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The Deschaine & Company “Advantage”

It starts with dividend yield and dividend growth, but it doesn't end there.

WARREN BUFFETT OFTEN NOTES that one of his primary investment objectives is to own companies that have a clearly defined “competitive advantage.” He refers to it as an economic “moat,” like the water surrounding and protecting a medieval castle from raids from barbarians. The idea is that the wider and deeper the moat, the more difficult it is for barbarians to take over the castle. The wider and deeper the economic moat surrounding a business, the stronger it's competitive advantage and the more likely the business will produce good results for shareholders. Buffett's unmatched success as an investor certainly lends credence to the concept.

The definition of an economic “moat” in business is where a business has something: a patent, a process, or a market position that allows it to grow and operate at a highly profitable rate of return compared

to its competitors. In other words, for a business to thrive it has to offer something to its customers a tangible benefit that its competitors can't match. Without

such a competitive advantage, the business is just one of many run-of-the-mill “commodity” type businesses that compete on price. Competing purely by offering the lowest price is usually not the road to economic success in the competitive world of business., the occasional success of a Wal-Mart notwithstanding.

While it's difficult for a small investment advisor (*or any investment advisor really*) like us to construct an impenetrable “economic moat” around our business to give us a competitive advantage, we do believe we've constructed a competitive advantage when it comes to managing your money. We believe our **EQUITY INCOME** Strategy has

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Year End Dividend Yield			
Year	D&C	S&P 500	Difference
2010	6.70%	1.97%	4.73%
2009	6.20	2.10	4.10
2008	6.51	2.50	4.01
2007	6.41	2.49	3.92
2006	6.04	2.14	3.90
2005	5.82	1.98	3.84
2004	4.63	1.95	2.68
2003	5.23	1.43	3.80
2002	6.52	1.36	5.16
2001	7.12	1.28	5.84
10-Year Average	6.12%	1.92%	4.20%

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D&C Gets New Highland Digs *By Matt Powers*

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WE ARE PLEASED to announce the Highland office has expanded into new offices located at 1300 Mercantile Drive. In addition, Jason Loyd has joined me in the Highland office. Jason can now be reached at (618) 654-6262.

Jason and I joining forces in the same office makes operational sense and is a natural fit as our

business has grown significantly in the metro-east area since joining the firm in 2009. So, after careful consideration and reviewing a number of options, we settled into a newly renovated space in Highland. Jason and I have built a core of great clients with Highland as a central location to these efforts. Working out of the same office will allow us to provide client service and investment management support to each just as Mark and Marnie are able to do in the Belleville office.

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

The Seven Things Successful Investors Understand

These are the Common Denominators Among Great Investors: We should pay heed.



IN ADDITION TO DOING BATTLE daily with the stock market over the last three decades, I've spent countless hours studying the great stock investors. I've been an advocate of learning from the success of others ever since my father pointed out to me the foolishness of trying to reinvent the wheel. He once told me, "Just about anything you might want to accomplish in this world has already been done. So don't waste time trying to figure out how to do it for yourself from scratch or trial and error. Simply find someone who's already accomplished whatever it is you want to do and figure out how they did it. Then copy what they did." In other words, don't reinvent the wheel.

Ever since then, I've been a believer in learning by studying the success of others starting with learning to shoot a basketball by mimicking the greatest player in the history of the NBA, Jerry West, to throwing a baseball like Denny McLain.¹⁾ When it comes to investing, I've studied such great stock market investors as Warren Buffett and Charlie Munger, Michael Price, Seth Klarman, Ruane Cunniff, Jeremy Grantham and Ken Heebner, just to name a few.

If you study the great investors, it quickly becomes clear that to a man that they tend to focus on a few basic things when investing in stocks.²⁾ The consistency among the few things is truly amazing. I've summarized them into seven things and appropriately call them the seven "things" all successful investors understand. An eighth "thing" arguably could be to keep it simple, but by following the seven things you automatically do that. I do know that most investors are prone to do the opposite which is to make investing complicated, often immensely so. Which is itself detrimental to being a successful investor. Certainly if you're busy worrying about all sorts of things that have no impact on the outcome of your investment plan then, by definition, you have less time to focus on the few things that really matter. But then isn't that true with every aspect of life? As my buddy Confucius once said: "Life is really simple, but we insist on making it complicated."

So, what's the seven things most successful investors understand?

1) Successful investors understand compounding. We talk endlessly about compounding on these pages for a reason, it's the very foundation of understanding investing. At its core, the objective of investing is to compound your money at as high rate of return as possible for as long a period of time as possible. If you're able to do that, you will eventually end up rich. This is the basic definition of compounding most investors can relate. I've used the doubling of a penny previously in these pages to exemplify this definition of compounding. If you double a penny every day for thirty days, in other words, earn a rate of return of 100% on your money every day for 30 days, a penny will grow to over \$10 million

dollars. What's the catch? Well, the catch is being able to earn 100% on your money every day for 30 days. Which, as any experienced investor can tell you, is kind of hard to do. At the same time, most investors assume the only way to earn a high rate of return is from capital appreciation. Yet, as I've tried to explain over the years, stock market history shows focusing on capital appreciation is the most difficult way to try to achieve consistently *positive* returns from investing in stocks, much less consistently *high* returns.

From August 1982 to March 2000 the stock market, as represented by the Vanguard S&P 500 Index fund, compounded at an annual rate of more than 19% per year. The number breaks down into about 15%

The Seven Things Successful Investor Understand

- 1) Successful investors understand compounding.
- 2) Successful investors understand the power of regular cash flow to their portfolio.
- 3) Successful investors understand that success comes from the long-term ownership of a profitable growing business.
- 4) Successful investors understand stock market history and the proper role of the stock market plays in the investing process.
- 5) Successful investors understand diversification.
- 6) Successful investors understand risk.
- 7) Successful investors understand the importance of minimizing fees, commissions and taxes.

annually from capital appreciation and the other 4% from dividends. I rounded the numbers for simplicity. During the bull market, all an investor had to do to earn a healthy annual rate of return was to throw money at the Vanguard's S&P 500 Index fund starting in August 1982, (say with \$10,000) and then regularly sock away additional money (say \$2,500 a quarter?). Had said investor done so, they've earned an annual compounded rate of return of just over 18% and their investment of \$185,000 would have grown to over \$1.27 million.

Yet, numerous studies of *actual* investor stock market returns for that period show that the average mutual fund investor earned less than 6% compounded annually. What accounts for the difference? The studies show the average investor bought *and then sold* their mutual funds, frequently buying at or near market highs and then selling at or near market lows. Doing so at a time, as I said, when all they really had to do to earn above average annual returns was invest regularly in an index fund. Alas, it appears that it's not in the emotional make-up of the average investor to do something so simple.

I also think investors behave this way because they don't truly grasp compounding. If they did, they'd have the confidence to invest regularly and reinvest their dividend income to try to capture as much compounding as possible over as long of a period of time as possible regardless of what the stock market was doing over the short term.

High Returns—Hard to Do

Of course, now the question is: If investors can't earn high returns during a period when the stock market's up more than 19% a year then what chance do they have of earning high returns during periods like the last ten years when stocks are up less than 3% per year? I'll answer my own question: *slim to none*. I suspect that the average investor's 401k

(Continued on the next page)

1) Denny McLain was the last major league pitcher to win more than 30 games in a season when he went 31 and 6 for the 1968 Detroit Tigers (losing twice to Bob Gibson, before winning critical game six in the 1968 World Series.) Denny went on to win 24 games in 1969 before injuring the big toe on his right foot which hurt his pitching shoulder. His major league career ended a few years later with the old Washington Senators. He later spent two stints in prison for securities fraud and theft of pension assets from a company he ran as well as a colorful stint as a Detroit radio personality. See, you learn all kinds of interesting, if not useless information reading Viewpoint. 2) No gender bias intended.

(Continued from Front Seat page 2)

or other investment accounts have posted negative annualized (*capital appreciation plus dividends*) returns since the market peaked in 2000. They're just not aware of it because their accounts been growing from contributing more money with each pay check.

2) Successful investors understand the power of regular cash flow to their portfolio.

Fortunately, capital appreciation is just one part of the compounding equation. Admittedly, it can be an important part (*at least during bull markets*) and if your portfolio appreciates significantly over the next ten years, during a period when we expect stock prices to remain essentially flat, then more power to you.

If the stock market's not going to provide us with an investment environment to earn an easy 19% a year anytime soon, then we've got to find other ways to fuel compounding.

This is where our high-yield, dividend growth strategy comes into play. It generates a growing dividends for reinvestment to build share positions which in turn grows income and builds wealth even without any capital appreciation. In fact, as I note frequently in these pages, since we expect to be net-buyers of stocks over the next ten years, for ourselves and for clients, we prefer stock prices remain flat or even trend down so we can buy as many shares as possible and capture higher dividends with each new dollar invested.

So how do we generate cash flow to our portfolio? We do it four ways: One, by locking in 5, 6, 7% dividend yields. Two, by owning companies we expect will *grow* their dividends 8, 10, or even 12% a year. The combination of dividend yield and annual dividend growth is a powerful contributor to the compounding equation. Three, by reinvesting all or most of our growing dividend income to essentially earn "double compounding" on our money.

Remember: A portfolio with a 5% dividend yield and a dividend growth rate of 10% or better will double in value in ten years and generate twice the level of dividend income—assuming all dividends are reinvested.

Believe it or not, earning a high annual rate of return is not critical to achieving your long-term investment objective. Earning consistently positive returns is equally important. For example if you invested \$10,000 a year and earn 5% on your money, at the end of 40 years you'd have \$1,278,398. So even a modest 5% per year on your money leaves you in pretty good shape come retirement. The sad truth is that most investors aren't going to retire with anywhere near \$1.3 million in savings. **Saving \$12,000 a year at 6.0% gets you to \$1,857,120!**

And four, by adding additional savings to the compounding equation. Great investors understand the importance contributing new money has on the final outcome. In our doubling of a penny example, if I add a penny a day to the equation, (*yes a single, solitary penny, per day, or a total of 29 additional cents*) at the end of 30 days, instead of \$10 million, the total would compound to more than \$42.9 million!³⁾

The significant difference between the two outcomes demonstrates the power of adding new money or "cash flow" regularly to your savings and investment program.

Successful investing requires patience and discipline to save and invest, particularly in the early years when compounding doesn't seem to be adding much to the bottom line. Great investors have boundless patience, discipline to invest regularly and all the time in the world to allow compounding to work its magic, because they understand its power.

3) Successful investors understand that success comes from the long-term ownership of a profitable growing business.

If there's one thing that separates the average investor from the successful one, this might be it. Successful investors understand that the stock market is a "market of stocks," not a "stock market." At the end of the day, success comes from owning great companies bought at reasonable prices and held for the long haul. Not from guessing or reacting to whatever the "stock market" happens to do that day, week or even that year.

Successful investors understand that the stock market is made up of a few great businesses and thousands of mediocre ones. Success comes from owning the few great businesses that have predictable cash flows and consistent and growing revenues. Critical to their long-term success as well, is that successful investors are extremely patient and will wait months and even years to buy great companies when their stock price is cheap. They also know that the fickle stock market will eventually give them the opportunity to buy just about any stock at 50% off its current price at some time in the near future.

Last, successful investors hang onto great

companies for years. Buffett never sells a business as long as it generates positive and growing cash flow. That's because great investors understand how difficult it is to find businesses that can grow revenue and earnings and generate positive cash flow consistently. So great investors own the few businesses that can generate growing cash flows and ignore the rest. *So do we.*

4) Successful investors understand stock market history and the proper role the stock market plays in the investing process.

Successful investors have a keen sense of stock market history. They understand that the stock market runs in cycles and they understand the cycles. That doesn't mean they try to "time" short-term swings in stock prices, only fools looking to be quickly separated from their money do such things, but successful investors understand that there are better times in stock market cycles than others to make major commitments to stocks.

Importantly, successful investors understand that the stock market is simply a convenient place where they can go to buy part or all of the few great business they want to own long term. The stock market is there to serve them, not to instruct them. Either the current price of a stock represents a good value to the successful long-term investor or it doesn't. And they will buy (*or sell*) their interest in the company accordingly. Regardless, the stock market never causes them to panic or make decisions about the companies they own in any way, shape or form.

5) Successful investors understand diversification.

Or rather, successful investors understand the proper role diversification should play in the management of their stock holdings. It's safe to say that the average investor has taken the concept of diversification to the extreme. Let me explain. It's quite common for a prospective client to show us their portfolio, which these days usually consists of a basket of mutual funds and a smattering of individual stocks. Since many investors participate in a 401k, where their primary investment options are mutual funds, this is not unusual. What's evolved over the last decade or so, however, is that investors tend to own a number of mutual funds, all in the name of diversification. Again, this is the product of 401k's and the mutual fund industry offering a huge selection of specialized mutual funds. Large cap, mid-cap, small-cap, sector, country, and industry funds, you name it, there's a mutual fund that specializes in every subset of the stock market.

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3) We're talking even a total return of 6, 8, 10% annually never mind the silly 100% a day for 30 days number in my cute little doubling of a penny example. X) \$10,000 invested initially, and \$2,500 a quarter from 1982 through 2000 equals \$185,000.

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Yet, when we load someone's portfolio of mutual funds into our handy-dandy Morningstar data base and analyze the individual stock holdings within their mutual funds, invariably they're "diversified" portfolio of mutual funds hold many of the same stocks. For example, I recently ran a security cross reference of ten randomly selected equity mutual funds and compared the equity holdings. Of the top 25 holdings across the ten funds there was a total of 77 stocks in common across four or more of the funds. Meaning there were 77 stocks held in four or more of the ten funds. Of the top ten holdings across the funds, there were 27 stocks in common. Again, these are ten equity funds with very different investment objectives. Yet the funds held a significant percentage of their assets in the same stocks. The point is that owning ten different mutual funds didn't really add anything in the way of "diversification" but certainly added costs (*the average annual ex-*

pense ratio for the ten funds was 1.83% with annual turnover of about 200%), complexity and a false sense of security against market volatility from "diversification." Most investor don't realize they could just as easily own the top ten or fifteen individual stocks in a portfolio of their own making and a lot more cost effectively. They don't have to hold any of the hundreds of mediocre stocks a big mutual fund must own because it has billions in assets in must invest. Successful investors reduce their risk by owning a few great companies and knowing a lot about those companies Successful investors have the luxury of owning only what they think are great companies. Mutual funds, because of their size are sometimes forced to own hundreds of mediocre companies. *Being a small and nimble advisor, we have the luxury of owning only the best companies.*

6) Successful investors understand risk. Successful investors understand that when the price of a security or an asset goes down, it becomes *less* risky, as a result, they're much more inclined to buy more shares after a price drop. The average investor thinks just the opposite. After a stock tanks, they usually sell thinking the stock's just to "risky." Successful investors define risk as the chance the company will go out of business or be overrun by competitors or run into the ground by poor management. This "risk" that can be reasonably quantified by investment research. The current price of the stock never enters into the equation.

If the current share price is too high relative to what they think the business is worth, successful investors simply don't buy. No risk there. If the price is low relative the value of the business, they see that as a good thing (*and the lower the price the better*) and the lower the risk they're assuming when buying part or all of the business. But then what's required here is a comprehensive understanding of the business which again, requires doing research. If you're not willing to do the research and know a lot about the companies you own in your portfolio, then maybe its time to turn the management of your investment portfolio over to someone who will. *Ah hum, Like us?*

7) Successful investors understand the importance of minimizing fees, commissions and taxes. Successful investors are ever mindful of the costs associated with investing and unceasingly work to minimize them because they know that every penny saved here is a penny that will compound into dollars over time.

It's through the religious implementation

of the seven "steps" that successful investors keep the investing process simple on their way to earning good returns. *And so do we.*

Walmart: Announces a \$15 billion Buy-Back.

Walmart Stores recently announced a colossal \$15 billion share buy-back authorization. Probably the biggest single company share buy-back ever. Since 2001, Walmart has bought back more than \$66 billion of their stock. One hedge fund manager points out that shareholders are basically allowing the company to sell itself back to the Walton family using company money. The Walton family ownership is now above 48% and growing every day. Grant's Interest Rate Observer, always keen for contrarian value plays, notes somewhat facetiously that at the current buy-back rate, in 15 years there will be one share outstanding. In case you didn't know, Berkshire Hathaway, Warren Buffett's company owns 4% of Walmart. It's noteworthy to point out that neither Buffett nor any member of the Walton family has sold any of their shares back to the company. The moral to the story is that buybacks certainly work to "buyback" the company for existing shareholders—with company, meaning—*shareholder* money.

Cash continues to build on corporate balance sheets as Apple disclosed it's cash including short-and long-term marketable securities as of June 30 was \$76.2 billion. That's more than the annual gross domestic product of 126 countries including Ecuador, Bulgaria, Sri Lank and Costa Rica. The gigantic sum prompted some investors to call for it to use some of the cash for dividend payouts.

Apple's not the only company in the tech sector piling up cash. As of June 30, Microsoft had \$60.9 billion, Google: \$39.1 billion, and Cisco had \$43.7 billion.

The cash horde is making for some strange bed fellows. Ralph Nadder recently called on Cisco to buy back stock and increase their dividend. Apparently, old Ralph's a long time shareholder and is not particularly happy with the company's stock price performance.

Ivory Investment Management recently had the same to say about Microsoft noting the stock is down 20% since 2000. It seems neither Nader nor Ivory have picked up on the fact that the stock market's in a decade long bear market. But give them time. Sooner or later they'll figure it out.

We're just glad to see more folks come around to our pro-dividend position. **MJD**

D&C's gets New Digs in Highland, cont.

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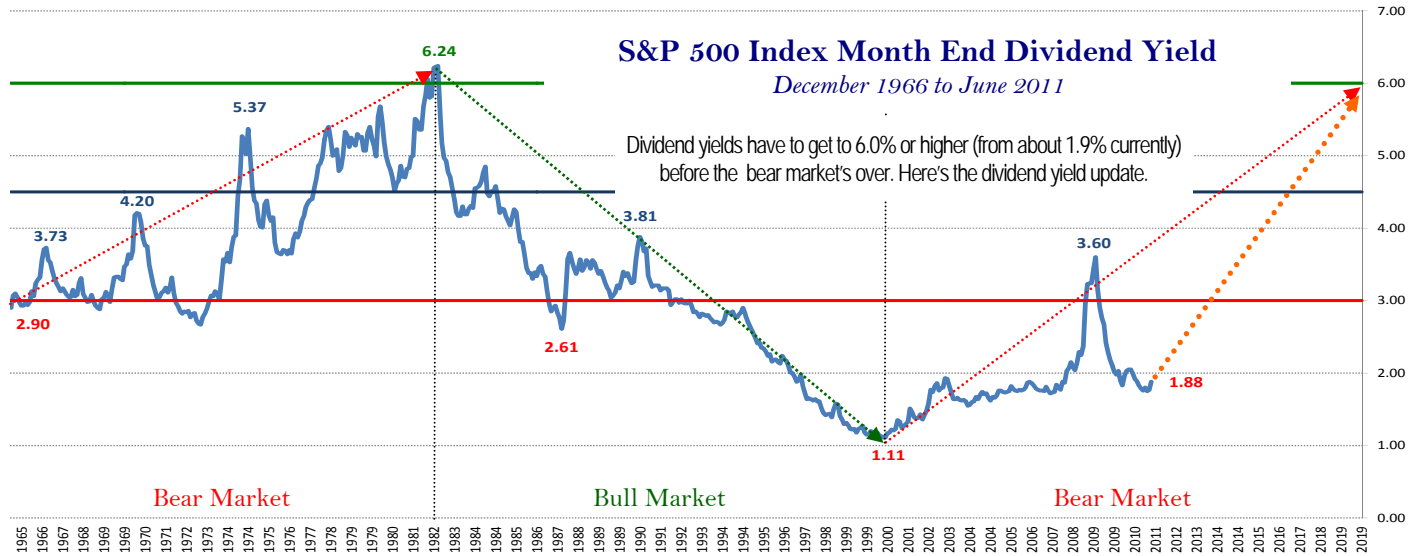
Just as from the very beginning, the firm remains committed to maintaining a manageable clientele in order to tailor each client's investment portfolio to meet their individual goals and objectives within our core strategy.

We're often asked; "how are you able to manage each client's account" or "how often do you look at my account." Our answer is simply... continuously and always. Because we have a small number of clients we're able to manage each client portfolio individually and to meet with each client at their convenience and conduct investment research without getting distracted by outside influences.

Simply stated, we are pleased with our new location and encourage you to visit our new digs if you find yourself in the Highland area.

We want each client who visits us to feel at home and comfortable, therefore we're committed to doing everything we can to make your experience interacting with our firm a positive one.

We truly enjoy working with each of our clients and look forward to further expanding our client relationships in the area from our new office in Highland. **MTP**



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several built in advantages that make it highly competitive with alternative equity investment strategies and makes it more likely that we'll achieve our investment objectives. So what are our "competitive advantages?" Here are the five most important.

High Dividend Yield. Our competitive advantage starts with our **EQUITY INCOME** Portfolio's (EIP) current dividend yield. Look at the table back on page one. It compares our year-end dividend yield going back to the inception of the EIP on December 31, 2001 to the dividend yield for the Vanguard S&P 500 index fund. Over the last ten years, the EIP's dividend yield has averaged 6.12% compared to Vanguard's average of 1.92%. Our competitive advantage, 4.2% at year. Or, to put it another way, in the highly competitive race to make money for clients, we start off each year with a built in 4.2% head start over the stock market. The market has to go up 4.2% just to catch up to our starting dividend yield. If you consider that the stock market has averaged somewhere in the neighborhood of 10% in total return over the last 100 years, that's quite a head start. We'll happily take that advantage each year.

Annual Income Growth Rate			
June 30, 2011			
Year	D&C	S&P 500	Difference
2010	12.0%	2.1%	9.9%
2009	-13.7	-19.6	5.9
2008	-5.1	2.6	-7.6
2007	16.4	18.4	-2.0
2006	26.9	10.0	16.9
2005	47.9	3.4	44.5
2004	19.9	38.6	-18.7
2003	-9.4	7.0	-16.4
2002	15.6	8.1	7.5
2001	38.4	10.4	28.0
10-Year Average	14.9%	8.1%	6.8%

Over time and through compounding, our high yield advantage really starts to add up. If, for example, you invested \$100,000 at the beginning of 2001 and earned the respective dividend returns of the two portfolios alone, \$100,000 invested in the EIP would now be worth \$181,049 compared to \$120,936 for the Vanguard fund. But a high dividend yield is just the beginning of our competitive advantage.

Dividend Growth. The table to the left highlights our second major competitive advantage. Annual dividend growth. When we put together a portfolio of quality stocks with a dividend yield of 6% or better that have a history of growing their dividend at an annual rate of 8, 10 or even 12% a year, we're able to grow dividend income at close to 15% per year even during a decade where we saw negative income growth in three out of the ten years. Let's be clear what the Annual Income Growth Rate Table shows. It's the total annual income growth for the EIP since inception. In other words, it is the compounding effect of reinvesting all dividend income over the last ten years. It is the benefit to a portfolio of a 6% annual income yield and the periodic increases in dividends from the companies boosting their dividends, all reinvested. Think of it as double-compounding from the

combination of dividend growth and full dividend reinvestment. It's what every investor should be doing with excess dividend income.

The bottom line is that we expect to grow annual investment income in an all-stock portfolio at close to 15% a year, if we're able to reinvest all of the dividend income. At a 15% annual growth rate, you math whizzes out there can calculate that your income will double every five years and grow 32-fold over 25 years. That means a portfolio with dividend income of \$6,000 (or a \$100,000 portfolio invested at 6%) would grow to \$192,000 in annual dividend income in 25 years. The question is, can you live on \$192,000 in annual dividend income? And that's just from compounding the growing dividend income through reinvestment. The outcome assumes you don't put any additional money to the pot along the way.

Dividend reinvestment. We just touched on the benefits of dividend reinvestment in the previous paragraph. But it's notable to repeat it here that a portfolio that's not invested in a group of stocks that have the magical combination of a dividend yield of 6% (or even 3 or 4%) and the potential to grow dividends at double digit rates, can't take advantage of the double compounding effect to grow income at 15% a year.

What's missing from most equity investors arsenal in their attempt to make money consistently in stocks is the built in compounding effect of the combination of dividend yield, dividend growth and reinvestment of a growing dividend. Trust us when we tell you that if your income is growing at 15% or better each

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Interest Rate Watch

Economist Lawrence B. Lindsey: Weekly Standard June 13, 2011

Right now, thanks in large part to Federal Reserve policy, Uncle Sam can borrow at an average cost of just 2.5%. The average borrowing cost over the last three decades was 5.7%. Our debt is now \$14 trillion and scheduled to grow to \$25 trillion by the end of the decade. If interest rates normalize over the next year the added interest costs in 2021 alone will be \$800 billion—more than 20 times the mere \$37 billion in budget cuts that tore up Congress in March. It would take virtually all of the cuts in the Ryan Budget just to cover that added interest, much less to start bringing down the national debt. Unfortunately, the Fed is now in a fiscal box. A normalization of interest rates would break the Treasury. Hence a normalization of rates really can't happen—we're stuck in a world in which the Fed must keep rates artificially low in order to prevent a budget disaster.

Low Rates, Slow Growth

Excerpt from Barron's June 25, 2011

McMahon (*Patrick McMahon, Founder MKP Capital*) was already a skeptic about global economic growth prior to the Federal Reserve's glum forecast last week (*June 16th*). He doesn't see world economic growth exceeding 4% annual of the next few years as many countries, including the U.S., avoid making painful fiscal and monetary changes. He sees European interest rates coming down toward U.S. levels and the euro weakening against the dollar. While McMahon doesn't believe a third round of quantitative easing, or QE2, is in the cards, he thinks the Fed's low-interest rate policy amounts to the same thing—an ongoing stimulus program. Governments (*world-wide*) right now are not willing to deal with pain. There is still significant leverage (*meaning debt*) in place and structural problems are not being dealt with. Governments are borrowing liquidity now and trading that for lower growth later. The Great Unwind (*of excess debt*) is still underway.

McMahon sees a global economic slowdown resulting from higher oil prices, consumer spending slowdowns in the U.S. and China, worsening inventory overhang and ongoing bank stresses. The weakness will keep interest rates low. "Rates in the U.S. are not going higher, not until 2013 some time. Investors could be in for very low returns or negative, real (*after inflation*) rates of returns from bonds for years.

We continue to maintain our position that the riskiest investment in a world of full of overpriced assets are long-term bonds and long-term bond funds because of the Federal Reserve's current interest rate policy. The yield on the 10-year U.S. Treasury recently reached their lowest level of the year dropping to below 2.95%. We have no particular opinion on the Fed's interest rate policy which have put bond investors in this pickle by driving interest rates to artificial lows, since it's without precedent in financial history. Additionally, we have no way of knowing when rates will begin to rise or rise by how much. What we do know is that sooner or later they have to rise. However, unlike the late 1970s and early 1980s where interest rates shot up to record levels, we've been pointing out to clients that all interest rates have to do this time is revert back to their historical mean, which is a fancy economic way of saying all they have to do is to go back up to their historical "average" yield, about 4.0% on the 90-day Treasury Bill (from about zero) and 5.5% for the 10-year Treasury Note (from 2.95%). When that happens, long-term bond investors face potential losses of 40 to 50% of their principle. That's the potential consequences for investors, but as Lindsey points out, there are additional consequences for the budget and the economy as well. Our suggestion, don't own bonds or bond funds with a maturity longer than a couple of years. And only the highest rated bonds at that. Then hang onto them until they mature and hope you get your principal back. Interest rates remain essentially unchanged from last quarter.

(Continued from page 5)

year and you're able to reinvest all or most of that growing income into more shares, sooner or later you're going to be rich. It's virtually built into the compounding equation. To not take full advantage of the double compounding effect of a growing dividend in your portfolio is to forego the most reliable and consistent return driver the stock market offers investors.

Fees, Commissions and Taxes In our efforts to earn good returns, we never lose sight of the fact that fees, commissions and taxes are the enemy. While we're cognizant of the fact that we make a living charging fees, we're also aware that they come out of your bottom line. At the same time, our fee of 1% on the first \$2.5 million in assets under management is as much as half the mutual fund industry average. When you combine our competitive fee with our very low annual turnover (*average about 20% per year, or less than 10% of the average mutual fund, mostly because we're buying stocks*) and keeping brokerage commissions and taxes low takes care of itself. On average, our annual cost competitive advantage in fees, commissions and taxes is more than 1% annually when compared to the average equity mutual fund or investment advisor.

Focused Portfolios Last, one of our major competitive advantages is that we own only the best companies in client portfolios. Because each client portfolio is designed and constructed to meet their individual needs and objectives, we can efficiently create a diversified portfolio of only the best companies. Since we don't have billions, to invest, we don't have to own a lot of mediocre companies just to get invested. That's often missed on mutual fund investors. Even a small equity mutual fund with a couple of hundred million dollars in assets has to own two or three hundred companies just to fully invest the fund's assets. Consider that the Wisdom Tree Equity Income Fund, (DHS) a decent low cost ETF with about \$200 million in assets holds over 311 stocks including many from our **EQUITY INCOME** portfolio. Not all 311 stocks are great companies or were bought at good prices.

When we add it all up, we believe our **EQUITY INCOME** portfolio strategy has a built-in advantage over the competition somewhere between 6 and 8% per year in potential return. Does that mean that we're going to outperform the stock market by 6 or 8% a year, of course not. But it certainly doesn't hurt to know that we start out each year with a nice healthy built-in competitive advantage. Can we put it to work for you?

EQUITY INCOME Portfolio *As of July 27, 2011*

Name	Ticker	Recent Price	Dividend Yield	P/E Ratio	52 Week High	52 Week Low
Abbott Laboratories	ABT	52.18	3.53	18.25	54.24	45.07
Alaska Communications	ALSK	7.63	11.27	16.50	11.65	7.46
Alliance Bernstein Global High Inc	AWF	15.11	7.90	NA	15.48	13.31
Altria Group Inc.	MO	26.16	5.81	13.64	28.13	21.82
Aqua America Inc	WTR	21.81	2.80	22.78	23.79	18.90
Arthur J. Gallagher & Co.	AJG	27.58	4.71	20.45	31.92	24.30
AstraZeneca PLC	AZN	49.13	7.54	8.60	53.53	44.98
Atlantic Power Corporation	AT	15.78	7.26	16.50	16.34	12.30
Compass Diversified Holdings	CODI	15.25	9.44	20.50	18.58	13.81
AT&T Inc	T	29.94	5.71	9.31	31.94	25.67
B&G Foods Inc	BGS	20.32	3.74	22.03	21.31	10.50
BGC Partners, Inc. A	BGCP	8.39	7.03	60.61	10.07	4.91
Black Hills Corporation	BKH	30.80	4.71	18.42	34.85	28.12
Bristol-Myers Squibb Company	BMJ	29.04	4.51	14.81	29.73	24.57
CenturyLink Inc	CTL	38.27	7.58	13.50	46.87	35.10
Chevron Corp	CVX	107.57	2.73	9.98	109.94	72.57
Clorox Company	CLX	73.30	3.07	27.40	75.44	60.56
Colgate-Palmolive Company	CL	86.89	2.55	18.25	89.43	73.12
ConocoPhillips	COP	73.61	3.44	9.03	81.80	52.00
Consolidated Edison, Inc.	ED	53.25	4.49	14.12	54.36	45.90
CPFL Energy SA ADR	CPL	29.23	5.39	14.37	30.66	22.42
Diamond Offshore Drilling, Inc.	DO	69.80	0.72	10.70	81.19	57.76
Dominion Resources Inc	D	49.30	3.85	9.05	50.45	41.13
Eli Lilly and Company	LLY	38.46	5.10	8.53	39.78	33.46
Energy Transfer Partners, L.P.	ETP	46.11	7.75	14.88	55.50	44.75
Eni SpA ADR	E	45.43	4.41	9.91	53.80	38.47
EV Energy Partner LP	EVEP	64.46	4.71	60.98	66.40	31.68
Federated Investors	FII	21.89	4.39	14.03	28.57	20.01
Fifth Street Finance Corp	FSC	11.52	10.12	17.24	13.95	9.79
Frontier Communications	FTR	7.67	9.78	40.16	9.84	7.39
General Mills, Inc.	GIS	37.80	3.03	14.77	40.00	33.11
Genuine Parts Company	GPC	54.48	3.16	17.18	57.66	41.60
Gladstone Investment Corp	GAIN	7.25	6.97	9.65	8.55	5.50
GlaxoSmithKline PLC	GSK	44.89	4.69	37.74	45.31	34.85
H.J. Heinz Company	HNZ	53.29	3.43	17.42	55.00	44.35
HCP Inc	HCP	37.52	5.04	40.32	40.75	31.87
Health Care REIT, Inc.	HCN	54.04	5.15	104.17	55.21	44.07
Integrus Energy Group Inc	TEG	51.46	5.29	13.68	54.45	46.73
Investors Real Estate Trust	IRET	8.19	8.38	15.60	9.80	7.97
Johnson & Johnson	JNJ	65.92	3.32	15.06	68.05	56.99
Kimberly-Clark Corporation	KMB	66.93	4.06	15.13	68.49	61.06
Kraft Foods Inc	KFT	34.91	3.32	20.41	36.02	28.76
Leggett & Platt, Inc.	LEG	23.16	4.66	21.01	26.95	18.83
Linn Energy LLC	LINE	40.30	6.48	22.50	41.13	27.17
Lockheed Martin Corporation	LMT	80.82	3.56	10.96	82.43	67.68
Main Street Capital Corp	MAIN	18.42	8.28	8.29	19.98	14.61
Maxim Integrated Products	MXIM	23.40	3.59	18.42	28.44	15.67
McDonald's Corporation	MCD	88.02	2.70	17.83	89.57	68.59
Mercury General Corporation	MCY	38.00	6.29	14.51	45.08	37.29
Microchip Technology	MCHP	34.24	4.02	17.24	41.50	27.46
Middlesex Water Company	MSEX	18.38	3.96	18.62	19.31	15.90
MLP & Strategic Equity Fund	MTP	17.10	5.60	21.71	19.60	16.19
Norfolk Southern Corporation	NSC	75.55	2.01	17.39	77.20	51.53
Paychex, Inc.	PAYX	29.53	4.20	21.74	33.91	24.65
PepsiCo Inc	PEP	64.07	3.05	18.83	71.89	62.05
Philip Morris International	PM	71.92	3.56	16.26	72.50	50.54
Pinnacle West Capital	PNW	43.73	4.80	15.72	45.64	37.90
Pitney Bowes Inc	PBI	22.14	6.64	14.95	26.36	19.06
Plum Creek Timber Company	PCL	39.03	4.30	40.00	44.28	33.11
Procter & Gamble Company	PG	63.09	3.19	16.75	67.72	59.17
Progress Energy, Inc.	PGN	47.47	5.22	16.50	49.03	41.61
Prospect Capital Corp	PSEC	10.07	12.03	7.53	12.38	9.09
Realty Income Corporation	O	34.11	5.07	28.74	36.35	31.35
Reynolds American Inc	RAI	35.37	5.65	15.67	39.87	27.14
Southern Co	SO	40.26	4.56	17.33	40.87	35.05
Suburban Propane Partners LP	SPH	48.15	7.06	16.67	58.99	47.17
The Coca-Cola Co	KO	69.19	2.63	12.99	69.82	54.43
UIL Holdings Corporation	UIL	33.08	5.22	14.66	34.34	25.72
Unilever PLC ADR	UL	32.67	3.62	15.29	33.40	25.90
Vector Group, Ltd.	VGR	17.70	9.04	21.23	19.81	15.37
Vectren Corp	VVC	27.22	5.05	19.72	28.84	24.08
Verizon Communications Inc	VZ	36.28	5.37	29.76	38.95	28.03
Wal-Mart Stores, Inc.	WMT	53.59	2.49	12.36	57.90	50.00
Wayside Technology Group	WSTG	13.35	4.72	13.32	15.49	8.89

EQUITY INCOME PORTFOLIO UPDATE

Second Quarter 2011 Dividend and Share Buy-Back Update

PRELIMINARY RESULTS SHOW that Standard & Poor's 500 stock repurchases in the first quarter surged 62.6% from the level of a year earlier, to \$89.8 billion. That makes seven consecutive quarters of growing buybacks, but only a 4% rise over 2010's fourth-quarter tally of \$86.4 billion. S&P senior index analyst Howard Silverblatt notes that the 4% increase is significantly less than the 8.1% average share-price gain in the same period, and so translates into fewer shares being bought back. "At this point, companies are continuing to use buybacks to control employee (*stock*) options, as well as shares used for dividend-reinvestment programs," he said.

TrimTabs CEO Charles Biderman observed last week that while companies are buying back stock, insiders aren't. "We've never seen such a sharp contrast between what insiders are doing with their own money and what they're doing with the money of the companies they manage," he said. Biderman thinks they "seem worried about what will happen to the economy when the Fed stops printing money." He adds that while "insiders are willing to use corporate cash to try to support the value of their stock based compensation, they don't seem to think their stocks are attractively priced"

Jason DeSena Trennert, chief investment strategist at Strategies Research Partners, isn't a fan of buy-backs. He wrote in a recent research report that "investors are increasingly rewarding" corporations that use their available cash to pay down debt or increase dividends, bestowing little credit on those companies that buy back stock noting: "A world marked by financial repression in coming years will, in our view, only strengthen the importance of dividends in the context of total return, while buybacks will be likely to enhance the reputation of corporate treasurers as poor market timers during a period in which business cycles are likely to be shorter."

S&P's Silverblatt, however, says he has "yet to see any convincing evidence—academic or practical—which proves that one is better than the other. The difficulty of obtaining proof lies in the ability to isolate the cause and effect over a long enough time period."

Dividend Outlook

Dividends continued their merry march upward in the second quarter. If dividends were a paycheck, dividend investors would have received an 11.1% raise in the first half of 2011. On a total dollar basis, U.S. companies paid out \$30.2 billion to shareholders in the first-half in dividends compared to \$26.5 billion in dividend payments for the same period in 2010.

Silverblatt looks for pretty much of a repeat performance over the rest of the year because of robust earnings "We expect to see dividend increases continue across the board for all sectors during the second half of 2011, but at a slightly lower pace.

Portfolio activity for First Quarter 2011: Sells World Wrestling Entertainment, Inc. cut their dividend. Loss of 24%. **Trimmed:** EV Energy Partners, gain of 152% on the position sold. **New Buys:** None. **Add to existing positions in:** GSK, LMT.



Investing without a Strategy is like Sailing without Experience: Never a Good Thing to do! By Jason Loyd

LIKE A SHIP WITHOUT A RUDDER, many brokerage firms have gently nudged their investors out to sea without providing them with a proper investment strategy. Indeed, no reasonable person would head out to sea without first being an experienced sailor themselves or having someone on board who is highly experienced in the art of sailing. So why do so many people invest their capital without a strategy? Well, quite frankly, we've found that it is as simple as many folks have never been taught what exactly is a strategy. Yet, having a strategy is absolutely essential for long-term investment success. We've seen far too many good folks sold on the idea that a strategy is simply owning a fancy financial plan with lots of glossy historical charts that rely on a rising stock market and strong economic growth in order to achieve their plan. Or, even worse, the plan may be predicated on nibbling on the illusive carrot of costly insurance (*annuities*) and other high commission products. At their worst, many insurance based investments are designed with large up front commissions to the salesman and high fees for the insurance company. At their best, they're nothing more than a rusty old ship, adrift at sea leaving investors still in need of a strategy.

The genesis of a sound investment strategy starts with basic but clear-cut objectives. Without a doubt, most investors today are schooled to accumulate a specific portfolio value over time. In other words, grow a pile of money. However, there are other investment objectives that may be more appropriate for their individual needs or the market environment. Like our primary objective—which is to compound our clients' money and accumulate a level of investment income by the time they retire. Whatever the individual long-term investment objective may be, that's just the starting point to constructing a sound investment strategy. The next question we need to address is the methodology or strategy one uses to achieve their goal. A true investment strategy incorporates the many different methods, investment options, and specific actions that might be taken *when* the investment landscape changes. Which, obviously, we know it will. For example, what to do when major market movements occur; such as stock prices suddenly dropping or rapidly grow say 10, 20, 50% or more. Note: we've had to make

a few adjustments to individual client strategies since the stock market has gone up almost 100% since the March 2009 lows. A good thing, of course, but it still requires "rethinking" one's long-term strategy. Periodic rethinking is critical to the process if for no other reason than to verify if the current investment strategy is still appropriate and viable. When significant price movement occur, we must seek to understand why it's happening and to rely on the strategy we have crafted to address it, while not letting our emotions rule the day.

The next item necessary to building a strategy is to choose the investment vehicles that complement the strategy. Wall Street has kept the average investor in a state of utter confusion here, with a multitude of investment options including mutual funds, stocks, bonds, annuities, options, ETF's, UIT's, closed end funds, and the list goes on, to choose from. Many new investment tools have come along and with the Internet have turned many investors into "traders" or even "day traders." Falling into the trap, many investors have fired up their computers, rolled the dice, and lost everything. They mistakenly and hyper-actively shoveled around their capital without a clear strategy. Instead, folks need to take their time and learn about the investment vehicles they or their advisers are using. They need to factor in liquidity, transaction costs, commission, and tax ramifications when undertaking such an aggressive, often futile short-term trading strategy.

A sound investment strategy will not only help investors achieve their objectives, but also give them the confidence to face an uncertain future. Here at *Deschaine & Company*, we've designed a proven investment process and repeatable action steps for investing your capital consistently by reinvesting a growing dividend to build shares and future income. We enjoy it more when the seas are calm *and* when the major swells come in; but we've also created an actionable *strategy* to expand portfolio income even when the seas get rough. Obviously, we don't claim any guarantees or omniscience about the investment weather outlook, but we do believe that our core strategy of compounding a growing dividend stream will provide our clients a good chance of arriving at bay—safe and sound. Perhaps a bit sea sick occasionally, but safely at bay none-the-less.

"If one does not know to which port one is sailing, no wind is favorable."

- Lucius Annaeus Seneca