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Making Money in Stocks without a Stock Market

Who needs price appreciation when we want to buy more shares anyway

STOCK PRICES BEFUDDLE MOST INVESTORS. They tend to bounce up and down like an out of control Yo-Yo. Okay, so it's not the greatest metaphor ever written and probably a bit of an exaggeration most of the time, but it's clear investors battle the price volatility blues just the same in their attempt to make a buck from investing in the stock market.

As we've noted many times over the years here at **VIEWPOINT**, most investors⁽¹⁾ invest in publicly traded stocks with the primary objective of price appreciation in mind. The overwhelming majority try to buy a stock at \$10 hoping to see it go to \$20 so they can sell at a hundred percent profit and repeat the process on the way to amassing great wealth. Given the stock market's propensity for price volatility there's certainly ample opportunity, theoretically at least, to try to do just that. Note however, in the case of Johnson & Johnson, as an example, (see below) over the last decade,

there wasn't any opportunities to trade the stock for a potential 100% capital gain. Since 2000, JNJ has hit a low of about \$35 in January of 2000 and then a high of about \$65 in the summer of 2008. Perfect timing on that price swing would have netted a nice tidy 85% return (not counting dividends) over the eight year period. But buying and selling JNJ on that basis would've required an investor to make decisions counterintuitive to basic investment fundamentals like P/E ratio. Because you see, JNJ was actually "cheaper" at \$65 in 2008 when it was trading at 13 times earnings then at \$35 when it was trading at 33 times earnings.

But then most investors looking to trade a stock won't hold on for eight years anyway. They're looking to flip it for a gain over a much shorter period of time. The trouble with such a strategy is that it's, well, a whole lot of trouble. It's virtually impossible to do con-

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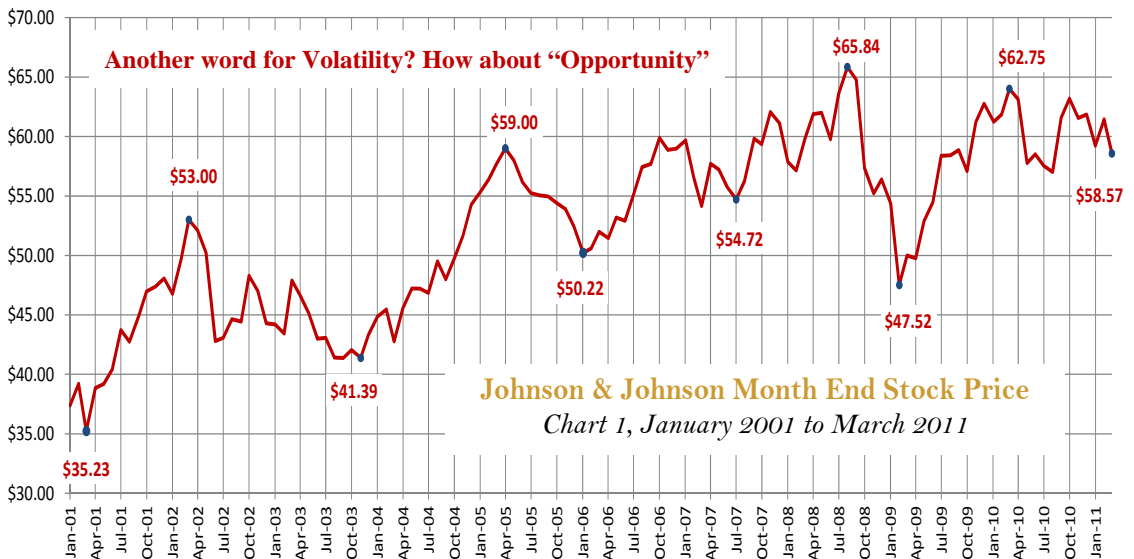
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VIEW FROM THE FRONT SEAT *by Mark J. Deschaine*

Can We Talk? Seriously, about Your Retirement

Retirement's coming whether you are prepared for it or not!

CAN WE TALK? Seriously, it's time we talked straight up on a subject that a lot of folks have been kicking around. And what subject's that? Well, as I'm sure you guess from the title above, why it's retirement of course. Or that impending period of idle we're all working so feverishly to reach. After all, as indelicate as it may be to suggest, none of us are getting any younger, including yours truly. I guess I'm partly feeling the need to bring up the issue of retirement because I turned 55 this past February and I'm beginning to feel it in my bones. Ordinarily, I don't make a big deal out of birthdays. For me, they're pretty much like any other day except I get to choose where the girls and I eat and I get a new shirt or two in a futile attempt to update a seriously dated wardrobe. Other than that, one birthday is pretty much like any other day.

This year's a bit different because turning 55 has become something of a rite of passage when it comes to the issue of retirement. Many retirement plans allow folks to retire at 55, assuming they've got some minimum number of years of service under their belt as an employee. Also, the now famous (or is it infamous?) AARP (*American Association of Retired People*) makes a major push to enroll people into their burgeoning association once they turn 50. Although, I saw from their web site that they actually encourage you to join at 50. Jeez, at 50, really? At that age, why we've barely had a life before we have to start contemplating retiring. Hardly seems fair. Besides, joining AARP at 50 kind of spoils my narrative for this piece, which is to say that I got the idea to talk about retiring because I recently turned 55.⁽²⁾ *But then, as many a veteran VIEWPOINT reader knows, getting knocked off point by an inconvenient fact has never stopped me from expounding on a topic built on a weak premise.*

I guess I'm also bringing up retirement because the subject increasingly dominates the dialog we have with clients and folks that come to see us. Increasingly, over the last year or two, I've got the distinct impression that a lot of folks are feeling like they've lost the match with retirement before they've even begun to fight. The poor performance of the stock market since 2000 and interest rates near zero has seriously hampered many a retirement savings account or 401K, leaving lots of folks feeling way under where they thought they'd be at this point in their retirement planning. And sadly, a recent study by Fidelity confirms their feelings, because it shows that, as of today, the average worker can expect to reach age 65 with about \$110,000 in their 401k plan. Hardly enough to retire.

But that's why we're here: To help you think through the process of preparing for retirement dispassionately, that is, without all the emotion. Our job is to help you plan a smooth transition to retirement with enough safe, predictable and

growing income to provide the kind of retirement you desire.

Retirement Outlook—*Retire to do what, exactly?*

The first question we ask someone when we initiate a conversation about retirement is simply this; "What do you want to do when you retire?" Surprisingly, a lot of people don't know. You'd think that after having given retirement years of thought—*every day while whistling away at the salt mines, see below*—most people would have at least some vague inkling of what they want to do when they finally get around to hanging up the cleats. Usually, they want to be able to not have to work. We get that. At the same time, they often have no idea what they want to do *instead* of work. Many say they'll keep on working to one degree or another simply to keep busy. But again doing what?

Part time jobs in a primary field of endeavor just aren't out there. Part-time brain surgeon anyone?

No matter how you look at it, the retirement issue increasingly comes down to income or more specifically, how does one generate enough income so they don't have to work, or at least be able to work less than they do now. We don't know everything here at *Deschaine & Company*, but we do know that for most people a comfortable retirement is as simple as this: *More income than you spend every month, you're pretty much free to do what you want and happiness ensues. Less income than you spend every month and something akin to misery results.*

Getting a Jump on Reducing Spending

If you're still working and earning a paycheck, spending more than you earn each month isn't necessarily fatal to getting to retirement with enough savings and income to retire comfortably. You may still have time to correct the situation by cutting your spending (and debt) or working harder to earn more money or both. In other words, an enterprising person can make an effort to bring spending inline with potential retirement income *before* retiring. However, once you're retired and your monthly expenses exceed your income, you're really limited to cutting your living expenses (*sometimes dramatically*) because generating more income from your investment portfolio is difficult to do—at least over the short run. The reality of cutting your living expenses once you've retired means reducing your life style in order to keep from running out of money. Not a good situation to find yourself in a year or two into retirement. An increasingly important part of the planning process for the ideal retirement is to begin to rein in spending well *before* retirement. As a wise old fellow wearing bifocals once said, "A penny saved is a penny earned."

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²⁾ Retirement has been on my mind a lot lately, not because I'm planning on retiring anytime soon, I'm not. In fact, I don't see myself ever "retiring." At least in the conventional definition of the term. Retire to do what exactly? Manage my stock portfolio? As of now, my plan is to continue to work managing money until I've completely lost my marbles and then maybe go into politics.

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The Retirement Realities of 2011

Additionally, any planning for retirement in 2011 must take into consideration some of the hard cold realities of the world we now find ourselves. Let's face it, the investment world has changed over the last decade. You can stick your head in the sand and pretend that it hasn't changed or you can adjust to the new economic and investment realities and plan and manage your retirement affairs accordingly. Just know that ignoring the new economic realities isn't going to make them go away.

Let's review just a couple of the new realities (*and compare them to the old*) we must take into consideration when planning for a long and financial secure retirement in today's investment world.

Old retirement reality:

retire at 65, collect a pension check from your employer's defined benefit pension plan and social security and die at 70. In the not too distant past, retirement was relatively straightforward. You worked for 30 or 40 years for one company which provided you with a defined benefit pension plan which meant that when you retired, the company sent you a pension check every month. That check, along with your social security benefits allowed you to live a reasonably comfortable and secure retirement. You worked until you were 65, so your life expectancy after retiring was maybe 5 or 10 years. Chances of outliving your money—*virtually zero*. As long as you lived within your fixed retirement and social security income, you were fine.

New retirement reality: Retire at 55, roll over your underfunded 401K and try to figure out how to generate enough income from your retirement and other savings to live comfortably for the next 25 or 30 (*or even 40?*) years.

In today's retirement world, you're pretty much left to your own devices as to how to make your retirement and savings assets generate enough income to

meet your living needs and how to make them last over what could be 25, 30 or even 40 years of retirement. The combination of people retiring much earlier and living much longer—the average life expectancy now stretches well into their 70s and 80s—means many people in today's retirement reality can look forward to spending many years (*decades in fact*) in retirement. The challenge in today's retirement world is to figure out how to generate sufficient income (*and a growing income to help combat inflation*) to provide for a greatly expanded retirement period. That objective, as we've said many times before is made demonstrably more difficult with interest rates currently at record lows.

We don't know everything here at *Deschaine & Company*, but we do know that for most people a comfortable retirement is as simple as this: ***"If you have more income then you spend every month, you're pretty much free to do what you want and happiness ensues. Less income then you spend every month and something akin to misery results."***

rates were 5 or 6 percent, that was a reasonably viable income generating strategy. You'd generate sufficient interest income to meet your needs and you didn't live long enough to feel the effects inflation and taxes can have on the purchasing power of a fixed income.

New retirement reality: Today, with interest rates on the 10-year Treasury Note about 3.50% that's not a viable income generating strategy. Even if you could buy a 10-year treasury note with a 5 or 6% coupon, by the time the note matured in 10 years you'd be earning virtually nothing after taxes and inflation. Not to mention that you'd be at the mercy of the bond market and whatever the prevailing interest rates were if you had to sell or when it came time to reinvest your maturing bonds to finance the next 10-year leg of your 30-40 year retirement. Not a good place to be if your income depends on locking in a high interest rate to generate needed income.

Old retirement reality:

For the last 50 years or so, retirement planning consisted of saving and investing in stocks (*usually growth stocks*) until you retired. Then as you got closer to retirement you'd begin selling your (*low yielding*) stocks to buy bonds to generate income. When your retirement period was maybe 5 or 10 years and interest

Growing Income from Growing Dividends *You've heard all this before*

The table at the top of page 4 is for Altria Group Inc. (Ticker MO).

Old-hand **VIEWPOINT** readers have seen variations of Altria's data over the years. We keep going back to it as the quintessential example of the kind of high-yield dividend growth stock we recommend to grow income over time and to combat the realities of record low interest rates. We can quibble with moral or social repercussions of owning a tobacco company, but as a business and a long-term investment, Altria is hard to beat. For starters, as Warren Buffett once suggested, the tobacco business is a great business because they make a product that, "costs a penny to make, sells for a dollar and it's addictive." As a result, MO generates exceptional amounts of discretionary cash—even after paying as much as 40% of their revenues in various cigarette and other excise taxes. Most of the cash gets paid to us in dividends.

Bad News is Good News for Investors

Jeremy Siegel in his 2005 book "*The Future for Investors*," noted that Altria was the best performing stock on the S&P 500 going all the way back to 1925. From 1925 through 2003, Altria delivered a 17% compounded annual return, 7.3% better than the index. Such stellar performance would have grown from \$1,000 in 1925 to over a quarter of a billion dollars (*yes as in B*) by 2003. Altria's returns since 2003 have been equally stellar.

As Siegel noted, "*readers may be surprised that Altria is the top performer given the onslaught of government restrictions and legal actions that have cost the company tens of billions in taxes and legal fees and threatened the cigarette manufacturer with bankruptcy. But in capital markets, bad news for the firm often is good news for investors.*"

Many investors shun the stock out of fear of the liability from producing a dangerous product—*cigarettes*—would eventually crush the firm. This aversion to the firm repeatedly pushed down the price of Altria shares which raises the return to investors who continue to reinvest their dividends in the stock over the long-term. According to Siegel, as long as the company survives and continues to be

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Altria Group (MO) Share Price & Dividend Reinvestment 1990 to 2010

Year	A one time \$10,000 investment in MO in December 1990									\$10,000 Invested Annually in MO		
	Mo Share Price	Ann Price Change	Annual Dividend	% Div Change	Year End Cur Yield	Cost Yield	Market Value	Dividend Income	Ann Inc GR	Market Value	Dividend Income	Ann Inc GR
2010	\$ 114.66	21.6%	\$ 5.24	11.0%	4.57%	4.57%	\$ 154,221	\$ 6,739	16.57%	\$ 637,229	\$ 29,121	12.79%
2009	\$ 94.28	22.2%	\$ 4.72	8.8%	5.01%	5.56%	\$ 121,267	\$ 5,781	14.87%	\$ 515,743	\$ 25,819	10.91%
2008	\$ 77.15	-22.4%	\$ 4.34	12.4%	5.63%	6.79%	\$ 94,503	\$ 5,033	16.80%	\$ 413,853	\$ 23,280	15.22%
2007	\$ 99.36	15.8%	\$ 3.86	16.3%	3.88%	5.27%	\$ 115,226	\$ 4,308	20.76%	\$ 520,115	\$ 20,205	18.54%
2006	\$ 85.82	14.9%	\$ 3.32	8.5%	3.87%	6.11%	\$ 95,803	\$ 3,568	12.94%	\$ 440,600	\$ 17,044	11.02%
2005	\$ 74.72	22.3%	\$ 3.06	8.5%	4.10%	7.01%	\$ 80,305	\$ 3,159	13.52%	\$ 374,906	\$ 15,353	11.48%
2004	\$ 61.10	12.3%	\$ 2.82	6.8%	4.62%	8.58%	\$ 63,083	\$ 2,783	12.00%	\$ 298,391	\$ 13,771	10.52%
2003	\$ 54.42	34.3%	\$ 2.64	8.2%	4.85%	9.63%	\$ 53,708	\$ 2,484	14.71%	\$ 256,861	\$ 12,460	12.58%
2002	\$ 40.53	-11.6%	\$ 2.44	12.4%	6.02%	12.93%	\$ 38,149	\$ 2,166	17.76%	\$ 183,853	\$ 11,068	18.91%
2001	\$ 45.85	4.2%	\$ 2.17	7.4%	4.73%	11.43%	\$ 40,706	\$ 1,839	12.36%	\$ 196,673	\$ 9,308	13.18%
2000	\$ 44.00	91.3%	\$ 2.02	9.8%	4.59%	11.91%	\$ 37,298	\$ 1,637	18.57%	\$ 179,141	\$ 8,224	16.27%
1999	\$ 23.00	-57.0%	\$ 1.84	9.5%	8.00%	22.78%	\$ 18,641	\$ 1,380	12.96%	\$ 88,415	\$ 7,073	23.49%
1998	\$ 53.50	18.2%	\$ 1.68	15.1%	3.14%	9.79%	\$ 40,148	\$ 1,222	18.78%	\$ 182,400	\$ 5,727	21.74%
1997	\$ 45.25	20.1%	\$ 1.46	19.7%	3.23%	11.58%	\$ 32,923	\$ 1,029	23.55%	\$ 145,815	\$ 4,704	28.48%
1996	\$ 37.67	25.2%	\$ 1.22	19.6%	3.24%	13.91%	\$ 26,552	\$ 832	23.66%	\$ 113,064	\$ 3,661	31.21%
1995	\$ 30.08	56.9%	\$ 1.02	15.9%	3.39%	17.42%	\$ 20,537	\$ 673	21.23%	\$ 82,298	\$ 2,790	31.94%
1994	\$ 19.17	3.4%	\$ 0.88	10.0%	4.59%	27.33%	\$ 12,659	\$ 555	14.75%	\$ 46,075	\$ 2,115	40.49%
1993	\$ 18.54	-27.9%	\$ 0.80	25.0%	4.31%	28.26%	\$ 11,705	\$ 484	28.11%	\$ 34,890	\$ 1,505	75.22%
1992	\$ 25.71	-3.9%	\$ 0.64	28.0%	2.49%	20.38%	\$ 15,561	\$ 377	30.39%	\$ 34,516	\$ 859	80.21%
1991	\$ 26.75	55.1%	\$ 0.50	47.1%	1.87%	19.59%	\$ 15,797	\$ 289	47.06%	\$ 25,507	\$ 476	141.89%
1990	\$ 17.25		\$ 0.34		1.97%		\$ 10,000	\$ 197		\$ 10,000	\$ 197	

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profitable while paying out a good share of its earnings in dividends, investors should do well. We certainly concur.

The amazing returns for Altria shareholders over the last 75 years illustrates an extremely important principle of investing. What counts is not just growing earnings, but the growth of earnings relative to the stock market's expectations for earnings.

Investors' low expectations for Altria worked to keep the stock price a bargain which allowed astute investors to reinvest their dividends into the stock in perpetual cheap mode. *In other words, a high dividend yield, high dividend growth and reinvesting the dividend at a low stock price is the formula for superior long-term total returns.*

The Beat Goes On

Altria's superior long-term total returns to shareholders have continued over the last 20 years. The table above outlines two investment scenarios for Altria starting in 1990. The first is a one time \$10,000 investment at year end 1990 and all dividends rein-

vested. In the second example we add \$10,000 to Altria at each year end.

In the first example, \$10,000 grows to \$154,221 by year end 2010, but more importantly it now generates a \$6,739 in annual dividend income. In fact the dividend income has grown by more than 19% per year when all dividends are reinvested. The dividend alone grew by more than 14% a year. Not bad for a relatively meager \$10,000 investment.

At the same time, those excellent returns pale when compared to an annual income that grows better than 28.0% a year when investing \$10,000 a year in MO. Investing \$10,000 a year since 1990 in MO and reinvesting all dividends grows your annual income from \$197 a year in 1990 to over \$29,000 a year in 2010. Not to mention that your position in MO is now worth over \$637,000 on an investment of \$200,000 in original capital and another \$214,000 in reinvested dividends for a total of \$414,000 over 20 years. That works out to a "yield on cost"³⁾ of about 7.0% as of year end 2010.

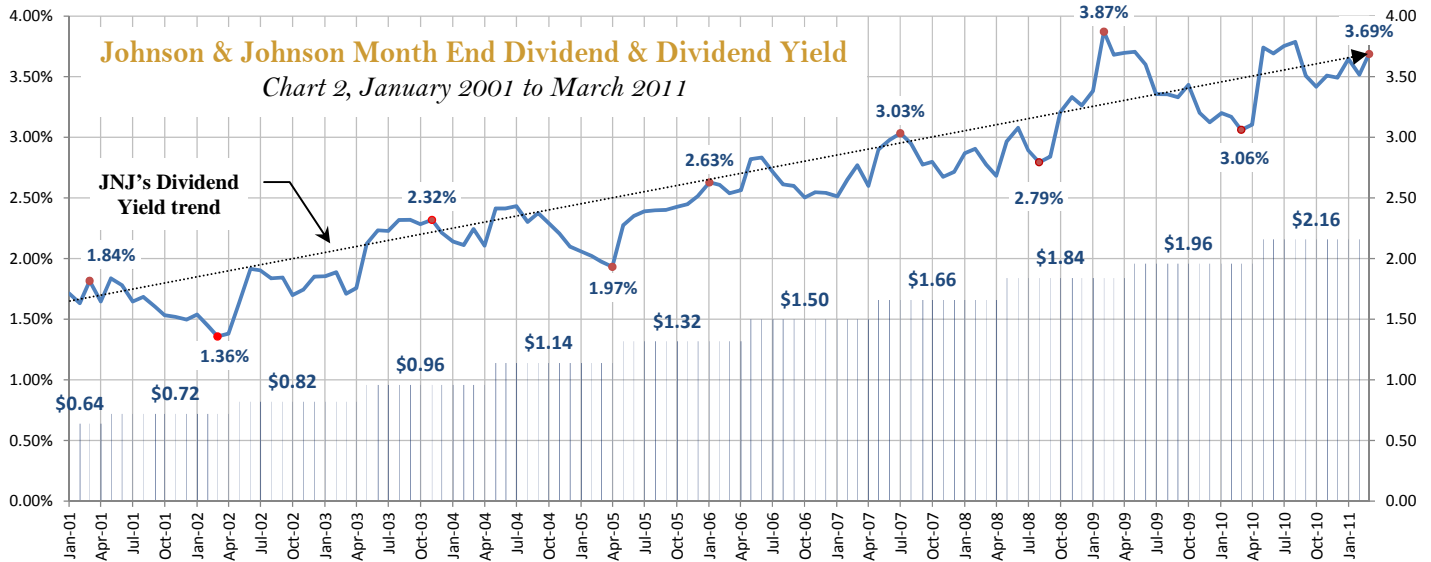
Keeping the Beat Going on

Altria has been a staple in every client portfolio since we began the quest for growing income from dividend stocks in 2000 and will continue to be for the foreseeable future. Which is our way of saying "forever."

The important point is that surviving and prospering in a world of longer retirements and low interest rates requires finding investments to provide a safe and growing income stream. The only way we know how to do that is to own companies like Altria and JNJ and hang on while they grow their dividends at double digit annual rates. *None of this requires us to buy stocks at one price hoping to sell at another.*

The sooner you get started on building a growing income stream from high-yield, dividend growth stocks, the greater your income will be over time. Fortunately, we're in the perfect stock market environment (*rising dividend yields*) for creating future income. The question is: How can we help you get to retirement with enough income to meet your needs? **MJD**

³⁾ Yield on Cost is the current annual dividend divided by the amount you have invested in the stock or your "cost." In the MO example above, we invested at total of \$414,000 over 20 years, \$10,000 a year plus all our dividends. If we divided our current dividend income of \$29,121 by \$414,000 we get a yield on cost of 7.08%. Note: dollar dividend for MO includes the dividend from Kraft and Phillip Morris International which were spun out of MO in 2007 and 2008 respectfully. They both pay nice dividends too.



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sistently and it's certainly impossible to do consistently for anyone who isn't willing or able to spend many hours a week staring at a stock price screen in hopes of doing the investing equivalent of catching lightning in a bottle.

Of course, from where we sit the real problem with trading stocks is that it's completely counter-productive to our primary goal which is to build wealth and produce a growing income over time. We do that by accumulating the biggest pile of shares that generate the largest amount of dividend income as possible. Buying and repeatedly selling stocks does nothing to get us to that objective.⁴⁾ Buying shares and then buying more shares when prices go down, and then again buying more when prices go down. Well, you get the idea.

Making Price Volatility Work for Us

Compare trying to grow your wealth from trading stocks to our methodology. Our primary objective is to identify companies like Johnson & Johnson, which has raised its annual dividend from \$0.08 cents a share in 1985 to \$2.16 this year, or a nice healthy annual growth rate of 14.1% a year. If we've learned anything over the years about how to make money from investing in stocks, it's that anything that grows at better than 14% a year will sooner or later make you rich.

Our secondary objective is to be patient and wait for prices to drop, boosting a stock's dividend yield, so we can capture as much yield as possible with each dollar of new investment. As the price chart on page one for JNJ shows, price volatility gives us endless opportunities to buy when yields are attrac-

tive. Consider that we could have bought JNJ at \$65.84 (a yield of 2.79% in the spring of 2008, or paid \$47.52 for a yield of 4.12% in January of 2009.) The difference in total return, is significant too, as the \$65 dollar price is down 11.0% in capital return while buying JNJ at the \$47.52 price would have appreciated 23.25% thorough the end of March. *The lesson, learn to embrace price volatility with the enthusiasm of an obsessed bargain hunter.*

The objective of buying shares at the highest yield is made a little easier too when we have a portfolio of attractive dividend growth stocks to choose from when reinvesting dividends. With a broad list of quality high-yield, dividend growth stocks to choose from there's always a stock or two that's trading at an attractive yield.

The interesting thing about JNJ's stock price over the last 10 years is that it's gone from \$35 to \$58, at the same time the stock's dividend yield has gone from 1.84% in 2000 to over 3.70% today. Usually when stock prices go up, dividend yields go down and vice versa. JNJ's dividend yield has gone up because the dividend has grown faster than the stock price has been appreciating—which as buyers of JNJ long term, is a good thing. It means that JNJ's stock price is getting progressively cheaper relative to its dividend, a trend exemplified by the rising dividend yield on **Chart 2** above. We see this trend continuing for now, giving us ample opportunity to buy all the JNJ shares we want at progressively attractive yields.

We've repeatedly articulated our belief that dividend yields for the stock market have to rise over the next ten years before stock prices reach a long-term bear market bottom.

JNJ's dividend yield since 2000 reflects that expectation. Even though the stock price has gone up 65% since 2000 (*while many stocks are flat or have gone down over the same period*), because the company's been able to raise the dividend over the same period. As a result, the annual dividend yield has marched steadily upward; as has the stock market's dividend yield. Consider that the yield on the S&P 500 index was less than 1.0% in January 2000—an all-time low by more than 2.0%. It's now about 1.73%—which represents a 92% increase in the markets dividend yield since 2000. Yet a dividend yield of 1.73% is still well below the *average* bear market bottom dividend yield of 6.0%. (*Yes folks, 6.0%! For the whole great big stock market.*) On a yield basis then, we're still a long way from the bottom of the current bear market cycle. That qualifies as the bad news.

The good news is just as **Chart 2** above for JNJ shows, bear markets provide an ever increasingly yield rich environment from which to invest. Having faith in the companies in our portfolios to increase their dividends steadily over time *and* faith in compounding through dividend reinvestment all the way to the bottom of the current bear market cycle should allow us to add to stocks at progressively cheaper prices, build income, and lock in dividend yields as high a 10% (*yes, that's 10%!*) by the end of the decade.

Summing up our process

So, rather than spend our day monitoring stock price movements in hopes of catching the right price to buy and then sell a stock to capture the ever elusive capital gain, we sit

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⁴⁾ Not to mention incurring broker commissions and generating costly taxable events along the way which history has shown is a major reason most investors fail at investing in stocks.

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back, buy companies that are raising their dividend at double digit annual rates, and then look to buy more shares when their price makes their dividend yield most attractive. **Remember, in the end, the investor with the most shares wins!**

JNJ Dividend Forecast—Just for Kicks

With a stock like JNJ, that is to say, a stock with a 67 year history of paying a dividend and 49 consecutive years of *raising* its dividend, its not unreasonable to extrapolate out 10 years and see where the dividend might go. Just to be on the conservative side, we'll use a 10% annual growth rate for JNJ's dividend instead of the company's actual historical 14% growth rate. In the uncertain game of stock market investing *and* in these particularly uncertain economic times, it doesn't hurt to err on the conservative side.

If JNJ does raise its dividend 10% a year over the next decade as we anticipate, the dividend would grow from it's current annual rate of \$2.16 a share to \$4.69 a share in 2020. ⁽⁵⁾ If JNJ's stock price behaves like it has since 2000, that is to say, bounces around and ends up about where it is today, the stock could potentially yield over 7.6% in 2020.⁽⁶⁾ For the record, we think that would be *awesome!*

Interest Rate Watch

Inflation or Deflation? That is the Question

For the most part, interest rates are unchanged since year end. And that prospect along with some further study has caused us to tweak our interest rate expectations just a bit. Not that acting on our prognostication for interest rates is going to make anyone a bunch of money one way or the other. It is however, we believe the biggest risk facing investors in today's financial environment. Interest rates are so low, all they have to do is go back to their historical averages, which all financial markets do eventually, and investor's in long bonds and bond funds stand to lose a sizable chunk of their capital. The operative question is **WHEN** do rates begin to rise? On that point, we conceded in the Year End 2010 **Viewpoint**, we don't have a clue.

On the one hand, the Federal Reserve is printing money at a record rate which historically portend inflationary consequences at some point. Higher inflation manifests into high interest rates. One the other hand, the current weak credit environment could throw us a curve with possible *deflation*.

John Mauldin, in his recent excellent book "*Endgame*" suggests deflation may work to keep interest rates in check for some time to come. We increasingly agree. So, as we said, while interest rates will certainly have to go up eventually, it's impossible to tell when that will be. All we can do at this juncture is keep an eye out for an upward sign or movement in interest rates and report it to you here in **Viewpoint**.

So watch this space for future interest rate bulletins.

The real beauty of a stock like JNJ is the opportunity to buy shares with a growing dividend—as *the yield rises*. That, folks is how to make price volatility work for us. As we're always willing to concede, we could be wrong and stock prices could rise over the next ten years. If that's the case, we'll just have to console ourselves with a healthy appreciation in portfolio value. Somehow, we'll manage.

Higher Earnings Leading to Higher Dividends

"Record earnings fueled by the highest profit margins since 1993 are giving executives more leeway to boost dividends as the bull market enters its third year." So writes Bloomberg News recently. As **VIEWPOINT** readers know, we would take issue with the tag line, "as the bull market enters its third year," only because a rebound from the March 2009 stock market lows, while really nice and all, does not constitute a "bull market" by any historical definition. But then we'll shut up now so as not to cast a negative vibe on the warm and fuzzy feelings investors get every time the market rallies.

Just to be clear, we like stock market rallies too, we really do, honest. Everyone feels good when the stock market rallies, what's not to like. But then again, as we've made a habit of pointing out each quarter, since we're long-term *buyers* of quality companies that pay a growing dividend, higher prices (*while again nice and all*) just makes our investment objective of buying as many shares as possible at the cheapest price possible that much more difficult.

Funny thing though, the stock market. Even after a nice two year rally in stocks (*up almost 100% since the bottom on March 9, 2009 thorough March 31, 2011*) from the dark days of early 2009, when the financial world really did come within a hair's-breath of a complete meltdown, more and more stocks are popping up on our radar screen at prices that are attractive on a long-term yield basis.

Then again, that's how long-term bear markets work, slowly, methodically, and relentlessly, lowering the value of all stocks even as it periodically stages a rally of the magnitude of the last two years. But that's one of the great things about investing in stocks, there's usually an attractive buying opportunity somewhere; we just have to always be on the lookout for them. That's okay, that's what we're here to do all day.

Record Profits Too

Equity analysts now expect profits for the

S&P 500 to rise 16% this year and surpass the \$100 mark for the first time in 2012. As pleased as we are as shareholders to hear such assertions, we also recognize that it's largely the direct result of the layoffs companies have instituted in order to weather the severe economic downturn the last two years. And equally significant the contraction in credit that comes with it. Companies had to do what they had to do to preserve cash to survive. As we discussed last quarter, the operative question now is: "What should companies do with the cash?"

Share Buy Backs etc.

One of the ways companies are choosing to spend the money is to buy back their own stock. Last year the companies in the S&P 500 paid \$325.8 billion to buy back their stock, more than double the lows of 2009 during the height of the credit crisis. It's really no surprise that share buy backs have more than doubled their 2009 amount, after all 2009 was not a great time for companies to be spending precious capital.

It's unfortunate, in our opinion, that the buy back craze has rebounded so quickly. We'd much prefer corporate boards institute a dividend policy that allows us to directly benefit from a company's cash flow growth and excess cash—while at the same time allowing us to remain a shareholder.

The primary argument in favor of companies buying back their own shares suggests that it benefits shareholders because it reduces the number of outstanding shares, making the remaining outstanding shares more valuable. Theoretically at least, we won't argue with that assertion. However, in reality, when management buys back shares while in a long-term bear market, where each year their shares get cheaper and cheaper—*by definition that's what a long-term bear market does, it makes stocks cheaper and cheaper until they eventually hit bottom*—management is wasting shareholders money by overpaying for their own shares. A case in point, Microsoft (Ticker MSFT) one of the most prodigious cash producing companies on the planet. Even though Microsoft bought back more than \$100 billion of its own shares since 2000, its stock has lost an average of 5.9% a year compared to a total return of about 1.3% a year for the S&P 500.

Compounding the negative wealth effects of share buy-backs is the fact that many

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5) In case you're wondering, if JNJ grows the dividend at 14% a year, the dividend would grow to over \$8.0 a share and the stock would yield over 12%. We could reach such dividend yields in an ugly end to the bear market. 6) How can we assume such things? Because dividend yields have reached such levels at the bottom of every long-term bear market since the beginning of time. The last time was from 1978 to 1983. I lived through that period so I got to see and invest in high stock yields first hand.

EQUITY INCOME Portfolio *As of April 14, 2011*

Company Name	Ticker	Price	Yield	YOC
Abbott Laboratories	ABT	51.00	3.76	3.90
Arthur J Gallagher & Co.	AJG	30.06	4.39	5.35
Atlantic Power Corporation	AT	14.58	7.67	7.43
Alliance Bern Global High Inc	AWF	14.72	8.15	9.81
AstraZeneca PLC	AZN	49.00	7.55	7.95
B&G Foods, Inc.	BGS	18.72	4.49	5.75
Black Hills Corporation	BKH	32.44	4.50	6.73
Bristol-Myers Squibb Co.	BMJ	27.61	4.78	5.76
Colgate-Palmolive Co	CL	81.84	2.83	3.93
Clorox Company	CLX	69.64	3.16	4.27
Compass Diversified Holdings	CODI	14.97	9.62	9.34
ConocoPhillips	COP	78.28	3.37	5.04
CPFL Energy Inc.	CPL	86.86	4.21	6.76
CenturyLink, Inc.	CTL	40.00	7.25	9.20
Chevron Corp	CVX	104.88	2.75	4.38
Dominion Resources Inc.	D	44.03	4.47	5.20
Diamond Offshore Drilling Inc.	DO	75.69	0.66	0.61
ENI S.P.A.	E	49.99	5.53	5.48
Consolidated Edison, Inc.	ED	50.09	4.79	6.02
Energy Transfer Partners LP	ETP	52.59	6.80	8.20
EV Energy Partners, Units	EVEP	54.04	5.62	13.52
Federated Investors Inc.	FII	26.15	3.67	4.39
Fifth Street Finance Corp.	FSC	13.09	9.77	11.53
Frontier Communications Corp.	FTR	8.06	9.31	9.89
Gladstone Investment Corp	GAIN	7.49	6.41	10.15
General Mills Inc.	GIS	37.05	3.02	3.84
Genuine Parts Company	GPC	54.01	3.33	6.02
Glaxo Smithkline ADS	GSK	40.75	6.04	5.47
Health Care REIT Inc	HCN	52.17	5.29	10.04
HCP, Inc.	HCP	37.50	5.12	6.54
H.J. Heinz Company	HNZ	50.21	3.58	4.79
Johnson & Johnson	JNJ	60.02	3.60	4.10
Kraft Foods Inc	KFT	32.95	3.52	4.56
Kimberly-Clark Corp.	KMB	65.37	4.28	6.07
Coca-Cola Company	KO	68.31	2.75	4.27
Leggett & Platt Inc.	LEG	22.87	4.72	4.71
Linn Energy, LLC	LINE	38.69	6.82	10.08
Eli Lilly & Co.	LLY	35.75	5.48	6.02
Lockheed Martin Corp.	LMT	77.73	3.86	3.69
Main Street Capital Corp	MAIN	18.44	8.46	11.46
McDonald's Corp.	MCD	77.07	3.17	3.27
Microchip Technology Inc	MCHP	37.53	3.70	5.24
Mercury General Corp.	MCY	38.76	6.19	6.26
Altria Group Inc	MO	26.89	5.65	8.16
Middlesex Water Co.	MSEX	18.09	4.04	5.07
MLP & Strategic Equity Fund	MTP	17.87	5.30	6.44
Maxim Integrated Products	MXIM	24.64	3.41	6.35
Norfolk Southern Corp	NSC	66.98	2.39	4.74
Realty Income Corp	O	34.93	4.97	7.36
Paychex, Inc.	PAYX	32.40	3.83	4.11
Pitney Bowes Inc.	PBI	25.13	5.89	6.35
Plum Creek Timber Co.	PCL	42.50	3.95	3.99
PepsiCo, Inc.	PEP	66.70	2.88	3.42
Procter & Gamble Co.	PG	63.30	3.32	4.46
Progress Energy Inc	PGN	46.01	5.39	5.76
Philip Morris Intl	PM	66.19	3.87	8.28
Pinnacle West Capital	PNW	42.53	4.94	5.03
Prospect Capital Corporation	PSEC	11.51	10.55	13.06
QWest Communications	Q	6.83	4.69	8.42
Reynolds American Inc.	RAI	36.43	5.82	8.99
Southern Company	SO	37.84	4.81	6.19
Suburban Propane Partners LP	SPH	55.71	6.12	7.10
AT&T Inc.	T	30.29	5.68	6.61
Integrus Energy Group	TEG	49.62	5.48	6.16
UIL Holdings Corp	UIL	30.19	5.72	6.32
Unilever PLC ADR	UL	31.78	3.60	3.64
Vector Group Ltd.	VGR	17.57	9.11	10.40
Vectren Corporation	VVC	26.98	5.11	4.86
Verizon Communications, Inc.	VZ	37.71	5.17	6.45
Wal-Mart Stores, Inc.	WMT	53.50	2.73	2.85
Wayside Technology Group	WSTG	14.10	4.70	7.76
Aqua America, Inc.	WTR	21.94	2.83	3.31
World Wrestling Entertainment	WWE	11.31	12.73	10.43

EQUITY INCOME PORTFOLIO

Second Quarter 2011 Update

Bread and Circuses, By Alan Abelson.

WHAT CAN IT DO FOR AN ENCORE! Well, there's always the end of the world or—and this is not only worse but truly unthinkable—the stock market could take a fall.

We're talking of course about 2011 and this still young-year's ram-bunctious first quarter, now history. In case you missed it, the first three months encompassed just about everything shy of Armageddon. To wit: A fiery contagion of revolution and civil war in the Middle East and North Africa that toppled governments and sent dictators scurrying; a horrendous earthquake, nuclear meltdown and tsunami in Japan; chronic financial woes that best threaten to dismember the European Union, exploding oil and food prices—*gad, we get the heebie-jeebies just reciting the lugubrious litany.*

But what man and nature conspire to pull asunder, Wall Street—hurray, hurray—conjured up the balm to ease the pain and provide reassurance that better days lay ahead. Bravely shrugging off each and every daunting calamity, equities pushed resolutely higher, calming the nerves as the market enriched net worth from Portland, Maine to Portland, Oregon, and inspiring investors far from these shores. The market thus again proved, as its increasingly numerous fans contend, it's great at foretelling the future (*except, of course, when it isn't*).

Whether magical thinking or evidence that the planets were in correct alignment supplied the spur, there's no gainsaying that stock turned in a sparkling performance in the three months ending March 31, 2011. The Dow tacked on 742 points, or 6.4% during the January-March stretch. That, in case you're keeping score, was the venerable average's second biggest first quarter gain ever. And swelled its cumulative rise over the past three quarters to 26%. It now stands some 88% higher than it was at its gloom-enshrouded low on March 9, 2009.

Least we be accused of favoring the good old Dow, we feel constrained to note that the Standard & Poor's index was up 5.4% in the March quarter, NASDAQ rose 5.6% and the Russell 2000 bolted to the front of the parade, climbing 7.6%. That lifted the S&P 500 to a level nearly double its March 2009 nadir (*for the finicky: its appreciation was actually 96%*), while the NASDAQ climbed a mind-boggling, heart-pounding 119% in the period.

And judging by the launch of the market on April fools day, no pun intended, this market is by no means ready to call it quits. Granted it isn't yet where it was in 2000 or 2007, when it seemly was discounting everything but the hereafter. But give it a chance it may yet get there, and sooner than you think. Meanwhile, enjoy the ride.

Portfolio activity for First Quarter 2011: Sells DuPont, for a 103% gain since 2009. Trim: Qwest, cut position approximately 50% for a gain of 65% since 2009. **Buys:** Walmart, WMT: at \$52.01, Yield 2.76%, Lockheed Martin: LMT; at \$81.46, Yield 3.68%. **Added to existing positions in:** GSK, WWE, BMY, COP, JNJ, VGR, ABT, PG, and HZN.

Equity Income Portfolio's Trailing Returns

Ending March 31, 2011

	1st Qrt 2011	Latest 1-Year	Latest 3-Year	Latest 5-Year	Since Dec 2000
EIP Total Return	6.0	20.2	5.4	5.2	9.2
EIP Equities	7.3	25.1	6.4	5.6	12.7
S&P 500	5.9	15.7	2.4	2.6	2.0
NASDAQ	5.6	20.4	10.2	6.1	2.9

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buy backs are poorly timed. Companies often announce them in bullish periods, when they're flush with cash. But that's often when stocks are at or near their price peaks, meaning companies are making a poor investment.

Research firm Biryini reports that the biggest year ever for buybacks was 2007 (*after a five year run up in stock prices by the way*) with companies on the S&P 500 buying \$863 billion of their own shares at the brink of the 2-year market correction. Warren Buffett was quoted in 2009 saying; "Most of the repurchases in recent years was foolish, and companies overpaid."

Conversely, in lean times, when many stocks are cheap, companies tend to hoard cash to ensure liquidity. Buybacks in 2009 were a mere \$125 billion as the recession took its toll on Corporate America, while share prices hit their lows for the market cycle in March 2009. Many stocks were down 50% or more from their highs.

In addition, when companies buyback shares, obviously a shareholder is selling shares which reduces or even eliminates their ownership interest in the company. It seems counter-productive to us to want to buy out good long-term shareholders. Don't most companies want long-term, loyal shareholders?

Needless to say, we think a better, more prudent approach to take is to consistently pay out a percentage of earnings in dividends. We like the idea of a company splitting profits with us 50/50. the company keeps half to grow the business and we get half of, ideally a growing earnings stream, to sock away in more shares, building our income and wealth over time.

Seems like a win-win to us.

As always, thanks for reading. MJD



THE FIRM was honored to receive the elite **FIVE STAR** wealth manager award for 2011. The **FIVE STAR** award recipients are selected by Crescendo Business Service after a survey by QMI Research an independent third party industry research firm which assists consumers in selecting wealth managers based on nine selection criteria: customer service, integrity, investment knowledge and experience, client communications, value for fees charged, meeting financial objectives and post-sale services, quality of recommendations and overall client satisfaction.

The **FIVE STAR** award is the only one of its kind to incorporate both client and industry professionals in its evaluation and review of managers. It is an exclusive award given out to less than 5 percent of the St. Louis area wealth managers.

We are very proud of being selected as one of the areas investment advisors to be awarded the **FIVE STAR** award for 2011. Everyone here At *Deschaine & Company* is most proud of the award because we believe it reflects our commitment as a firm to putting our clients first in everything we do.

Not one to rest on our laurels, we'll continue to work hard on our clients behalf in the prudent management of their hard-earned assets in honor of receiving the award.



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