

Executive Summary

Rotation to Dividend Payers: In March, a rotation away from lower dividend or non-dividend paying stocks into dividend paying stocks took place, signaling a defensive environment.

Q1 Leaders: Utilities, Healthcare and Technology

Q1 Laggards: Consumer Discretionary, Consumer Staples, and Industrials

Dividend and Earnings Growth

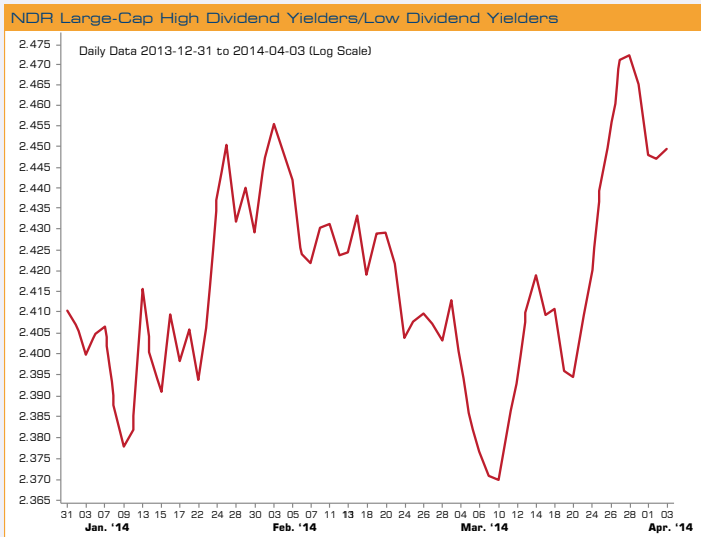
One of the highlights of the first quarter was a brief buying opportunity when the S&P 500 Index declined 5.8% in late January. The market volatility was accompanied by quarterly out-performance of T-Bonds, Gold, REITs and Preferred Stocks. The S&P 500 Index recovered to finish the quarter up a choppy 1.81% while the Dow Jones Industrial Average dropped 0.15%. In March there was a decided rotation from lower dividend or non-dividend paying stocks into dividend paying stocks. The transition is not unexpected as the market pauses from a strong 2013 rally and we suspect it is more than likely in the final stage of a bull market. Historically dividend paying stocks are more defensive, offering an attractive alternative during market uncertainty. One popular philosophy describes dividend investors as being “paid to wait” during market changes which may enhance long term total return. Below is an illustration of large cap dividend yielders out-performance vs low dividend yielders during the first quarter.

Sectors

Defensive sectors such as Utilities rose 9.02% followed by Healthcare up 5.40% versus the S&P 500 Index’s meager increase of 1.81%. Early in the quarter the portfolio weighting in Utilities was increased by adding to Wisconsin Energy yielding 3.33% and Nextera Energy 3.09%. In the Healthcare sector we own market leaders including Pfizer 3.23%, Merck 3.14%, Johnson and Johnson 2.68% and Amgen 2.05%. We believe the Healthcare sector has long-term earnings and dividend growth potential due to positive market demographics and expansion into the emerging markets region. The Financial sector slightly outperformed up 2.15% evidently in anticipation of a successful Federal Reserve Comprehensive Capital Analysis and Review (CCAR) and increased capital distribution allowances. Our largest financial holdings continue to be Wells Fargo 2.42%, JPMorgan 2.68% and PNC 2.23% all of which we believe are high quality and have the potential to increase earnings per share and dividend payouts.

Within the Technology sector we like KLA-Tencor yielding 2.59%, Intel 3.40%, Apple Computer 2.29% and Hewlett-Packard 1.96%. Although the Technology sector historically does not offer the highest yields it currently leads for the fifth consecutive quarter (year over year) for dividend per share (DPS) growth being up 36.4%. We believe this sector will continue to add value via higher earnings and broader representation in dividend growth.

The Consumer Discretionary sector was the poorest performer for the quarter being down 3.16%, but *FactSet* has projected it will have the highest 2014 DPS growth of up to 20.2%. The portfolio owns several Consumer Discretionary names such as Home Depot yielding 2.35%, Las Vegas Sands 2.45% and Time Warner Cable 2.14%. The portfolio is underweight the Consumer Discretionary area. During the quarter the dividend-heavy Staples, Energy, and Telecom sectors lagged but picked up momentum in March. As we enter a seasonally weak period from April to October we seek to continue to take profits in overvalued stocks rotating into undervalued equities with above average dividend yields.



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The S&P 500 measures the performance of the 500 leading companies in leading industries of the U.S. economy, capturing 75% of U.S. equities.

The Dow Jones Industrial Average is a stock market index that shows how 30 large publicly owned companies based in the U.S. have traded during a standard trading session in the stock market.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performers of developed markets outside the U.S. and Canada.

The MSCI Emerging Markets Index is a freefloat-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

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Index returns include the reinvestment of income and dividends. The returns for these unmanaged indexes do not include any transaction costs, management fees or other costs. It is not possible to make an investment directly in any index.

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