CENTURION COUNSEL
MARKET COMMENTARY
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First Quarter Rally

The markets staged an impressive rally this quarter after entering into a "bear market" last December. The markets are off to their best start since 1991. As markets approach new record highs, the road to these new highs could be a little bumpy as Brexit and China trade talks continue. As you will see your enclosed performance report, your portfolio also staged an impressive rally after a challenging fourth quarter. We hope you are pleased with your results.

Dividends are not Bonds

Like many money managers, we love companies that pay dividends. Dividends bring tangible benefits, and over the last hundred years, half of the total stock market returns came from dividends. In a world where earnings often represent the creative output of CFOs' imaginations, dividends are paid out of cash flows, and thus are proof that a company's earnings are real. In addition, a company that pays out a significant dividend has to have much greater discipline in managing the business, because a significant dividend creates another cash cost, so management has less cash to burn in empire-building acquisitions.

Over the last decade, however, artificially low interest rates have in the mind of some investors turned dividend paying companies into bond replacements. Investors that used to rely on bonds for a constant flow of income are now forced to resort to dividend-paying companies. Some investors assume that a company whose dividend was raised for 25 years will continue to be raised (or at least maintained) for the next 25 years. GE, a dividend aristocrat, raised its dividend until the very end, when it cut it by half and then cut it to a penny. In a normal, semi-rational world, dividends should be a byproduct of a thriving business; they should be a part of rational capital allocation by management. But low interest rates turned companies that pay dividends into a bond-like product, and now they must manufacture dividends, often at the expense of the future.

There is a very good reason why investors should be very careful in treating dividend-paying stocks as bond substitutes. Bonds are legally binding contracts, where interest payments and principal repayment are guaranteed by the company. If a company fails to make interest payments and/or repay principal at maturity, investors will put the company into bankruptcy. It is that simple. When you start treating a stock as a bond substitute, you are making the mental assumption that the price you pay is what the stock is going to be worth at the time when you are done with it

(when you sell it). Thus, your focus shifts to the shiny object you are destined to enjoy in the interim, the dividend.

What should investors do? View dividends not as a magnetic, shiny object but as just one part in a multivariable analytical equation, and never the only variable in the equation. Value a company as if it did not pay a dividend, after all, a dividend is just a capital-allocation decision. This is why analyzing corporate management is so important. A lot of management teams will tell you the right thing; they'll sound smart and thoughtful; but their decisions will fail a very simple test. Here is the test: If management owned 10% or 20% of the company, would they be making the same decisions?