# The Copeland Review

First Quarter 2020

*"We believe that stocks with sustainable dividend growth consistently outperform the market with less risk."*


*Some say the world will end in fire*
*Some say in ice…*
*From what I've tasted of desire.*
*I hold with those who favor fire…*

*- "Fire and Ice," Robert Frost*

We would like to express our gratitude for everyone on the front lines dealing with COVID-19, from those in the healthcare industry to those keeping the food supply chain open and everyone in between. Our hearts truly go out to you as well as to those individuals and families directly impacted by the virus. We wish everyone strength and good health throughout this difficult period.

In this difficult time, you can be confident that while Copeland's offices are closed, consistent with state and local mandates, we have a sophisticated business continuity plan in place, and continue to operate at full capacity to serve our clients' needs.

### *Fire*

To say that this is the most difficult quarterly missive we've ever written is an understatement. Even in the Great Financial Crisis – during which we had genuine existential concerns about the financial system – we felt well qualified to opine on the situation, having lived through and studied past crises, and generally understanding the policy responses that were required by the circumstances. Today's crisis on the other hand looks more daunting, and more rapidly evolving. This is not a single fronted war that can be fought with only monetary measures, or even a strictly economic war that can be won by marrying aggressive monetary and fiscal measures. Instead, this challenging period will only be put completely to rest when we also have some real measure of scientific success in combating the virus. Even then, our lives and our culture are likely to be changed in ways both big and small for years to come.

Against that backdrop, we were reminded of Frost's words, penned exactly 100 years ago. Though Frost – contemplating how the world might come to an end – declined to include the inglorious possibility of a global pandemic alongside fire and ice, that has not prevented COVID-19 from registering a truly horrendous global toll.

In addition to staggering statistics of those sickened or killed by the disease, people throughout the world have put their lives on hold for weeks, rarely leaving their homes, let alone engaging with co-workers or friends, for fear that they will only exacerbate the spread of the disease. Cherished institutions are closed, sports seasons are cancelled, school years have been cut short and commercial activity has been severely curtailed – if not outright banned until we see some improvement in the virus data.

This is in stark contrast to how we started the year. In January the IMF was calling for handsome economic growth across most emerging and developed economies.[1] Today, a worldwide recession has begun.[2] Domestically, businesses have been forced to shutter their doors and have laid off millions of employees in response.[3]

The hospitality industry has been hit especially hard. Hotels, restaurants, amusement parks, cruise lines and movie theaters are all in severe economic distress. The transportation industry is equally in the ashcan: airlines have eliminated many flights, rental cars are languishing in overflowing lots, and Uber has seen ride activity fall by up to 70% in some cities.[4,5,6] The scope of the carnage goes well beyond this select group however, weighing in varying degrees on everything from elective medical procedure volumes, to brick-and-mortar retail, to the auto industry, where sales have come to a screeching halt.

One ancillary result of this diminished economic activity has been a steep decline in the demand for fuel. And, it couldn't have come at a more difficult time for energy companies, as Saudi Arabia and Russia - two of the world's largest oil producers - were concurrently locked in a vicious price war, exacerbating the collapse of crude oil prices. While the two countries have since come to an agreement to cut supply, the cuts are modest relative to demand destruction, much of the industry remains in dire economic straits, and bankruptcy remains a real possibility for marginal producers.

Unfortunately for all of these industries, and many others, while revenues have slowed to a trickle, costs have not followed suit. Rents and mortgages are still due, utility bills will still come in and banks still expect loans to be repaid. As a result, corporate profit expectations are falling and forecasts now call for second quarter GDP to be down by more than 30%.[7] The duration of the decline is more important than the depth however, and given its dependence on the unknown path of the battle with a virus, it is even more difficult to predict. A conflagration of this magnitude will not be doused easily.

But it will be doused!

The first order of business is to contain the virus. The world-wide health care industry is working furiously to develop tests and therapeutic drugs to stop the spread and come up with a cure, with many promising therapies already in test phase. There is a global race for a vaccine, and one is likely to be ready sometime next year. Once the grim Covid-19 statistics start to abate confidence will slowly return and pent-up demand will be unleashed.

In the meantime, while economic policy won't win this battle alone, rest assured that historic monetary and fiscal stimuli ARE being applied to the global economy. Therefore, while the most bearish forecasts call for devastation that has certain parallels to the Great Depression, it is equally important to recognize significant differences in policy responses as well.

First, in 1929 the US congress instituted the infamous Smoot-Hawley tariffs on a dozen of our trading partners, who, in turn, forcefully retaliated. Alternatively, today, previously announced tariffs are being partially rolled back.[8] Secondly, in 1928 the discount rate was raised from 3.5% to 6%. Today the Federal Reserve has lowered interest rates to near zero. Third, over the course of the Great Depression thousands of banks failed, while today our banks are in far healthier condition.[9] Fourth, during that fateful era fiscal tightening occurred as congress attempted to balance the federal budget. Today, congress has approved huge deficits to stimulate the economy. Finally, between 1929 and 1933, the money supply shrank by 40%.[10] Today, the Federal Reserve balance sheet is exploding upwards by trillions of dollars.[11] For perspective, even the response during the Great Financial Crisis – which, at the time was absolutely unprecedented – pales in comparison (Chart 1). Back then, the Fed's balance sheet popped by over $1.2T in nine weeks, but not until we were deep in a recession. By contrast, though we may only be in the early phases of a recession today, the Fed has tacked $2.2T on to its balance sheet in just seven weeks, with talks of more stimulus to come.

The most recent factor in those deficits is the Coronavirus Aid Relief and Economic Security (CARES) Act, passed by congress in late March. Though this $2 trillion package is but one element of stimulus Uncle Sam is throwing at the economic malaise, it covers a lot of ground. The Act provides relief for individuals, small businesses, large corporations, hospitals, and state and local governments. Individuals will receive direct payments and businesses with fewer than 500 employees that maintain their payrolls will be eligible to receive up to 8 weeks of cash-flow assistance that will be treated as a grant. Large corporations are eligible to receive low interest loans for up to 5 years with the airline industry specifically targeted for relief.[12] This package is just the tip of the global stimulus iceberg though, as the US is not alone in establishing such a package.

Indeed, the firehoses are out!

*…But if it had to perish twice*
*I think I know enough of hate*
*To say that for destruction ice*
*Is also great…*
*And would suffice.*

**ICE**

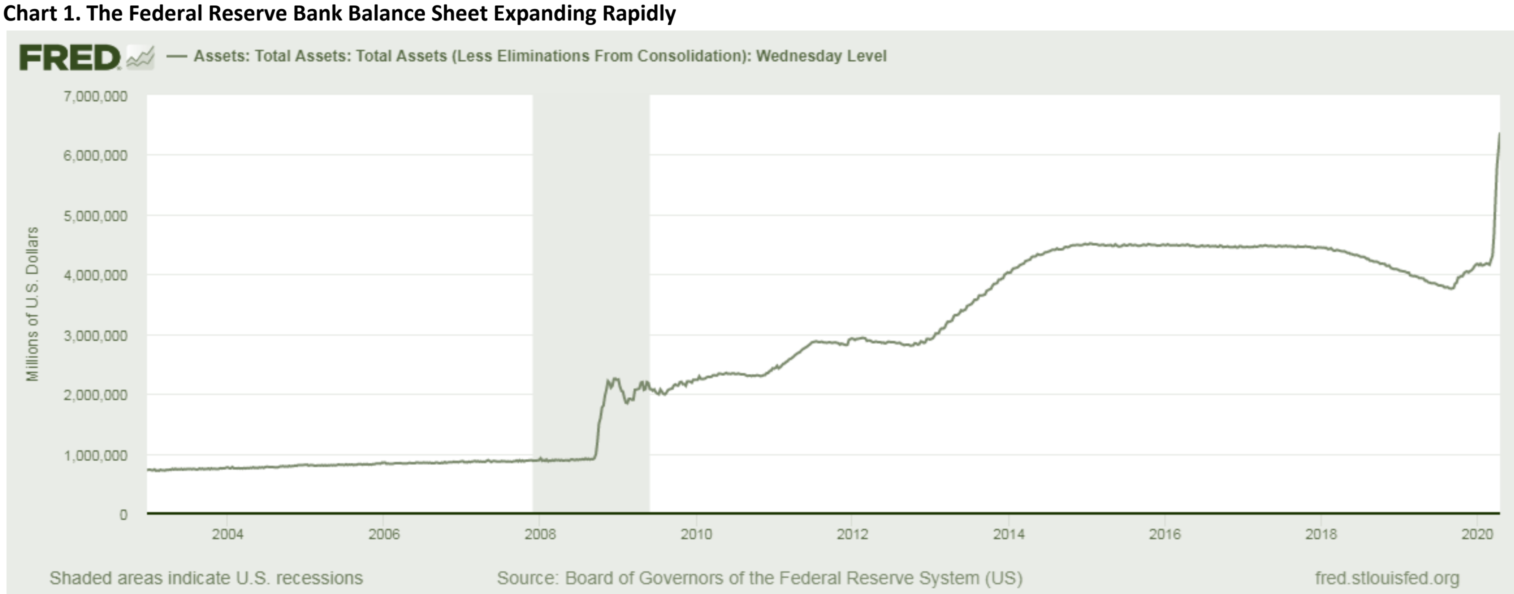
Through most of the first quarter, there was however one area assuredly not on fire: global equity markets, all of which have turned ice cold. In fact, with the basketball tournament of the same nickname unceremoniously cancelled, stock markets around the world gave new meaning to the term "March Madness." As virus fears accelerated, so did volatility, with the VIX Index spiking to levels not seen since 2008. The US stock market, as measured by the S&P 500 Index, saw its fastest 30% drop in history, shedding 34% in only 24 trading days. No surprise, industries most impacted by the virus led the declines, though few areas emerged unscathed. While a furious rally closed out the quarter and continued into April, we will not fall prey to the illusion that we've been given the all clear. A tough road lies ahead for the economy, corporate earnings and employment, and as a result stock market volatility is likely to persist.

**Dividends & The Virus**

Faithful readers of these Reviews know that Copeland only invests in companies that consistently raise their dividends year after year. Focusing on Dividend Growers has proven to be an excellent investment approach through the years as it leads one to equities with greater business resiliency. These companies tend to have inherent stability supported by strong competitive advantages and leadership teams that maintain strict capital allocation discipline. These attributes, in turn, translate into what we believe to be strong profitability and excellent returns over time.

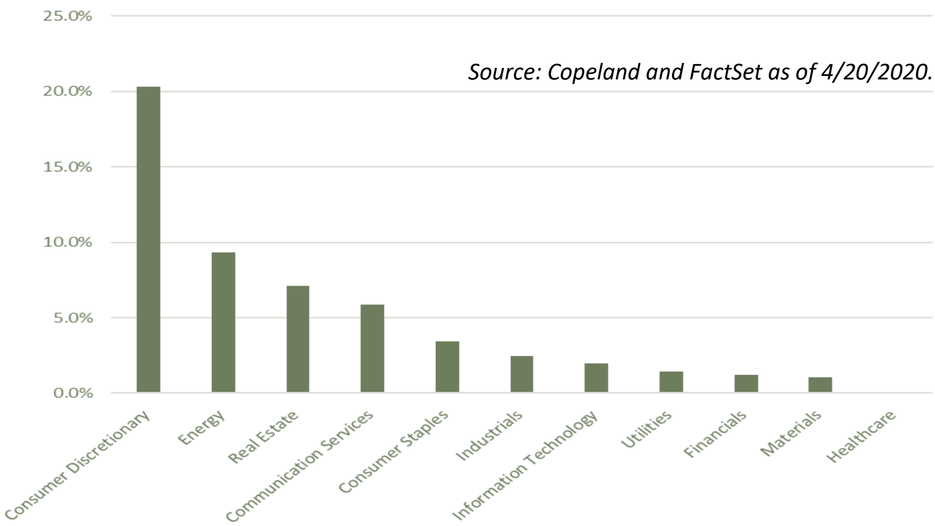
Dividends are an especially useful guide during bear markets because the dividend decision is an important gauge of management's confidence in the future. We fully expect that many companies will cut or eliminate their dividends in 2020, similar to the experience of prior recessions. Often that is wise given the uncertainty of even the near future and

**Chart 1. The Federal Reserve Bank Balance Sheet Expanding Rapidly**




*Source: Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/WALCL*

**Chart 2. Percentage of Dividend Growth Stocks Cutting or Suspending Dividends by Sector: Between 3/1/20 and 4/20/20**




the importance of maintaining a strong balance sheet during volatile times. Occasionally this can even lead a stock to rally following a dividend cut, as the balance sheet suddenly becomes more secure…even if only temporarily. We're happy to leave such high-risk stocks to turnaround and deep-value investors.

Alternatively, Copeland's focus is on ensuring that if the economy and markets remain weak, our companies will survive and even flourish. Since only businesses with the most resilient models, led by adept management teams, are likely to have the wherewithal to raise their dividends in this environment, we believe our Dividend Growth approach is an effective way of identifying such survivors. By putting together a portfolio of these names, we believe we can more predictably attain higher full-cycle returns, while sustaining the lower downside participation profile to which we aspire.

In the current downturn, despite the massive economic dislocation described above, dividend cuts and suspensions have been slow to materialize among domestic Dividend Growers, with only approximately 5% of the 1300 companies that were dividend growers prior to the crisis announcing negative dividend actions between March 1st and April 20th.

Largely these negative dividend actions have been concentrated within sectors directly impacted by the virus, including: Consumer Discretionary, with its many closed retail establishments; Real Estate, which is dealing with potential rent forbearance; and, Energy, following massive oil price declines (Chart 2).

As the consequences of the shutdown flow through the economy, the pain will likely spread more broadly. In the meantime, many companies have chosen first to eliminate stock buybacks and to cut operating expenses in hopes of sustaining some level of cash flow (and thus their dividends). Others are simply delaying the inevitable given the timing of their next expected dividend announcement.

As always, Copeland will look to companies' dividend actions to help guide our decision-making process, both with regard to existing portfolio positions as well as new investments. Our aim is to do our best to avoid the losses that typically precede a dividend cut, utilizing all quantitative and fundamental analysis tools at our disposal. Meanwhile we are confident that in this cycle, as in prior cycles, that there will be ample dividend growth survivors across all sectors, market capitalizations and regions of the globe that will utilize the acumen of management, consistency of their business models, and strength of their balance sheets to continue to reward shareholders with a higher payout each year.

This has been an extremely challenging time for investors, with a vacuum of information and no historical playbook for how navigate such a situation. Yet, we at Copeland have seen extraordinary volatility before and therefore believe that our Dividend Growth approach will serve our investors well in the future as it has in the past. The day is coming when this malaise will be relegated to the dustbin of history and investors will focus once again on a growing economy and healthy markets. Through it all we will continue to invest in companies that demonstrate strong capital discipline, and which have a history of growing their dividends along with the will and capacity to continue to do so.

April 20, 2020

[1] *https://www.imf.org/en/Publications/WEO/Issues/2020/01/20/weo-update-january2020*
[2] *https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020*
[3] *https://www.wsj.com/articles/a-second-round-of-coronavirus-layoffs-has-begun-no-one-is-safe-11586872387*
[4] *https://www.bloomberg.com/news/articles/2020-04-08/airlines-to-cut-summer-flights-up-to-90-with-rebound-far-off*
[5] *https://fortune.com/2020/02/06/uber-q4-2019-profitability-plan/*
[6] *https://www.theverge.com/2020/3/19/21186865/uber-rides-decline-coronavirus-seattle-sf-la-nyc*
[7] *https://www.marketwatch.com/story/morgan-stanley-forecasts-38-drop-in-second-quarter-us-gdp-2020-04-03*
[8] *https://www.cnbc.com/2019/12/13/trump-says-25percent-tariffs-will-remain-but-new-china-duties-will-not-take-effect-sunday.html*
[9] *https://livinghistoryfarm.org/farminginthe30s/money_08.html*
[10] *https://www.sjsu.edu/faculty/watkins/depmon.htm*
[11] *https://fred.stlouisfed.org/series/WALCL*
[12] *https://www.morganstanley.com/ideas/cares-act-overview*

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**Chart 2:**  FactSet is a company that offers financial industry analysis, financial data, analytics, and analytic software for investment professionals. The information contained herein: (1) is proprietary to FactSet Research Systems Inc. and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither FactSet Research Systems Inc. nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. ***This is not the performance of any strategy overseen by Copeland and there is no guarantee that investors will experience the type of performance reflected in the information presented.***

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