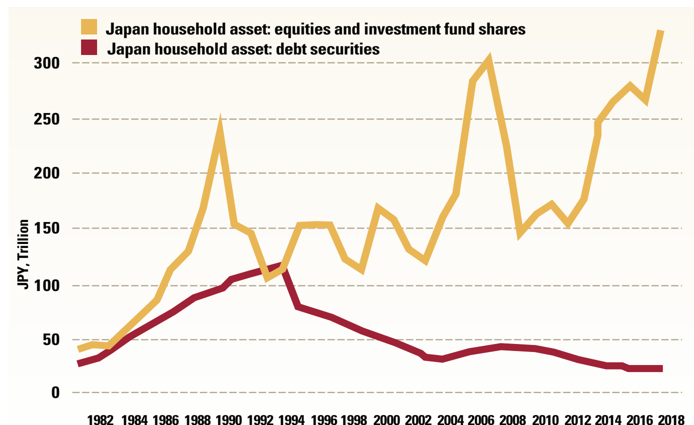
Source: MSCI and Bloomberg

Verdad, a Boston-based asset management firm, recently published a research article discussing investment performance in Japan for various asset classes during 20 years of ZIRP. The table above reveals Verdad's findings.

As seen in the table, stocks outperformed bonds, value outperformed growth, and real estate appreciated measurably too.

Charles Schwab analyzed Japanese investor behavior during ZIRP and found Japanese households increasing their allocations to stocks. As stock dividends rise and surpass bond yields that are stuck near zero, Japan household assets shifted to stocks. The chart below shows the significant swing.

With Japan's experience as our guide, it appears ZIRP has the potential to push more investor assets to stocks in search of higher investment income. As stock dividend yields maintain a meaningful advantage over bond yields, a shift in asset allocations to favor stocks seems likely.




Source: Charles Schwab, Macrobond, Bank of Japan, Japanese Cabinet Office (CaO) as of 9/3/2019

# IRS PROVIDES RMD RELIEF

The CARES Act was enacted in an attempt to mitigate the economic effects of the COVID-19 pandemic. Among other things, it waives the Required Minimum Distribution (RMD) rules for certain defined contribution plans and IRAs for calendar year 2020. The waiver applies to both 2019 RMDs required to be taken by April 1, 2020, and RMDs required for 2020. It applies for calendar years beginning after December 31, 2019. But, because the law wasn't enacted until late March 2020, some individuals had already taken RMDs for the year. If they wanted to roll over those now non-RMD distributions to an eligible retirement account, they needed to satisfy the rule that generally requires tax-free rollovers to be made within 60 days of distribution. Moreover, IRAs generally are subject to a "one-rollover-per-12 month" restriction.

The IRS previously extended the 60-day rollover period to the later of 60 days after receipt or July 15, 2020, for 2020 RMDs taken as early as February 1, 2020, but that left out individuals who took their 2020 RMDs in January. Notice 2020-51 extends that period to the later of 60 days after receipt or August 31, 2020, for all distributions that, but for the CARES Act, would have been RMDs. Notice 2020-51 also permits an IRA owner or beneficiary who has already received a distribution that would've been an RMD for 2020 to repay it to the IRA by the later of 60 days after receipt or August 31, 2020. The repayment is exempt from the one-rollover-per-12 month limit on IRAs.

### Stay tuned

As the number the COVID-19 cases continues to spike across the country, it's possible that Congress, the Department of Treasury and the IRS may provide additional tax and financial relief. We'll let you know about the latest developments that could affect your financial picture.

## UPDATES ON OUR CLIENT & COMMUNITY EVENTS

**Peoria Client Event :**
*Postponed into 2021 date TBD*

**Florida Client Event:**
*Scheduled for 2021 date TBD*

**Hank Lebioda Golf Challenge:**
*Tentatively scheduled for Spring 2021 date TBD*

**Ping Pong Challenge:**
*Postponed into 2021 (For 2020, DVI will make a charitable donation to South Side Mission)*

**Peoria DVI Fall Forum:**
*Scheduled for October 20, 2020*
*Greg Valliere - Guest Speaker*
*In-Person / Virtual Venues*

**Beth Salmon**
*Vice President of Operations*

# OUR PLAN FOR A NEW NORMAL BEGINS WITH A RETURN TO THE OFFICE

Like so many organizations during the initial months of the COVID-19 pandemic, DVI's number one priority was dealing with the immediate demands of the crisis while emphasizing the health and safety of our clients and Associates. As we executed our business continuity plan, we focused our assessment on the virtualization of nearly our entire workforce to the home office environment and its impact on our ability to execute both timely investment management decisions and highly engaged client services. Now, as we begin to emerge from the response phase, we are focusing our efforts on the longer-term organizational needs for recovery and the business opportunities that will shape our 'new normal'.

Our biggest challenge, as lockdown measures were relaxed, was the tension between preparing our Associates for a return to the office—while also embracing a new reality—rethinking work beyond the pandemic.

With that in mind, our Return-to-Office Plan, effective June 1st, was communicated to DVI Associates in late April and May. It was important for our Associates to know that the Return-to-Office Plan was developed with an abundance of caution and our genuine commitment to their health and safety. The following tenants of the plan were emphasized:

- The success of the plan is a shared responsibility – we really are 'all in this together'.
- A phased and flexible approach to reopening both the Peoria and Winter Park offices was our main focus and includes an ongoing work from home component.
- Humility in our approach to creating the plan was top of mind with full recognition that the plan would evolve as more information, guidance and best practices were updated by governmental agencies. To that end, as we write this article, our Winter Park, Florida Associates are all once again working from home given the increasing number of positive COVID-19 tests and the increasing positivity rate in that area of Florida.

As of July 1, 2020, we resumed hosting client meetings in our Peoria office with limited capacity and with additional health and safety protocols in place to help prevent the spread of COVID-19 in our community and our workplace. Similar procedures have been put in place for our Winter Park office and will be implemented once we believe the risk from COVID-19 has stabilized from its current state.

Going forward, we are committed to a business continuity plan that institutionalizes the concepts of flexibility, redundancy and responsiveness. We are committed to a perpetual work from home staffing solution that forces us to incorporate a resilience and preparedness into our future business model to ensure that DVI can weather any future disruptions.

*CONTINUED FROM PAGE 1*

valuation and relative high dividend yield, they are far more sanguine placing their investment dollars in high price earnings and companies that pay little or no dividend yield. It is hard to argue with their rationale; when the market goes up, these stocks have participated more than 1 for 1, and when the market has declined, they are far less volatile and have declined far less.

| SECURITY NAME | MKT CAP | DIV YLD |
|---|---|---|
| Amazon.com, Inc. | $ 1,376,033.00 | 0.00% |
| Alphabet Inc. Class C | $ 966,496.00 | 0.00% |
| Facebook, Inc. Inc. Class A | $ 647,457.00 | 0.00% |
| Adobe Inc. | $ 208,803.00 | 0.00% |
| Netflix, Inc. | $ 200,128.00 | 0.00% |
| Salesforce.com, Inc. | $ 168,487.00 | 0.00% |

*Source: Factset*

## In a World of Yield Starvation

For those that require cashflow from their investment portfolios, the current relative attractiveness of dividend-paying stocks have seldom been more desirable. Interest rates across the developed world, with an abundance of central bank intervention, have rarely been lower. In the current economic disruption, it is totally understandable that skeptics would suggest that we are in a new normal and the old rules no longer apply. However, a high yield dividend strategy has never been an exact science nor a "set it and forget it" approach. During times like these, drawing upon decades of investing experience is essential. Embracing best practices such as: (1) incorporating broad industry diversification within a portfolio, (2) focusing on companies with a cultural commitment towards paying dividends and (3) recognizing the importance of free cashflow; all these factors increase the probability of success. Investing for the long-term requires patience, stamina and courage. When the world is at an inflection point, you rarely know at the time if you have made the right decision. The rearview mirror will always know, but only years down the road.

May you and your families be safe. God Bless.

Quarterly Perspective is published quarterly by David Vaughan Investments, LLC. Copyright 2020 by David Vaughan Investments, LLC. All rights reserved.
This newsletter represents opinions of DVI and are subject to change from time to time and do not constitute a recommendation to purchase and sale any security nor to engage in any particular investment strategy. The information contained herein has been obtained from sources believed to be reliable but cannot be guaranteed for accuracy.