Secrets Behind AAII's New Dividend Grader:

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Veteran's Day

On behalf of everyone at AAII, thanks to those of you who have served or are currently serving.

Secrets Behind AAII's New Dividend Grader

Presentation Overview

- *AAII Dividend Investing* (DI) strategy
- Three pillars of *Dividend Investing*
- Why using a dividend grader can help you build lasting income
- Process behind developing the AAII Dividend Grader
- Practical ideas for building a dividend portfolio using the Dividend Grader
- AAII Dividend Grader demonstration

AAII Dividend Investing

www.aaiidividendinvesting.com

AAII Dividend Investing Strategy

- **Dividend Investing's strategy:** Seeks stocks that have the potential to rise in price and make larger dividend payments in the future — a total-return strategy
- DI seeks to identify the best dividend investment opportunities by **focusing on a select universe of well-financed companies** that have a long history of:
  - Sales, earnings and dividend growth
  - Positive free cash flow
  - Attractive valuations
- Strategy based on robust studies of market factors that have contributed to strong long-term market returns
- <u>Unique value proposition</u>: provides subscribers complete control (addition/deletion decisions, tax situation, etc.)
- Weekly email/commentary; Monthly *Dividend Investing* newsletter with article archive

Provides the education and tools necessary to analyze, research and manage a successful dividend portfolio

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AAII Dividend Investing Model Portfolio

AAII Dividend Investing

- Model portfolio with real capital investment
- Portfolio inception: 2012
- 24 hand-picked dividend-paying growth stocks
  - U.S. exchange-traded
  - Diversified across sectors; no REITs or MLPs
  - Large-cap value tilt
  - Pays monthly dividends; current portfolio composition
  - Current yield ~3.0% vs. market yield ~1.7%
  - Compared to Dow Jones U.S. Index (IYY)
- Proprietary quantitative strategy—rules-based
- Alert members of portfolio additions/deletions

Current DI holdings - sample

Walgreens Boots Alliance
PEPSICO
Medtronic
UNITEDHEALTH GROUP
HUBBELL
THE HOME DEPOT

Former DI holdings - sample

P&G
WEC Energy Group
Microsoft
McDonald's

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Three Pillars of Dividend Investing

1 Valuation / Attractiveness

Stock prices tend to **fluctuate between high** and **low extreme valuation levels**, these relationships can be used to determine a stock's value range

Characteristics Analyzed:

- Dividend yield
- Trailing price-earnings ratio
- Forward price-earnings ratio

Dividend Yield: Main valuation metric

2 Growth Trends

A company's success is driven by its ability to **generate sales** and **convert revenue into earnings** and **cash flow**

Characteristics Analyzed:

- Revenue
- Gross margins
- Operating margins
- Net profit margins
- Earnings
- Earnings per share
- Operating cash flow
- Return on assets (ROA)
- Dividend growth

Growth: Does, and can, the company grow its dividend?

3 Financial Strength / Quality

Understand company's underlying financials and its ability to **generate cash flow, pay its obligations** and **return capital to shareholders**

Characteristics Analyzed:

- Earnings payout ratio
- Free-cash-flow payout ratio
- Leverage ratio
- Interest coverage ratio
- Free cash flow
- Dividend history
  - Consistency
- Returned capital
  - Share buybacks & dividends

Sustainability: Can the dividend payment be sustained in the future?

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Rationale Behind AAII's New Dividend Grader

- Deliver more meaningful tools and resources to help dividend-focused investors
  - Identify and evaluate dividend-paying stocks that meet your income investing needs
- Exclusive dividend grading tool designed to analyze any U.S.-traded dividend-paying stock
  - Based on the three pillars of Dividend Investing: valuation, growth and financial strength
- Easier way to start analyzing dividend-paying stocks
  - Generates an outcome that combines numeric scores with letter grades
  - Dividend grades are determined by their underlying scores, which provides a level of detail and transparency

AAII Dividend Grader: Build Lasting Income

- Why using a dividend grader can help you build lasting income
  - Receive objective feedback on a dividend-paying stock's underlying characteristics
  - Evaluate a buy or sell decision
  - Get a second opinion on a dividend-paying stock you already own or are considering buying or selling
  - Generate a list of dividend-paying stock ideas
- Grading system is just like you had in school
  - A's and B's are good; D's and F's are not
  - Grades make it easier to quickly identify what was attractive, what was within an average range and what was unattractive

Developing the AAII Dividend Grader

- Collaborative effort among the Dividend Investing (DI) investment committee and research team
  - Considered several important characteristics of dividend-paying stocks
    - Purposely sought metrics shown to be predictive of strong dividend growth, safety, consistency and attractive relative valuations
  - Studied competitive landscape
  - Based on academic research studies
  - Identified a unique approach to assess dividend sustainability
  - Backtested the results of the scoring system across all letter grades (A to F) for the period of 1998 through 2019 to ensure validity
- AAII Dividend Grader will continue to evolve
  - Already receiving feedback on enhancements
    - Ability to filter dividend-paying stocks by using a slider
    - Ability to import a portfolio(s) maintained in A+ Investor into the grader

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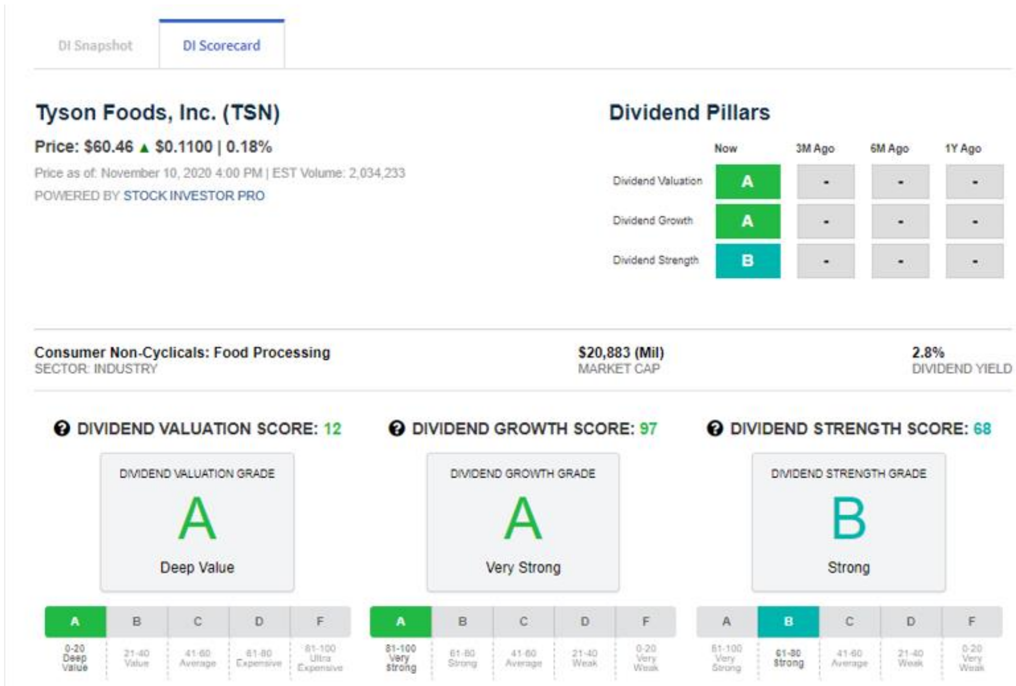
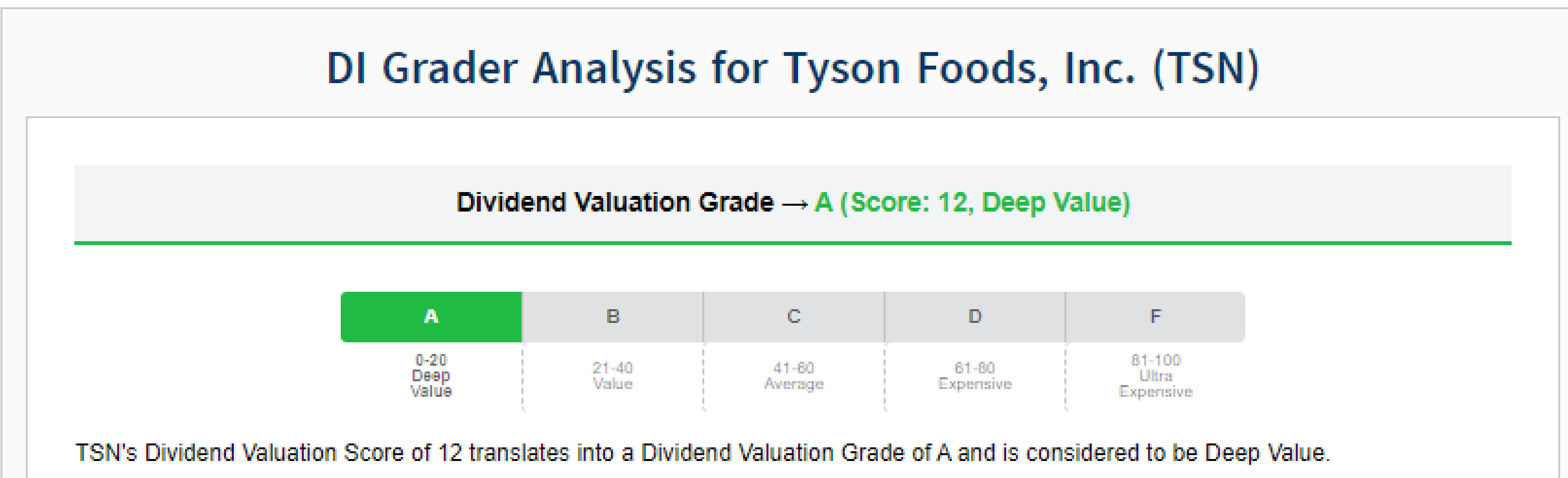
Practical Ideas for Building a Dividend Portfolio

- Generate a list of dividend-paying stock ideas based on:
  - Replicating the *AAII Dividend Investing* (DI) model portfolio
  - Evaluating stocks passing the DI Ideas screen
  - Consider all the dividend pillar grades together or individually
    - Dividend valuation grade
    - Dividend growth grade
    - Dividend strength grade



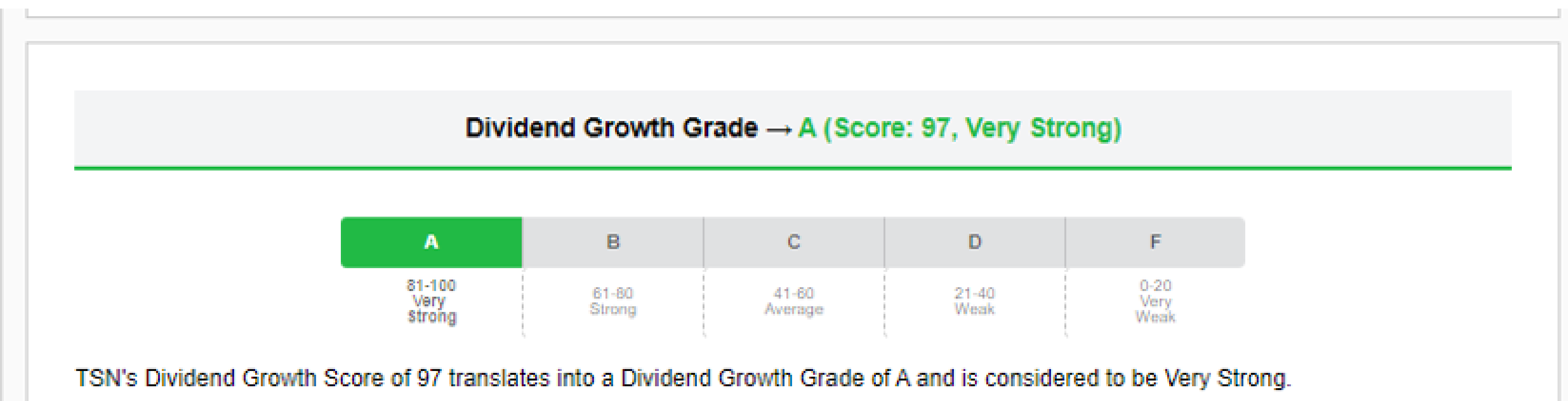
Dividend Valuation Grade

- Dividend Valuation Score definition:
  - Percentile rank of the average of the percentile ranks of:
    - Relative dividend yield
    - Shareholder yield
  - The score is not variable, meaning it must consider both relative yield and shareholder yield to be valid
  - Unlike other valuation measures, both of these yields are inversely related to value, with higher yields implying lower valuations



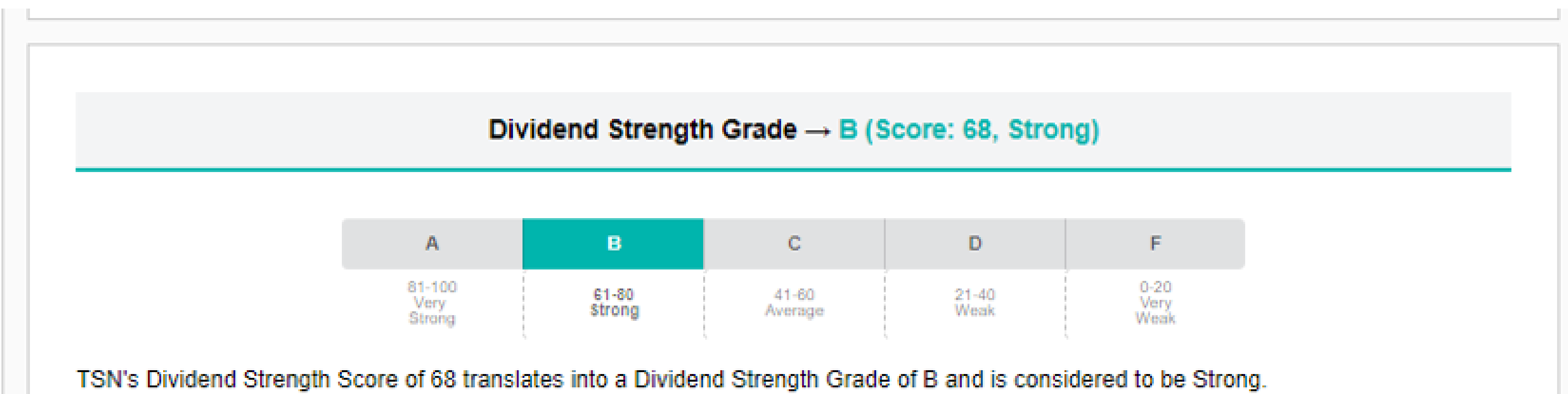
Dividend Growth Grade

- Dividend Growth Score definition:
  - Percentile rank of the average of the percentile ranks of:
    - Cash from operations growth
    - Return on assets (ROA) compared to its sector median
    - Dividend growth rate for the last 12 months
    - Average annualized dividend growth rate over the last five years
  - To be assigned a Dividend Growth Score, stocks must have a valid (non-null) percentage and corresponding ranking for at least three of the four growth components



Dividend Strength Grade

- Dividend Strength Score definition:
  - Percentile rank of the average of the percentile ranks of:
    - Earnings payout ratio compared to its sector median
    - Ratio of total liabilities to total assets
    - Times interest earned ratio compared to its sector median
    - Dividend sustainability score
  - To be assigned a Dividend Strength Score, stocks must have a valid (non-null) percentage and corresponding ranking for at least three of the four strength components



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My *AAII Dividend Investing* access includes:

- AAII Dividend Portfolio (24 holdings)
- Monthly DI Newsletter (with briefings & portfolio changes)
- Company snapshots, commentaries and more at the Dividend Investing Website

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Wednesday, November 18, 2020, 7:30 p.m. CST

Wayne Thorp Rebroadcast of Investing Like a Stock Superstar
Wednesday, December 2, 2020, 7:30 p.m. CST

Charles Rotblut on Taxing Issues for Investors: A Preview of AAII's 2020 Tax Guide
Wednesday, December 9, 2020, 7:30 p.m. CST

Charles Rotblut on Key Year-End Financial Planning Steps
Wednesday, December 16, 2020, 7:30 p.m. CST