Looking To Cash In On Dividends?

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If you are looking to cash in on dividends this is one investment you need to look into. What I'm talking about is the C-Tracks ETN Strategic Dividend Reinvestor (DIVC) based on the Miller Howard strategic dividend index and issued by Citigroup. The index is a basket of 30 companies, the ETN is a derivative investment vehicle based on index methodology, focused on growth and reinvests all dividends. One reason this issue is an attractive means of capitalizing on dividends is the structure of the investment; ETN's are tax advantageous and allow for tax-free reinvestment of dividends. This by itself is no reason to buy it but can serve as added incentive once you get an idea of the growth opportunity inherent in this asset. Caveats include credit risk as these are a debt offering based on index performance and not an equity stake in the companies held. The upshot to the credit risk is that the notes are issued by Citigroup, a financial institution of sound standing according to recently passed Federal Reserve Stress tests.

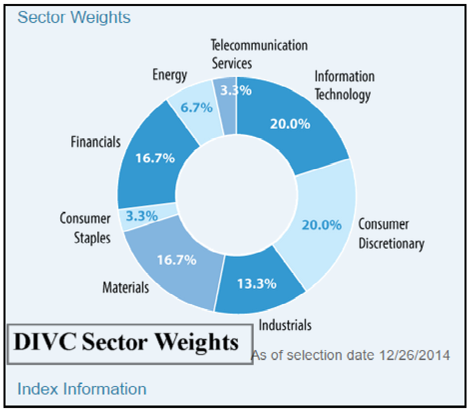
First a little about the firm and index methodology. Miller Howard is a boutique investment management company with over 20 years of experience serving retail and institutional clients. They focus on dividend growth and cash flow strategies and also offer a number of proprietary investment funds through its network of partnerships. The company maintains two indices based on core strategies with derivative investments based on each. This article is about the Strategic Dividend Index, an index of 30 companies diversified across 10 sectors not including REITs or MLP's. REITs and MLP's are both powerful methods of capturing cash flow through dividends, and the focus of other Miller Howard products.

The Strategic Dividend Index is an equal weighted index that is rebalanced quarterly. The focus of the fund is to find large and mega-cap stocks that are undervalued with a strong history of dividend payments, the greatest chance of dividend increases and expected growth. The goal is to increase value through dividends, dividend increases, capital appreciation and re-investment. The idea being that a fundamentally sound stock in a dividend-increasing cycle attracts long term buyers, has upside momentum and will increase in value in the short and long term. In order to qualify companies can not have lowered or suspended its dividend in recent history and they must be a corporation, or at least an ADR trading on the US market, with a market cap of at least $1 billion. The average yield per stock in the index is low, less than 5%, but still well above the current S&P 500 average which is less than 2%. The thing to keep in mind is that this index is focusing on healthy stocks and targeting growth, rather than high yeilders that may or may not be around tomorrow to pay dividends.

Is Dividend Growth Expected?

I have to say that yes, divided growth is expected in 2015. Not only has the net amount of dividend payments been on the increase over the past few years 2015 is already showing significant increases. Looking back at the 4th quarter of 2014 the net increase in dividend payments was over $12 billion across 971 companies. The total increase for all of 2014 is well over $54 billion and to put it into even greater perspective, that growth is 30% more than the previous year and the fourth year of double digit dividend growth.

Analysts agree that 2015 should be another stellar year. Howard Silverblatt, Senior Index Analyst at S&P/Dow Jones Indices, has been quoted saying "2015 should easily set another record for cash dividend payments." Some may say that too many companies are focused on share buybacks and that is what is supporting the market. It looks to me like a lot of cash is being delivered through dividends as well and that support is not going to disappear soon.



DIVC Sector Weights

How Has The Strategic Index Stack Up?

So, how does the Miller Howard Strategic Index stack up compared to its mission and market expectation? Pretty well from what I can tell. At first glance the index looks like a random mix of well known large cap names, many with yield below 3% as I have mentioned. Even at second glance the list is not that impressive, but when you start to dig down into performance, on a sector by sector and company by company basis you start to see how the methodology is working. The calendar 1st quarter 2015 earnings reports says it all. Of the 30 companies included in the index all delivered positive results with a number of recurring themes. For one, they all paid their dividends which is in essence the very core of the strategy. For another, 10 companies, a full third of them, increased their distributions with an average cash gain of 9.45%. The smallest increase was 4.1%, the highest 17%. Taking this and averaging it across the entire portfolio comes up with an increase of 3.15% per company.

Other positive themes this earnings season include beating estimates, positive guidance, strong momentum, newly announced buy backs, insider buying and sales growth. In terms of earnings and revenues, more than 20 beat Wall Street estimates and 8 produced positive guidance or earnings

outlook. There were also 7 new buy backs announced during the quarter and based on the results of the bank stress tests it is quite possible that some of the financial names could be added to that list. In terms of expectations and shareholder value all news items are positive and will help support prices if not lead to higher ones.

Current Positioning Of The Miller Howard Strategic Dividend Reinvestor

The index is facing a rough road over the next few months but is well positioned to benefit from the expected return to growth the economy faces later in the year. If you look at the break down of the Strategic Dividend Reinvestor you can see that it is diversified, but also weighted by sectors in tandem with growth expectations for the over all market. You can also see that many of the stocks in the index are already producing the desired results, either

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through dividend increases, share repurchases or both and all are expected to see growth in the second half of 2015.

Looking ahead,earnings for the broad market are expected to decline in the first quarter of 2015 and this is causing concern for dividends and dividend growth. This concern may lead to a market sell-off that, if happens, will become an excellent buying opportunity. Something to keep in mind is that earnings declines are primarily expected in the energy sector, which is projected to fall by more than -60%, but that ex-energy earnings are still expected to rise with most recent estimates over 1%.

Looking at the whole index the 9 sectors, ex-oil, are projected to grow earnings by 0.85%, well above the blended projection of -4.6% for the entire S&P. Looking at the market this way it is easy to see how earnings ex-energy are going to be much more important than total blended earnings. It also raises the possibility that fear of dividend decreases is be misplaced and the chance that increases could come from sectors where they have already appeared. On a sector by sector basis there are a total of 6 S&P sectors that are expected to see declines in earnings this quarter. The largest of them, ex energy, is only -6.2% and the remaining four average near 2.5%. What many are losing sight of now is the fact that earnings for the year are supposed to rise, with much of that occurring during the second half of the year. When this happens you can be sure to see additional buybacks and dividend increases.

Technology/Telecom – Seven companies make up the this segment of the portfolio, not surprising since these sectors were expected to see strong earnings growth. According to FactSet these are the number 2 and number 4 leading sectors for earnings growth this quarter, together comprising just over 30% of the total. Three of the companies currently included in the index increased dividend this quarter with several more in position to increase distributions or initiate share buybacks in the coming quarter. Stocks within this segment include Analog Devices, Harris Corp, Cisco Sytems, Microsoft, Qualcomm, Telus Corp and Xilinx. The first quarter of 2015 may see a small decline in earnings across this sector but the second half of the year is expected to see a return to growth.

Consumer Discretionary/Staples

– Seven companies make up this segment . These include Ford, GM, Hasbro, AMC Entertainment, Coca Cola Enterprises and Kohl's. This sector is well positioned for a number of reasons. First and foremost is the rising tide of employment in America. There may still be weak areas of employment, and some college degrees may yet prove to be unemployable, but you can't argue with the trends. Jobs creation is strong and unemployment is on the decline, two factors that will provide tailwind for the consumer. Five of these companies beat on the top and bottom line and at least 3 of those received upgrades from prominent analysts. The two auto-makers, Ford and GM, are expected to benefit from rising sales in China and expected US sales growth in 2015 as well as improvement expected in the EU this year. On top of this GM has recently announced a $5 billion share repurchase program which has stock values at a 15 month highs. Earnings growth is expected to slow but not decline in the first half of the year with a return to expanding growth in the second half.

Financials – This is the third biggest sector and includes 5 names ranging from regional banks to major re-insurers. These include BBCN Bancorp, Huntington Bancshares, Montpellier RE Holdings, Hanover Insurance Group and Validus Holdings. Only one of these raised dividend this past quarter but all are in position to do so in the coming quarters. The major theme among these is that they all beat earnings expectations, and all have positive forward guidance. This sector is expected to see the second highest level of growth in the first quarter of this year and is in prime position to benefit from improving employment conditions. Most importantly is the results of the bank stress tests and capital plans which is having a positive affect on the entire sector, including the banks in the MH index. All 31 of the major banks passed and many of the top names have already announced dividend increases and share repurchase programs, a trend that is lifting the entire sector, including Huntington Bancshares and BBCN Bancorp. Huntington Bancshares was one of the banks required to submit a capital plan and has, upon approval of the Federal Reserve, upped the divided by $0.07 and initiated a $366 million share repurchase program.

Materials – This segment also includes 5 names: Compass Minerals, Potash Corporation, Domtar, International Paper, and Watsco. This sector saw the biggest increases in dividend distributions of all; four of the five companies raised their dividend this quarter and represent the top four increases for the entire index. All five companies reported strong earnings with the expectations of future growth. This sector is expected to see the largest decline in earnings, except for the energy sector, with no sign of dividend decreases among the five companies included in the Strategic Dividend Reinvestor. In fact, at least two of the companies should see revenue/earnings growth contrary to sector expectations, a factor not typically associated with declining distributions.

Industrials – There are only four names here; Boeing, Macquarie, Dow Chemical and Eaton. All four of these companies beat expectations. One of them has significant insider buying, another is exhibiting growth and momentum the third increased its dividend by by 4% and the fourth increased its by 12%. As a sector, it is expected to grow by 2.2% in the first quarter.

Energy – This is the smallest segment of the portfolio and includes only 2 names, Exxon and Marathon Petroleum Company. Both of these companies beat estimates for earnings but share price is suffering along with the rest of the sector. There is expectation for oil prices to rebound somewhat in the second half of the year, returning this sector to growth. Until then, or until oil makes a definitive bottom, I expect to see this sector remain underweight in this portfolio.

Conclusion – The Dividend Reinvestor (DIVC) is a well positioned dividend investment that is showing growth, and expected to grow into the foreseeable future.

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