REVISITING HARD TIMES, EASY MONEY, & SLEEPING WELL

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EDGE is an independent financial firm whose objective advice helps individuals and institutions realize their goals in the areas of investment management and corporate finance. The Edge Research Team's thoughtful and timely reports are based on extensive independent research and analysis of firms, financial developments, and macroeconomic trends.

We thought it timely to revisit our thoughtful white paper – *Hard Times, Easy Money, & Sleeping Well* – that we published exactly two years ago to summarize our forward looking views and provide for additional summer reading.

It was a reminder that Monty Capuletti's "Easy Money" isn't what it used to be, as safe investments don't pay like they used to. Growth and yield was in short supply; meanwhile, the demand for the things and experiences we find dear continued to climb higher, resulting in some sleepless nights knowing that traditional income streams are insufficient for keeping up with continuing obligations and rising costs. We considered some alternative thinking on how you can best approach the problem of higher expenses in a low-growth, lower-return world. We investigated what a return composition that favors growing cash flow streams might accomplish.

Thankfully our conclusion to shift duration risk from long-term core fixed cash flow to growing cash flow in the form of dividend equities and MLPs has been more fruitful and prompt than we anticipated. Fixed cash flow has struggled whereas growing cash flows have flourished. With a broad and profound expansion of equity valuation multiples – even for boring dividend equities and MLPs – since our bold recommendation two years ago, it may appear the "easy money" has been made.

In the spirit of capturing themes from classic movies with twisted humor, we quote Carl Spackler, Bushwood Country Club's assistant greenskeeper in the movie "Caddyshack" played by Bill Murray: "I have to laugh, because I've out finessed myself. My foe, my enemy, is an animal. And in order to conquer an animal, I have to think like an animal, and—whenever possible—to look like one. I've gotta get inside this guy's pelt and crawl around for a few days."

Our foe, our enemy, is not an animal. It's valuation. In this timely review of our thesis from two years ago, we too get inside the valuation's fur for some serious rethinking of what traditional fixed income streams and growing cash flow have to offer. In the current environment, investors need to make every penny work for them in what has become a more expensive world. The best approach to the problem continues to favor growing cash flow streams for long-term investors, but lower total returns and rising volatility need to be expected.

INVESTORS ARE STILL VERY CONSERVATIVE

Faced with uncertainty along with 10 and 5 year investment results that produced steady returns for fixed income but volatile, below average returns for equities, it was no surprise that many investors two years ago were very conservative with their asset allocation. Fast forward to today, many investors remain conservative and at odds with their stated goals. With today's low interest rates and bond

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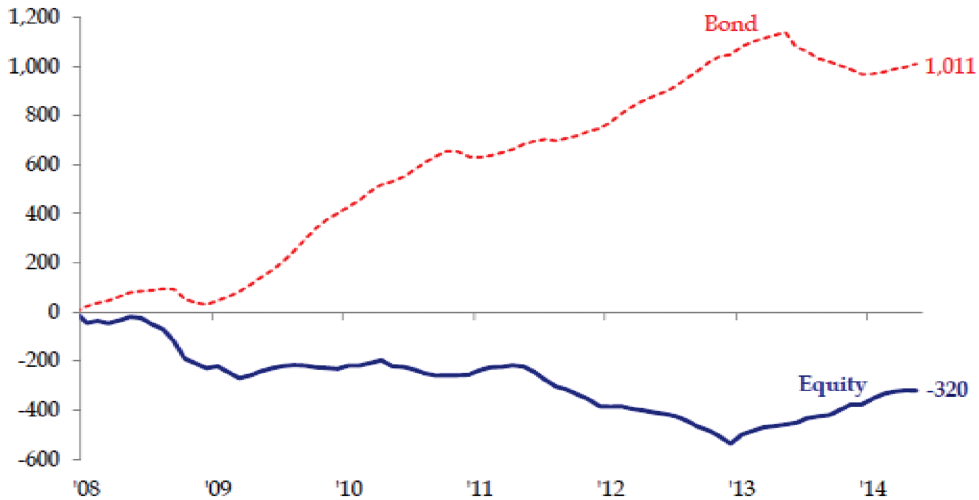
yields, the funding gap is equally daunting for a family of four, a foundation with a 5% minimum distribution requirement, a pension with a 7% return hurdle, or a family trust with a restricted investment policy towards investment grade fixed income. Yet funds continue to flow to bond funds since 2012 despite yields near historic lows and real yields approaching zero.

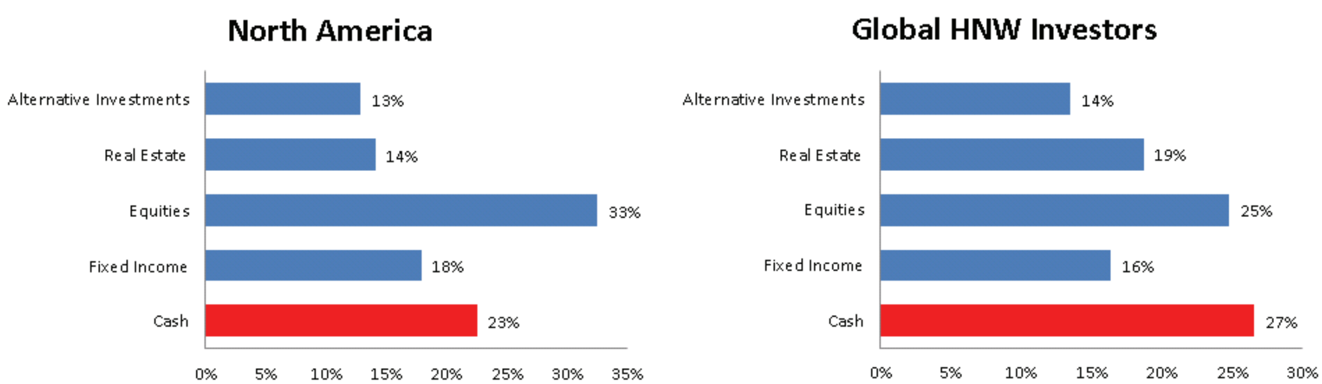
Cumulative Mutual Fund Flows ($billion)



Source: Strategas

Furthermore, asset allocation surveys suggest both retail and institutional investors are in a state of risk aversion and not necessarily acting in their own best interest. Nothing illustrates today's affection for cash, which earns next to zero, better than the findings of Capgemini's 2014 World Wealth Report. High net worth investors globally have more cash (27%) than any other asset class.

Sample High Net Worth Asset Allocation



Source: Capgemini (as of Q1 2014)

Looking at institutional asset allocation, where fiduciaries must remain fully invested, the trend has been towards reducing traditional equity exposure. For pensions, according to the Milliman 2014 Pension Funding Study which surveys the 100 largest defined benefit plans in the U.S., the primary trend has been to reduce equities in favor of fixed income. These plans have equal funds earmarked for fixed income and equities, yet the allocation to equities in 2005 was 62% while the allocation to bonds was just 28%.

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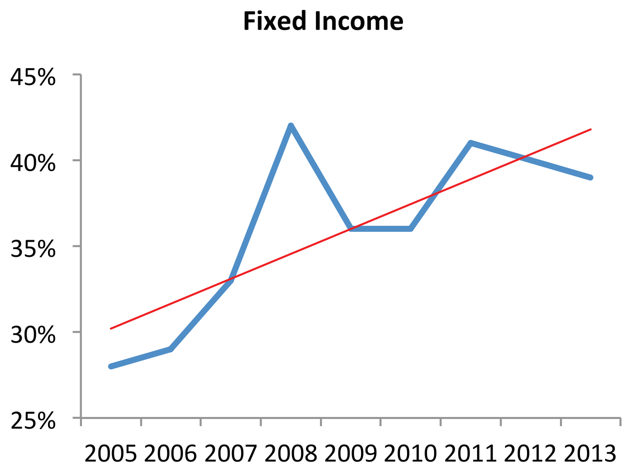
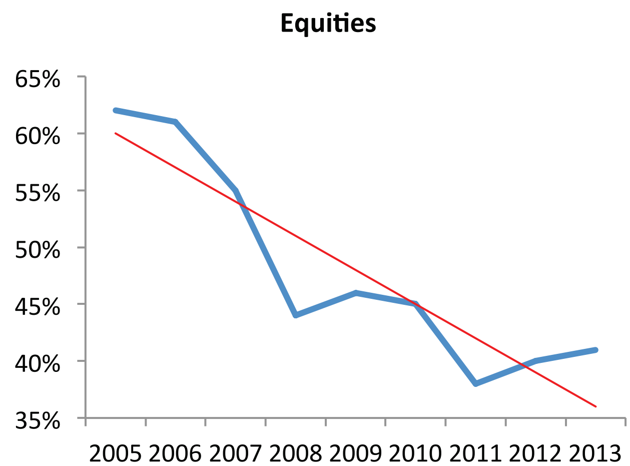
Sample Pension Asset Allocation

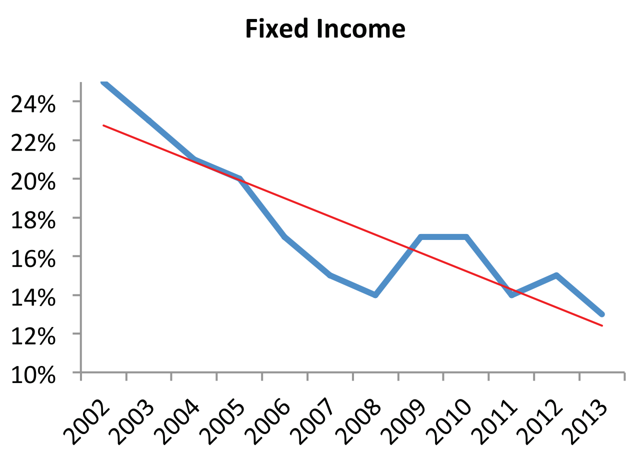


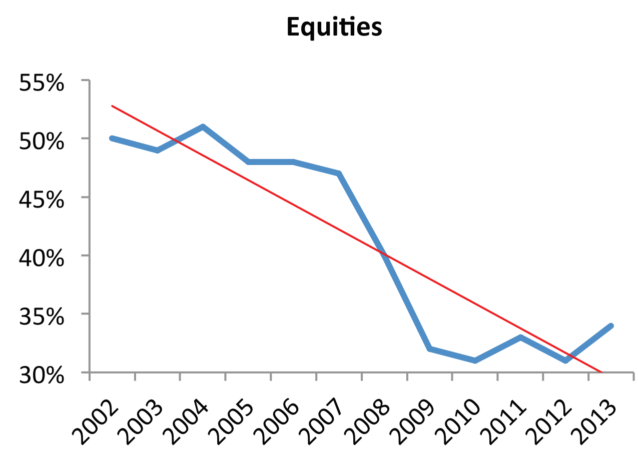


Source: Milliman 2014 Pension Funding Study

College and university endowments on average have cut their exposure to fixed income, from 23% in 2002 to 10% today, and equities, from 50% to 34%, in exchange for alternative investments which have more than doubled from 24% to 53%. Endowment fiduciaries are compensating for the low fixed income yields and higher volatility for equities by boosting risk-adjusted returns offered by alternative investments.

Sample College/University Endowment Asset Allocation





Source: NACUBO (dollar-weighted average allocation and fixed income includes cash)

It appears colleges and universities are taking a long-term view towards fixed income given today's low yield environment and the potential for future inflation. Meanwhile, pensions appear to be seeking more safety in fixed income to prevent further funding deficits that might result from any future drawdowns in equities.

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STAKES ARE HIGH FOR ASSET ALLOCATORS MANAGING RISK & RETURN

Today's environment is as challenging as two years ago for managing risk and return thanks to more expensive valuations for all asset classes. Valuations are higher with equity prices at all-time highs in anticipation of continued improvement in economic fundamentals – more on this later. But it is certainly a lot more difficult to manage risk and return than other previous equity market tops in 2000 and 2007.

As a fiduciary for asset allocation and investment implementation, there are few alternatives today outside of equities. Unlike previous market tops in 2000 and 2007, where asset allocators could overweight cash and fixed income when nominal yields were attractive, today's cash and fixed income nominal yields are downright unattractive. For comparison purposes, we demonstrate these challenges using cash, fixed income, and real asset yields vs. the earnings yield + the dividend yield offered by equities at the time.

NOMINAL YIELDS	March 2000	Sep 2007	June 2014	Source
Inflation Rate	3.8%	2.8%	2.1%	CPI
CASH	6.3%	5.3%	0.2%	30 day LIBOR
FIXED INCOME	8.4%	6.0%	2.9%	Average
10yr Treasury Yield	6.0%	4.6%	2.5%	
Intermediate Corporate Yield	7.7%	5.7%	2.2%	Barclays
Intermediate Muni Yield	7.3%	5.3%	1.9%	Barclays
High Yield Corporate Yield	12.5%	8.6%	4.9%	Barclays
US EQUITY	4.3%	6.7%	6.6%	Average
Core Earnings Yield + Dividend Yield	4.7%	6.5%	7.5%	S&P 500
Growth Earnings Yield + Dividend Yield	0.8%	4.5%	4.1%	NASDAQ
Value Earnings Yield + Dividend Yield	7.6%	9.0%	8.3%	Russell 1000 Value
INTERNATIONAL EQUITY	4.2%	8.2%	8.4%	
Europe Earnings Yield + Dividend Yield	5.3%	10.1%	8.4%	Bloomberg European 500
Japan Earnings Yield + Dividend Yield	1.8%	6.3%	6.6%	Nikkei-225
Emerging Markets Earnings Yield + Dividend Yield	5.5%	8.1%	10.2%	MSCI Emerging Markets
REAL ASSETS	9.5%	5.1%	4.6%	
REITs Yield	8.5%	4.5%	4.0%	NAREIT All REIT
MLPs Yield	10.5%	5.7%	5.1%	Alerian MLP

In 2000, for example, one had many valuation choices. While none of these valuation metrics accurately predict future returns, one could have averted poor returns by avoiding US growth and Japanese equities while concentrating on cash, fixed income, real assets, US value stocks, European equities, and emerging market equities. 2007 was more difficult but at least one could remain overweight cash and fixed income.

Today's valuation environment illustrates how much more attractive equities and real assets are relative to cash and fixed income. It is the opposite of 2000 but, importantly, investors must stomach a longer term time horizon and greater volatility. The greatest valuation opportunity amongst equities today is

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outside the U.S. Currency risk adds another challenge with international equities in managing return expectations for U.S. investors. Another case for staying overweight equities and real assets is inflation, which has not reared its ugly head since the late 1990's. We illustrate the real yields offered then and now below. In particular, cash offers negative real yields while investment grade fixed income offers nearly a 0% real yield.

REAL YIELDS	March 2000	Sep 2007	June 2014	Source
Inflation Rate	3.8%	2.8%	2.1%	CPI
CASH	2.5%	2.5%	-1.9%	30 day LIBOR
FIXED INCOME	4.6%	3.2%	0.8%	Average
10yr Treasury Yield	2.2%	1.8%	0.4%	
Intermediate Corporate Yield	3.9%	2.9%	0.1%	Barclays
Intermediate Muni Yield	3.5%	2.5%	-0.2%	Barclays
High Yield Corporate Yield	8.7%	5.8%	2.8%	Barclays
US EQUITY	0.5%	3.9%	4.5%	Average
Core Earnings Yield + Dividend Yield	0.9%	3.7%	5.4%	S&P 500
Growth Earnings Yield + Dividend Yield	-3.0%	1.7%	2.0%	NASDAQ
Value Earnings Yield + Dividend Yield	3.8%	6.2%	6.2%	Russell 1000 Value
INTERNATIONAL EQUITY	0.4%	5.4%	6.3%	Average
Europe Earnings Yield + Dividend Yield	1.5%	7.3%	6.3%	Bloomberg European 500
Japan Earnings Yield + Dividend Yield	-2.0%	3.5%	4.5%	Nikkei-225
Emerging Markets Earnings Yield + Dividend Yield	1.7%	5.3%	8.1%	MSCI Emerging Markets
REAL ASSETS	5.7%	2.3%	2.5%	Average
REITs Yield	4.7%	1.7%	1.9%	NAREIT All REIT
MLPs Yield	6.7%	2.9%	3.0%	Alerian MLP

A logical question is why is today a better environment than 2007? We have lots when comparing 2007 to now is valuation.

For example, the ten-year buy and hold strategy in investment grade bonds looks just as risky as two years ago: there is a real chance that you can lose principal or the power of money over time. Fortunately, there are other ways to use cash (outside of ten-year bonds) that might be less risky than you think—and more fruitful.
With growth and yield in short supply just now, we have bigger worries than whether we'll be staying at the Ritz: we're losing sleep that we might end up spending our last two bits "Puttin' on the Ritz." (Thank you, Irving Berlin.) Whether you are a wealthy investor maintaining a similar lifestyle or an institution keeping up with rising liabilities, we consider some alternative thinking on how you can best approach the problem of higher expenses in a low-growth, lower-return world. We investigate what a return composition that favors growing cash flow streams might accomplish.

Over the last decade, bond returns have been attractive and far less volatile than equities, especially with two 50% stock market drops during the period. This makes it hard to blame investors for being

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infatuated with bonds. Nevertheless, the present risk-aversion trend presents several unsettling possibilities about long-term investors, including:

- Investors are expecting a prolonged period of low growth (or even deflation) where interest rates will remain stubbornly low and core bond yields will continue to fall (and prices appreciate).
- In order to seek safety, investors are comfortable with a lower total return objective despite the possibility of a funding gap.
- Investors are focused on the short term and believe they can accurately time the market by making asset allocation changes to reduce exposure to core U.S. fixed income should rates reverse their trend.
- Investors are chasing performance.
- Investors do not understand the risk they are taking to meet their long-term total return objectives.

It is certainly possible for the U.S. to enter into a Japan-like environment in which core US bond investors will continue to be rewarded with lower bond yields. This is obviously a scenario no one wishes for, as we will all be worse off ten years from now.

It is possible that investors are comfortable with trading a low total return objective for safety and thereby accept the possibility of a funding gap that reduces net worth. There is no doubt that investors are as short-term focused as ever. As for timing the market, very few have the skill set to successfully time market tops and bottoms. Based on fund flows, we remind you that the U.S. equity markets have nearly doubled in the last four years at the very time that investors were selling their equity funds.

Investors are known to chase returns. Awareness of this leads to the unsettling realization that investors may not understand the risk they are taking with core US fixed income today. Our friends at *Grant's Interest Rate Observer* calculated the price that the 30-Year US Treasury bond yield needs to reach in ten years in order to generate a total return of 96%, the same return as the 30-Year US Treasury experienced over the last ten years. Specifically, the current February 2042 Treasury bond with a 3.125% coupon needs to rise in price from 94.2 today to 153.7 in 2022, which would result in a 0.3% yield.[1]

Today's global bond markets are counterintuitive. The 10-Year US Treasury now yields less than 1.5% while the 2-year sovereign debt of the Netherlands, Switzerland, and Germany each has a negative yield. We all know that sovereign debt yields of Spain, Greece, and Italy have been climbing. At the same time, equally or more heavily indebted nations (as a percentage of GDP) like Japan and the U.S. continue to raise new money easily and see yields decline. Market logic says this makes sense; but as a bond investor, why would you want to lend more to those countries who have the most debt and need to borrow more?

The continuing retreat to bonds is understandable given market volatility and serious economic and financial uncertainties around the globe. With equities taking a wild ride, bonds seem to offer a sense of certainty, an emotional comfort, if not much income. Despite all this, the trend surprises us because of a nagging question: will the bond market continue to enjoy its bull market over the next decade?

While anything is possible—one supposes that North Korea could tender a hostile takeover bid for the Vatican with money borrowed from Liechtenstein—probabilities are altogether different. This is especially true for the future relationship between bonds and bulls.

[1] "New Cult of Bonds", Grants Interest Rate Observer, April 6, 2012, p.1.

Cautious best describes our short-term view. Thanks to the wide range of potential outcomes in today's fragile global economy where policy makers in the U.S., Europe, and China are still in control, bond

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investors may continue to be rewarded in the near-term so long as deflation appears to be a greater threat than inflation. But we see little prospect for the bull market in bonds to stretch out over the next ten years.

We think it is more likely that interest rates will rise and bond prices will fall over the next decade. If this happens, bond investors may suffer a negative total nominal return and most certainly a negative total real return (and higher volatility) in their core fixed income portfolio.

The price and yield of investment grade bonds today offer a long-term risk/return profile that makes it difficult to keep income growing ahead of rising costs. More formally, the income stream paid for bonds today is very costly and, as Warren Buffett described in his annual letter to Berkshire Hathaway shareholders in February, "[bonds] are among the most dangerous of assets."[1]

Let's focus on the risk and return profile of core fixed income portfolios today using US Treasuries as our example. If rates stay the same over the next ten years and an investor buys and holds at purchase, the total annualized return will be roughly 1.5% for a 10-Year US Treasury. But what if interest rates rise five percentage points over the next decade, to near the levels where the 10-Year US Treasury rate stood ten years ago? This scenario is certainly possible if we enter into an inflationary environment or if US Treasury bonds are downgraded further because of deficit issues and, as a result, investors demand higher yields. For simplicity, below we assume rates rise 0.5 percentage points per year for the next decade with the slope of the yield curve gradually flattening by 2022 at 6.5%.

Estimated returns for the 2-Year, 5-Year, and 10-Year US Treasury

	Total Return		
Year	2 Yr	5 Yr	10 Yr
2013	-0.28%	-1.14%	-1.34%
2014	0.32%	-0.60%	-0.91%
2015	0.92%	-0.05%	-0.48%
2016	1.52%	0.50%	-0.04%
2017	2.13%	1.06%	0.41%
2018	2.73%	1.61%	0.86%
2019	3.34%	2.17%	1.31%
2020	3.96%	2.73%	1.77%
2021	4.57%	3.29%	2.23%
2022	5.18%	3.86%	2.69%
Annualized Return	**2.42%**	**1.33%**	**0.64%**

	Cumulative Return		
	2 Yr	5 Yr	10 Yr
1 Year Return	-0.28%	-1.14%	-1.34%
2 Year Return	0.04%	-1.73%	-2.24%
3 Year Return	0.96%	-1.78%	-2.71%
4 Year Return	2.49%	-1.29%	-2.75%
5 Year Return	4.68%	-0.24%	-2.35%
6 Year Return	7.53%	1.36%	-1.51%
7 Year Return	11.13%	3.56%	-0.22%
8 Year Return	15.53%	6.39%	1.55%
9 Year Return	20.81%	9.89%	3.81%
10 Year Return	27.06%	14.13%	6.61%

Source: Edge Institutional Liquidity Management

While this smooth gradual rate increase is unlikely since rates tend to move in bits and spurts, it effectively illustrates expected returns – numbers which some investors may be in denial about. Our Institutional Liquidity Management team expects the 10-Year US Treasury will generate a cumulative return of 6.61% (or 0.64% annualized return) over the next decade. A short duration portfolio (assuming the 2-Year US Treasury), by contrast, is expected to generate a cumulative return of 27.06%

[1] http://www.berkshirehathaway.com/2011ar/2011ar.pdf

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(or 2.42% annualized return) over the next ten years. The 2-Year US Treasury does better since one can reinvest at higher rates.

Neither outcome is especially happy; but what alternatives do income-oriented or absolute return investors have?

PUTTIN' ON THE RITZ

Dean Vernon Wormer in the movie "Animal House" informed Mr. Kent Dorfman (a.k.a. Flounder) that "Fat, drunk and stupid is no way to go through life, son." Well, whether you are an individual or an institution, combining higher expenses with lower income is no way to go through life either.

We see a better path to follow, one beyond core fixed income, one that is more likely to lead toward the promised land of keeping income ahead of rising costs.

Traversing this path requires some courage and no small amount of willpower. With those, however, we believe today's investor will find a sustainable long-term income stream that can grow. In addition to patience, our Research Team believes the trick to generating more income is to grow cash flow and rejigger the portfolio so that it provides a more sustainable, predictable return. In short, investors need to focus on a selective and sustainable income stream that can grow rather than worrying about the ups and downs of the value of their portfolio during short-term time periods.

Today we like dividend equity and master limited partnerships (MLPs), which offer higher yields and the potential for rising payouts. MLPs are generally energy infrastructure investments that offer attractive yields with steady, fee-based cash flows and inflation escalators. We like those characteristics.
We also continue to see dividends as an important component of total return, especially during this period of low economic growth.

Using the S&P 500 as a proxy, dividends on average have contributed over 50% of the S&P 500's total return. In low-growth periods, such as the 1940s and 1970s, dividends accounted for over 75% of total returns for the S&P 500.

Dividends matter: S&P 500 return by decade

Decade	Total Return	Price Appreciation	Dividends	Dividends % of Total Return
1940s	143.1%	34.8%	108.3%	75.7%
1950s	467.4%	256.7%	210.7%	45.1%
1960s	109.5%	53.7%	55.8%	51.0%
1970s	76.9%	17.2%	59.7%	77.6%
1980s	389.2%	227.4%	161.8%	41.6%
1990s	432.2%	315.7%	107.5%	24.9%
2000s	-9.1%	-24.1%	15.0%	NM
Average	**229.9%**	**125.9%**	**102.7%**	**52.6%**

Source: Strategas

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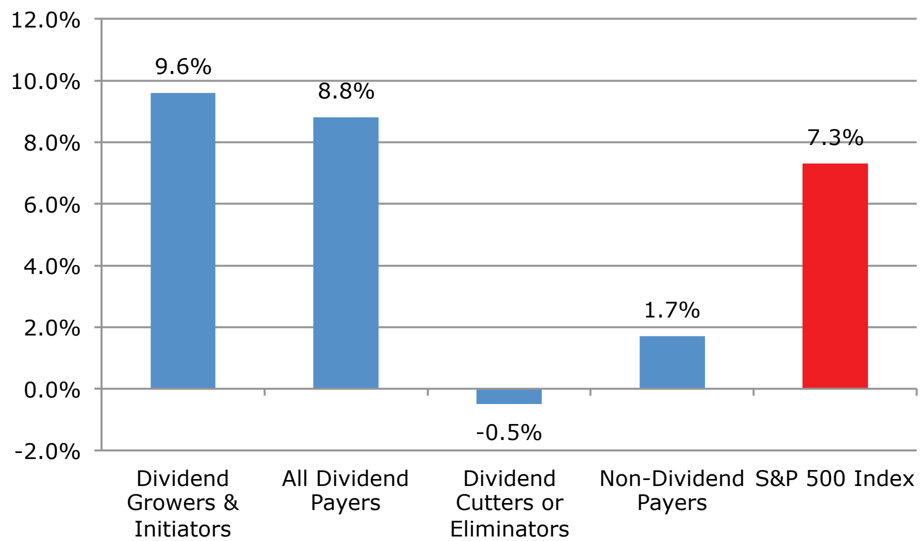
Importantly, not all dividend stocks are created equal. Chasing high dividend yields does not necessarily produce better results. For example, in the last five years an index of stocks with higher-than-average dividend yields (as measured by the FTSE High Dividend Yield Index) underperformed the S&P 500 TR Index. The annualized return was -3.8% vs. a flat return for the S&P 500. The primary rationale behind this underperformance is leverage associated with a particular business, such as financials and Real Estate Investment Trusts (REITs). REITs for example, have experienced a -1.6% annual distribution growth rate over the last ten years (as measured by the equity REIT component NAREIT). Nearly every bank and brokerage firm either cut or reduced their dividend from 2007 through 2009. Equity investors in General Motors – a long-time dividend payer – were wiped out.

Therefore, the critical strategy to equity dividend investing is finding those companies who are committed to the dividend and have a balance sheet and business model that can produce a sustainable dividend during both good times and bad. As an example, the S&P 500 Dividend Aristocrats Index measures the performance of S&P 500 constituents that have followed a policy of increasing dividends every year for at least 25 years. This index has produced a positive 4.5% annualized return over the last five years; this is a nearly 9% annualized outperformance difference to all stocks with higher-than-average dividend yields. Over the last ten years this index has produced a 7% annualized return compared to the 4% annualized return for the S&P 500 TR Index.

The benefits of management teams with a commitment to grow their dividend payments also are demonstrated by the historical return of stocks within the S&P 500 index between 1972 and 2010.

Historical return of stocks within the S&P 500 (1972-2010)



Source: Ned Davis Research

In addition to the contribution towards total return, dividends provide improved corporate governance and a margin of safety from market drawdowns and inflation. If a company has a long history of paying a dividend and increasing its dividend - much like the S&P 500 Dividend Aristocrats - it is highly likely that management is committed to meeting its dividend payout before making other strategic decisions on how to best use the rest of free cash flow. In summary, dividend payout policies foster disciplined behavior for management teams to be efficient stewards of capital.

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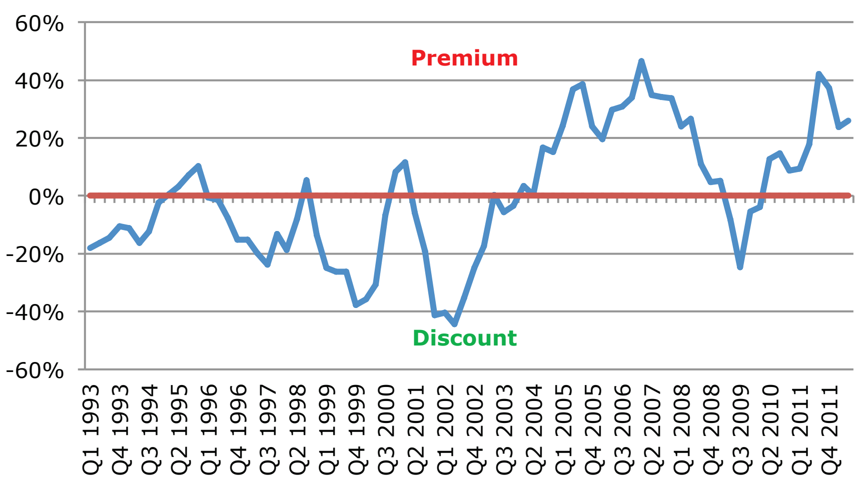
If the total return data above for dividend equities does not provide enough conviction for their margin of safety from market drawdowns and inflation, consider the following. First, Robert J. Shiller, in his book *Irrational Exuberance*, calculated the dividend per share peak to trough decline averaged -8% during the last five U.S. recessionary periods while the earning per share peak to trough declined -42%. Dividend equities can also provide an inflation hedge through their dividend alone as dividend payments can increase in line with or at a higher rate than inflation. Over a rolling ten-year period, the average growth in the S&P 500 dividend per share is 6% per year since the 1940s. The annual dividend growth over the last 10 years has been 5.5%. Since 2003, the annual growth in distributions for the Alerian MLP index is 7.1%.

Dividend equity is by no means a shocking discovery; the praise has become so widespread that the trendiest investment firms have started turning bearish on dividend equities. Taking a hard-nosed look at the evidence, we respectfully disagree with the bears.

We are reminded regularly that the price paid and income received for any investment is critically important for long-term results. It is no different for dividend equities than it is for 10-Year US Treasuries.

Some dividend equity sectors are pricier than others. The sectors that appear bubbly today and offer price risk (as opposed to income risk) are the less cyclical industries, namely utilities (broadly), consumer staples (selectively), and telecom (broadly). All of these sectors are trading at a relative historical premium to the S&P 500. REITs, broadly speaking, are also pricey. Despite improving distribution growth, REITs are yielding just 3.4% - not enough current pay for us based on historically low cap rates and high FFO multiples.

Utilities vs. S&P 500: Valuation Premium/Discount



Source: Bloomberg as of 6/29/12

That being said, there are plentiful opportunities with high quality dividend payers in other sectors, including less cyclical industries such as healthcare and more cyclical industries like technology, energy, industrials, materials, and consumer discretionary. Based upon our research, we have identified over 200 US companies that have grown their dividend payment for at least ten consecutive years. The majority of these companies are in sectors other than utilities, consumer staples, telecom, and REITs—a group that taken together represents just one-third of the companies that have increased their dividend for ten consecutive years or more.

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Edge Global Growth & Income (U.S. universe)

Consecutive years of annual dividend growth	Number of companies	Sample companies with attractive valuations and a dividend yield > 2.5%
50+ Years	10	3M, Emerson Electric, Genuine Parts
40 – 49 Years	31	Target, Becton Dickinson, Illinois Tool Works
30 – 39 Years	38	Abbott Labs, Wal-Mart, Walgreen
20 – 29 Years	37	Chevron, Air Products & Chemicals
10 – 19 Years	103	Conoco, Norfolk Southern, Caterpillar
	219	

Source: Edge Capital Partners as of 6/21/12

To further illustrate the long-term attractiveness of dividend payers, we screened the 219 U.S. companies who have increased their dividend for at least ten consecutive years. We eliminated companies that have a 2012 dividend coverage rate below two (i.e., terminating those at risk of not being able to increase their dividend) or a dividend yield under 2%. An equal weighted average of the remaining 83 companies produces a 3.1% dividend yield, a 34% dividend payout ratio, a 7.9% average annual dividend growth rate over the last ten years, and an 11.5 P/E based upon 2012 earnings estimates. Furthermore, the estimated average growth of 2012's dividend payment over last year is 16%.

In addition, the opportunity set of attractive dividend payers continues to grow. For example, Microsoft only began its rising dividend policy in 2004. Even Apple, with roughly $100 billion in cash and no debt, just initiated a dividend that makes it the second largest dividend payer in the world. Surprisingly, information technology is now the second largest dividend payer behind consumer staples in the U.S. If Google were to start paying the same dividend rate (yield) as Apple, information technology would beat out consumer staples as the largest dividend payer.

While we (selectively) like US high dividend equities, it is important to remember that in looking for valuation and attractive income streams that can grow, the opportunities extend beyond US dividend equities and MLPs. European dividend payers, in particular, are trading at a meaningful discount to their U.S. peer group and have an equally impressive history of growing dividend payments.

In the following analysis, we highlight the relative valuation, earnings growth estimates, and dividend yield among U.S. and European companies with similar business models. This specific basket of high quality, multi-national companies that happen to be domiciled in Western Europe offers a higher growth rate, a lower P/E, and a higher dividend yield on average than a basket of U.S. peer companies. That being said, investors must be mindful of the currency risk involved with such an investment.

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The European Discount

		% of Sales			Est. Long-	Valuation	
	Domicile	US	Europe	ROW	Term Growth	Current P/E	Div Yield
Industrial Conglomerates							
General Electric	U.S.	47%	20%	33%	12.0%	16.4	3.4%
Siemens	Germany	20%	53%	27%	26.2%	13.9	4.5%
Luxury Brands							
Polo Ralph Lauren	U.S.	64%	22%	14%	13.0%	20.5	1.1%
Louis Vuitton	France	22%	32%	46%	14.1%	18.9	2.2%
Consumer Goods							
Procter & Gamble	U.S.	37%	26%	37%	8.1%	19.6	3.6%
Unilever	Netherlands/U.K	33%	20%	47%	8.5%	17.5	3.8%
Automobiles							
Ford	US	59%	27%	15%	9.2%	7.3	1.9%
Volkswagen	Germany	11%	65%	24%	20.4%	3.2	2.6%
Alcoholic Beverages							
Brown Forman	U.S.	44%	27%	29%	12.0%	25.7	1.5%
Diageo	U.K.	34%	27%	39%	11.9%	23.8	2.6%
Integrated Energy							
Exxon Mobil	U.S.	37%	27%	36%	4.9%	10.1	2.7%
Royal Dutch Shell	Netherlands	20%	40%	40%	4.0%	6.7	5.2%
	U.S. Average:	**47.9%**	**24.8%**	**27.3%**	**9.9%**	**16.6**	**2.4%**
	Western Europe Average:	**23.3%**	**39.5%**	**37.2%**	**14.2%**	**14.0**	**3.5%**

Source: Bloomberg and company annual reports as of 6/20/12

We see another category of attractively priced high cash flow investment streams—those that do not grow. There are a variety of liquid non-investment grade fixed income opportunities that are interesting right now, such as BB rated corporate bonds, high yield municipal bonds, and non-agency residential mortgage backed securities (RMBS). Senior bank loans are another liquid non-investment grade solution but offer variable income return streams based upon LIBOR rates – a characteristic that would be beneficial if rates were to rise.

Sample high yield fixed income alternatives

Non-Investment Grade Fixed Income	Yield To Worst	Modified Duration
US Corporate High Yield	7.5%	4.1 years
Municipal High Yield	6.0%	9.7 years
Non-Agency RMBS	10.0%	NA

Source: Bloomberg and Barclays Capital as of 6/21/12 for corporates and municipals
DoubleLine as of 5/10/12 for non-agency RMBS
Barcap Muni High Yield Index as of 5/10/12 for Municipal High Yield
Barclays US Corp High Yield Index as of 5/10/12 for US Corporate High Yield

The margin of safety for non-investment grade bonds can be best described as "ok" if we enter a period of rising rates. The spreads for high yield corporates, for example, are above their historical average spread relative to US Treasuries, but one must be mindful of how low US Treasury rates are. Meanwhile, for a non-agency RMBS portfolio of 70% Alt-A, 23% prime, and 7% subprime mortgages, the average price is $71 and the average coupon is 7%.

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For those investors who can afford illiquidity, there are many other high cash flow alternatives that offer attractive current pay with the opportunity for principal appreciation. These include niche strategies such as account receivable financing, consumer debt loans, infrastructure loans, mezzanine loans, distressed debt, and rental yields from residential homes.

FORWARD LOOKING RISKS AND BENEFITS OF GROWING INCOME STREAMS

So what are the risks? The obvious elephant in the room is the near-term outlook for the global economy and the fact that we are in the hands of policymakers (still). If bond investors are correct, we are due for a prolonged period of low growth or deflation where current earnings estimates and multiples are at risk for equities. This also presents risk to the sustainability and growth of dividend and distribution payments for dividend equity, REITs, and MLPs.

Another risk with growing cash flow streams is to the upside. The opportunity cost of not being in higher growth stocks can be significant should the global economy surprise most by delivering 3%+ growth for a sustainable period. As an example, in 2009 dividend equities substantially underperformed the broad equity markets, capturing just over half of the upside.

Taxes may be a greater cause of concern for dividend equity. Under current legislation, taxes on dividends to wealthy individuals will almost triple in 2013, rising to 43.4% from 15%. As we understand it today, the 3.8% "Obamacare" tax on investment income is applicable to any income (except for municipal bonds) above $250,000 of adjusted gross income for joint filers ($200,000 for single filers). If a family with $250,000 in adjusted gross income assumes a 5% total return from dividend equities, half from the dividend yield and half from principal appreciation, taxable investors would pocket 4.0% should the Bush tax cuts expire. Any adjusted gross income above $250,000 – excluding municipal bond income – would be taxed an additional 3.8%. From a corporate planning perspective, management teams could potentially pull back on dividend increases and instead increase share buybacks.

While there is no denying the fact that higher taxes will make the total return composition less attractive for taxable investors (4.0% in 2013 vs. 4.6% in 2012 in the example above), it is worth mentioning that during the most recent tax rate increase from 1990-1993, dividend equities outperformed the broader market by 1.3% on an annualized basis. In addition, they performed in line with the S&P 500 for the first year after tax increases were enacted in 1936 and 1954. Meanwhile, nearly 50% of dividend-paying investors do not pay taxes and management teams recognize that cutting back on dividends would also disappoint tax-exempt investors.

Total return of U.S. dividend equities for first year after tax increase enacted

Year	Administration	Dividend Tax Increase	S&P 500 Return	Avg Dividend-Paying Stock
1936	FDR	Exempt to 79% top rate	33.9%	29.2%
1954	Eisenhower	Exempt to 91% top rate	52.7%	53.9%
1991	GHW Bush	25% to 31% top rate	30.5%	33.7%
1993	Clinton	31% to 43.4% top rate	10.1%	10.1%

Source: Hamlin Capital Management

Should the Bush tax cuts expire, municipal bonds will be a major beneficiary for wealthy investors seeking fixed income; yet dividend equity and MLPs will still offer a better after-tax yield than US Treasuries and corporate bonds.

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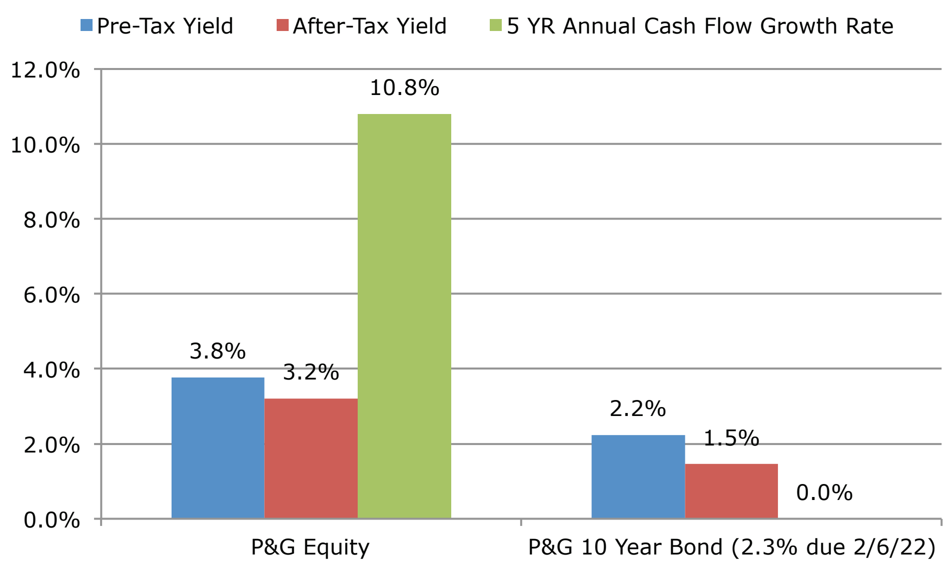
Given the positive underlying fundamentals, attractive valuations, low dividend payout ratios, and cash reserves of dividend payers, it is still an investment long-term investors cannot ignore even as concerns linger over the economy and taxes.

Looking forward, we demonstrate the opportunity in growing versus fixed cash flow over the next 10 years through Proctor & Gamble (P&G). Investors are currently paying a premium for its 10-year 2.3% coupon bond (which is fixed) while its equity dividend yields 3.8% (which has grown at an annualized rate of 10.8% over the last 5 years). If P&G were to continue raising its dividend at the same rate over the next 10 years, equity investors would generate a 6.3% annualized return in income from its growing cash flow compared to just a 2.2% annualized return for bond investors.

P&G: Capital structure alternatives



Source: Bloomberg as of 6/26/12
After-tax yield assumes 15% dividend tax rate and 35% ordinary income tax rate

To further illustrate the power of growing cash flow over the next ten years, we assume an equal weighted $1,000,000 fixed cash flow portfolio of US Treasury, AA Corporates, and Municipal bonds (with a bullet 10 year maturity held to maturity) compared to a $1,000,000 growing cash flow portfolio of 70% Edge Global Income & Growth* and 30% MLPs (Alerian Index). We also assume these portfolios are rebalanced annually and the after-tax income reflects the blended tax rate for joint filers earning $250,000 in adjusted gross income should the Bush tax cuts expire.

*Description of the Edge Global Growth and Income Composite:
The Edge Global Growth and Income Portfolio Composite ("The Composite") was created in May of 2012. The Composite includes all actual fee paying accounts with comparable investment objectives, restrictions and risks, managed by Edge for at least one full month. The Composite invests primarily in domestic or international securities the portfolio manager feels have the potential to deliver outperformance due to a combination of price appreciation and current income in the form of a dividend. The composite will typically invest in securities with a current dividend yield in excess of the broad equity markets with a history of consistently increasing the dividend rate and with what we believe to be strong fundamentals at an attractive price (i.e. low use of leverage, operating margins in excess of 5%, free positive cash flow yield, a price to earnings ratio at or below the market average, and earnings growth). Although there is no clearly comparable benchmark, The Composite is measured against the MSCI World Index.

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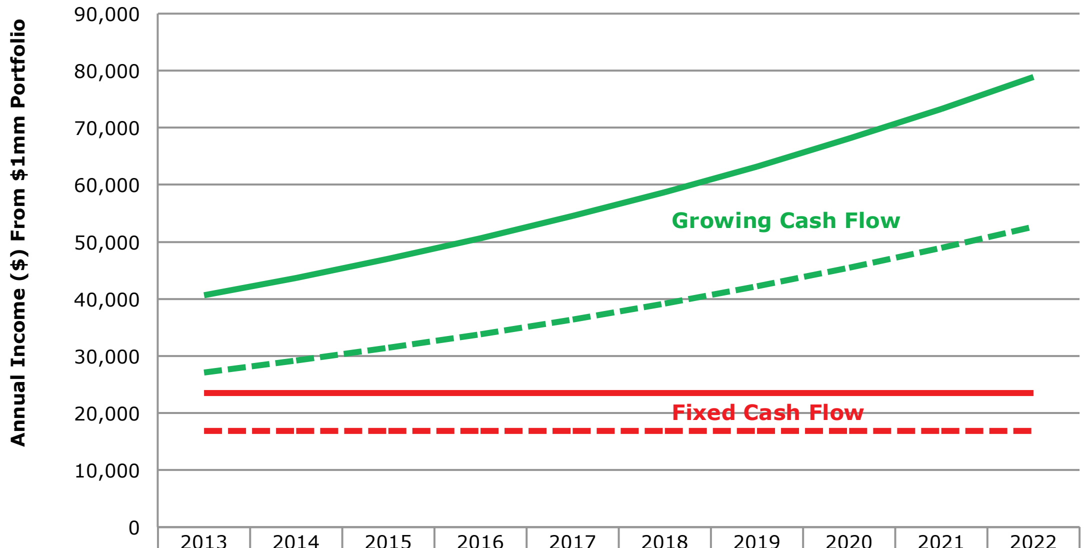
Hypothetical Annual Income ($): Fixed Cash Flow vs. Growing Cash Flow ($1mm)



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Growing Cash Flow (Pre-Tax)	40,600	43,710	47,058	50,663	54,544	58,722	63,220	68,062	73,276	78,889
Growing Cash Flow (After-Tax)	27,092	29,168	31,402	33,807	36,397	39,185	42,186	45,418	48,897	52,643
Fixed Cash Flow (Pre-Tax)	23,500	23,500	23,500	23,500	23,500	23,500	23,500	23,500	23,500	23,500
Fixed Cash Flow (After-Tax)	16,845	16,845	16,845	16,845	16,845	16,845	16,845	16,845	16,845	16,845

Assumptions are based upon the estimated pre-tax and after-tax yields and 10 year historical annual cash flow growth rate below.

Source: Bloomberg
Important Tax Rate Assumptions

- Adjusted gross income is $250,000 for a joint filer and therefore excludes 3.8% "Obamacare" tax
- Current dividend tax rate is 15.0%
- Current ordinary income tax rate is 35.0%
- Current blended MLP tax rate is 15.0%
- Post Bush tax cut dividend tax rate is 36.6%
- Post Bush tax cut ordinary income tax rates is 39.6%
- Post Bush tax cut blended MLP tax rate is 18.5%

10 Year AA Corporate Bond is BAML AA Corporate Bond (7-10 year maturity) Index
10 Year Municipal Bond is BarCap Municipal Bond Index
10 High Yield Municipal Bonds is BarCap High Yield Muni Index
High Yield Corporate Bonds is BarCap US Corporate High Yield Index
REITs is MSCI REIT Index and NAREIT Equity REIT Index
Dividend Equity is Edge Global Growth & Income
MLPs is Alerian MLP Index

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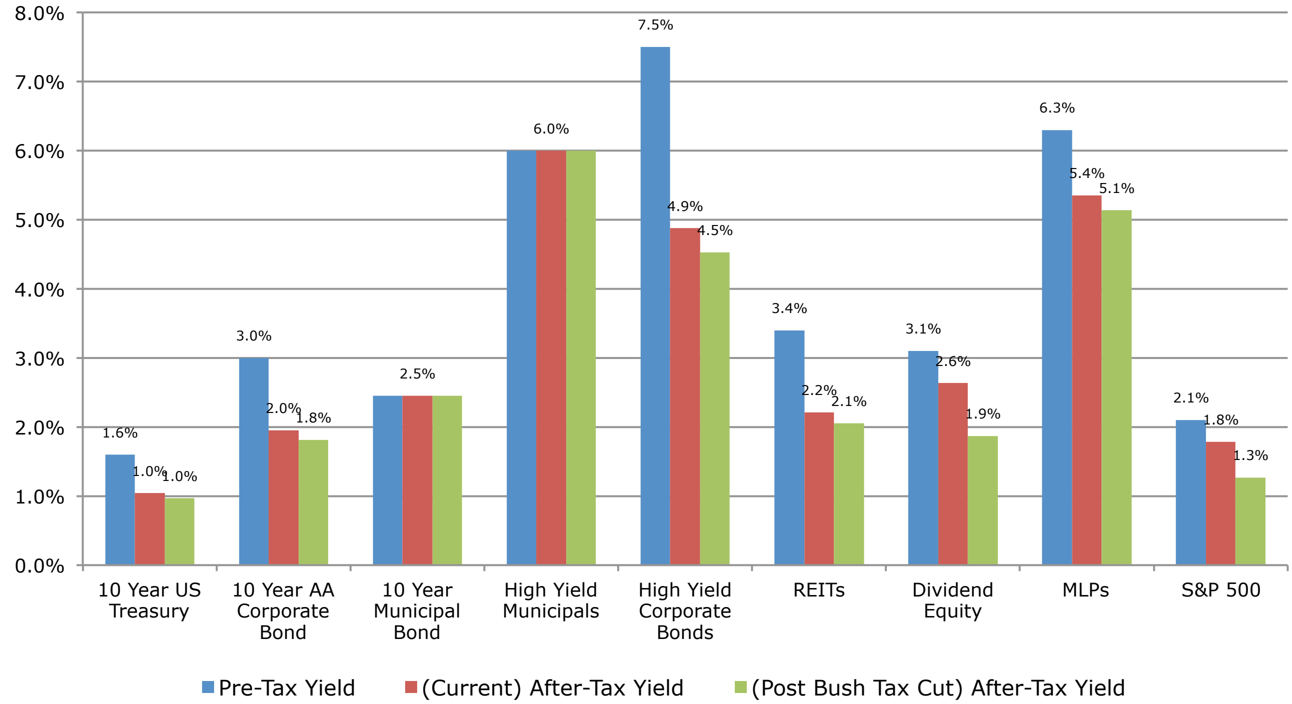
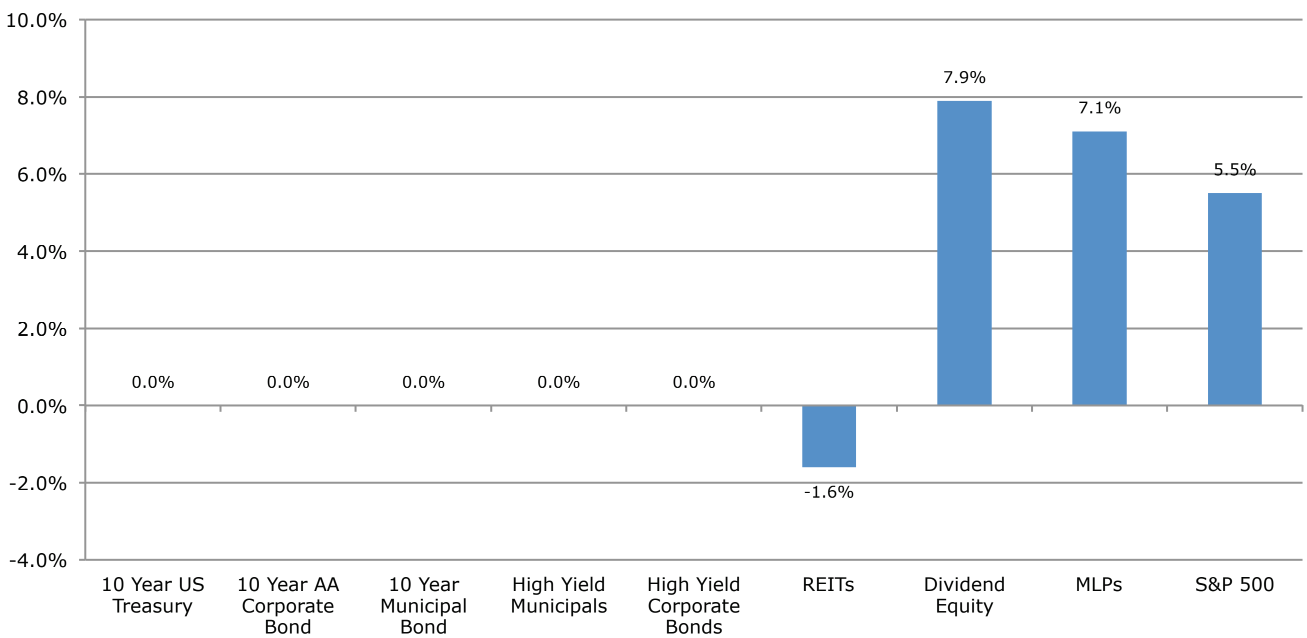
Current pre-tax and estimated after-tax yields



10 year historical annual cash flow growth rate



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CONCLUSION

To summarize, income is down but expenses continue to grow. Meanwhile, “financial repression” has created an environment where both yield and growth are scarce. The solution is to change the return composition in favor of growing cash flows. One example is shifting duration risk from long-term core fixed cash flow to growing cash flow.

Our Institutional Liquidity Management team runs short duration bond portfolios that can weather the storm when interest rates move higher over the next ten years. This conservative approach will serve investors well in a rising rate environment relative to longer duration bond portfolios.

The Edge Global Growth & Income portfolio consists of companies with dividends currently twice the yield of 10-Year US Treasuries and that we believe are likely to continue to raise their dividends over the long term. We expect these companies will continue to provide an attractive income stream that can grow.

The Edge High Income portfolio incorporates high fixed cash flow investments along with growing cash flow investments. The Edge High Income portfolio currently yields 4.5%, a substantial income return at a time when the traditional sources for portfolio income are insufficient. We expect the amount of income generated to rise as companies increase their dividends and distributions, and we believe that the portfolio has potential for long-term capital appreciation.

We like shifting the composition in favor of growing cash flows. While the strategy may cause anxiety in the near term, it offers many potential rewards. We encourage investors to stay patient and be selective and opportunistic in pursuing the value associated with growing cash flow strategies. In our view, over the long term, growing cash flow will be a relative winner in a deflationary or low-growth environment. It will be an absolute winner in an inflationary or high-growth environment.

Our team believes that even in this low-growth, low-yield environment, there are plenty of attractive income alternatives to ease the frazzled mind of investors who see their income falling while costs rise. Pursuing them may give you enough confidence and portfolio income that no matter where you are, you’ll be sleeping like you’re staying at the Ritz.