



## Screening for Dividend Paying Stocks

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At SmartTrust®, we look to provide for diversified income and total return opportunities through innovative investment strategies. The majority of SmartTrust® Unit Investment Trusts (UITs) offer diversified income opportunities (*as well as the potential for total return*) and have incorporated such underlying investment strategies as individual taxable and tax-free bonds, individual stocks, preferred stocks, business development companies (BDCs), closed-end funds (CEFs) and exchange traded funds (ETFs). This particular report will focus on how we select equity securities for our income based strategies.

Dividend income has long been an important component of the total return performance of stocks. To this end, according to Guinness Atkinson Management, dividends have accounted for over half of the total return of stocks represented in the S&P 500 index (S&P 500) for individual decades, on average, since 1940, not including the decades of the 2000s due to its negative overall total return.

### S&P 500 Returns for Individual Decades Since 1940

Decade	Total Return	Price Appreciation	Dividends	Dividends as a % 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%	25.4%
2000s	-9.0%	-24.1%	15.0%	Not Meaningful
Average	228.6%	125.9%	102.7%	52.7%

Source: Bloomberg, Guinness Atkinson Asset Management, 12/31/40 – 12/31/11, “Why Dividends Matter.” *Past performance is not indicative of future results. Data provided for informational purposes only. Returns do not reflect, nor should they be compared to, actual UIT returns.*

Recognizing the importance of dividends, the question then becomes how to find the common stocks of companies that have financial strength and pay a high relative dividend while possessing the ability to sustain that dividend in the future. Accordingly, when selecting equity securities for applicable SmartTrust UITs, the factors that typically serve as our primary screening criteria generally include, but are not limited to, the following:

- **Current Dividend Yield** – we strive to identify common stocks that pay a current dividend at least two times the current yield of the S&P 500.
- **5 Year Dividend Growth Rate** – we strive to identify common stocks that have positive 5 year dividend growth rates.
- **Trailing Twelve Month (TTM) Free Cash Flow Balances** - we strive to identify common stocks that have a positive TTM free cash flow balances. This is a very important measure in our view as it is a strong indicator of financial strength of a company as it shows how much “free cash” is left over after capital expenditures are deducted from net cash flow from operations. This free cash could be used to sustain or increase dividends, buy-back shares or reinvest into company operations.
- **Mean Analyst Rating** – we strive to identify common stocks that have a mean analyst rating of “Hold” or better. Those common stocks that do not have a mean analyst rating but meet our other screening criteria require further review.
- **Beta** – we strive to identify common stocks with reasonable Betas such that the weighted Beta of the overall portfolio will be less than 1.00.
- **Average Volume** – we strive to identify common stocks that have sufficient liquidity based upon a review of historical average trading volume.

Other factors that are typically reviewed but do not necessarily serve as our primary screening criteria generally include, but are not limited to, the following:

- **3 Year Dividend Growth Rate**
- **1 Year Dividend Growth Rate**
- **P/E Ratio**
- **1 Year Total Return**
- **3 Year Total Return**
- **5 Year Total Return**
- **Dividend Payout Ratio or Funds From Operations Payout Ratio (REITs)**
- **GICS Sector** (depending upon defined objective and portfolio strategy of the Trust series)

While a high dividend payout ratio may be indicative of a dividend that may be difficult to sustain for a given company, and certainly should not be discounted entirely, we do not include dividend payout ratios as primary screening criteria, at this time, for a variety of reasons.

1. The ratio does not necessarily provide meaningful information for all security types. For example, a better gauge of dividend sustainability may be to use funds from operations or adjusted funds from operations as the divisor as opposed to earnings. The reason for this is that real estate depreciation is a large non-cash expense that likely overstates any decline in property values, and thus dividing dividend per share by earnings or net income per share could similarly understate the ability of a particular REIT to sustain dividend payments in the future.
2. High dividend payout ratios may not signify a company with deteriorating financial strength and/or one that cannot sustain its current distribution in the future. Companies are generally

reluctant to cut dividends due to the negative signal that such an action sends to shareholders and the company's desire to maintain their dividend may drive them to pay out more in terms of dividends per share than they are currently earning per share over some interim period of time. In these cases, it is important to also look at free cash flow support and the previous five year history of dividend growth.

3. It is often more helpful to review future earnings growth potential estimates, as opposed to current earnings, vs. current and expected future distributions to better gauge future, potential dividend sustainability

Some current examples of well-known U.S. companies that currently have a high dividend payout ratio but have a positive 5 year dividend growth rate include the following (recognizing that these stocks may not meet some of the other criteria to make it into a given series of a SmartTrust® UIT):

- a. **AT&T** (Ticker: *T*) – current yield of 5.46% with a high dividend payout ratio of 141.35 – yet they have 1, 3 and 5 year dividend growth rates of 2.26%, 2.31% and 2.37% respectively.
- b. **B&G Foods Inc.** (Ticker: *BGS*) - current yield of 3.91% with a high dividend payout ratio of 91.40 – yet they have 1, 3 and 5 year dividend growth rates of 11.82%, 21.84% and 8.82% respectively.
- c. **Merck & Co.** (Ticker: *MRK*) – current yield of 3.40% with a high dividend payout ratio of 83.87 – yet they have 1, 3 and 5 year dividend growth rates of 2.37%, 4.42% and 2.62% respectively.

It should be noted that each one of the three companies highlighted above each had positive TTM free cash flow balances as of the writing of this report.

Here are some representative examples of SmartTrust® UIT strategies, developed either through our own research or through relationships with Portfolio Consultants or Licensed Index Providers, which invest entirely in equity securities and do not use the dividend payout ratio as primary screening criteria.

- **Morningstar Dividend Yield Focus Index Trust**
- **High 20 Dividend Strategy Trust**
- **Adelante REIT Growth and Income Trust**
- **Capital Innovations Global Infrastructure and MLP Trust**

For each of the strategies, we researched the distribution history of the equity strategies selected for each series, as of January 16, 2014, to determine the following:

- Average distribution \$ increase / (decrease) of all of the equity securities in each portfolio since its inception
- Average distribution % increase / (decrease) of all of the equity securities in each portfolio since its inception
- # of individual security distribution increases in each portfolio since inception

- # of individual security distribution decreases in each portfolio since inception
- # of individual security distributions that were sustained in each portfolio since inception

Here were the results of this research exercise:

#### **Morningstar Dividend Yield Focus Index Trust**

Series	Avg. Distribution \$ Increase/(Decrease)	Avg. Distribution % Increase/(Decrease)	# of Individual Securities Distribution Increases	# of Individual Securities Distribution Decreases	# of Individual Securities Distributions Sustained
Series 1	0.0106	3.46%	42	1	32
Series 2	0.0166	2.23%	32	1	42

#### **High 20 Dividend Strategy Trust**

Series	Avg. Distribution \$ Increase/(Decrease)	Avg. Distribution % Increase/(Decrease)	# of Individual Securities Distribution Increases	# of Individual Securities Distribution Decreases	# of Individual Securities Distributions Sustained
Series 1	(0.0209)	0.00%	15	3	2
Series 2	(0.1363)	(9.87%)	9	7	4
Series 3	0.0095	5.53%	16	4	0
Series 4	0.0351	5.44%	14	3	3

#### **Adelante REIT Growth and Income Trust**

Series	Avg. Distribution \$ Increase/(Decrease)	Avg. Distribution % Increase/(Decrease)	# of Individual Securities Distribution Increases	# of Individual Securities Distribution Increases	# of Individual Securities Distributions Sustained
Series 1	0.0000	4.86%	4	1	11

#### **Capital Innovation Global Infrastructure and MLP Trust**

Series	Avg. Distribution \$ Increase/(Decrease)	Avg. Distribution % Increase/(Decrease)	# of Individual Securities Distribution Increases	# of Individual Securities Distribution Decreases	# of Individual Securities Distributions Sustained
Series 1	(0.0029)	4.74%	26	11	2
Series 2	0.0760	2.71%	30	13	11

Please note: Distribution on underlying equity securities provided by Bloomberg as of January 16, 2014. We believe this data to be accurate but cannot be held responsible for errors or omissions. Increase/

*(Decrease) calculations are based on initial Series inception date values. Past performance is not an indication of future results.*

While no screening criteria can guarantee the sustainability of dividend payments over time, we believe that the multi-factor approach employed at SmartTrust® can be helpful in providing portfolio strategies that strive to pay high, sustainable levels of income over the duration of each respective Trust series.

If you are interested in learning how we screen for high levels of sustainable distribution opportunities for other security types (Ex. Closed-end funds), please do not hesitate to contact our Internal Support Desk at 888-505-2872.

*This paper is provided for informational purposes only. The discussion of specific stocks or UITs is not a solicitation to buy or sell any of the referenced securities. Investors should consider the Trust's investment objective, risks, charges and expenses carefully before investing. The prospectus contains this and other information relevant to an investment in the Trust. Please advise your clients to read the prospectus carefully before they invest. If a prospectus did not accompany this literature, please contact SmartTrust at (888) 505-2872 or visit [www.smarttrustuit.com](http://www.smarttrustuit.com) to obtain a free prospectus.*