Digging into Capital Investment Advisors'

Income Investment Methodology

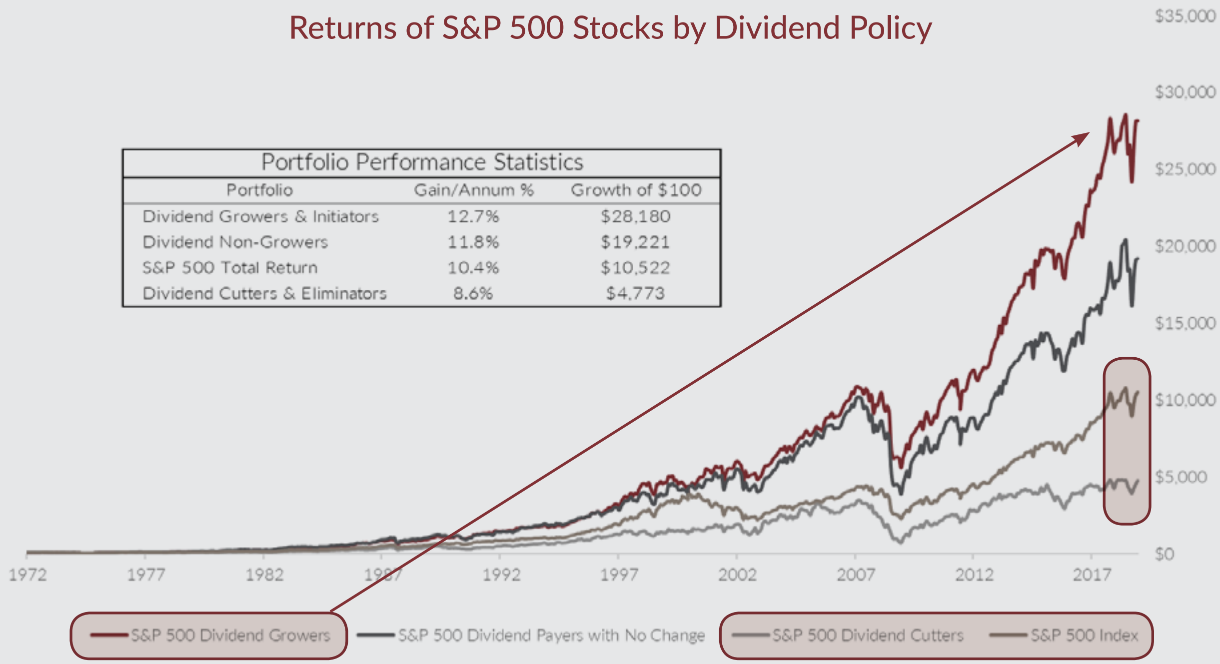
Capital Investment Advisors

Equities — Dividend Growers Generally Produce Better Returns Over Time

Below shows a long-term history of stocks by dividend policy. Capital's proprietary stock selection process attempts to identify companies that fall into the dividend growers and initiators category.

As you can see from the chart, stocks with a growing dividend policy have outpaced their counterpart.

Returns of S&P 500 Stocks by Dividend Policy



Portfolio Performance Statistics

Portfolio	Gain/Annum %	Growth of $100
Dividend Growers & Initiators	12.7%	$28,180
Dividend Non-Growers	11.8%	$19,221
S&P 500 Total Return	10.4%	$10,522
Dividend Cutters & Eliminators	8.6%	$4,773

Data from NDR

Dividend policy returns are equal weighted. The S&P500 Total Return is cap weighted.

Dividend Growers — Generally Produce Higher Returns with Better Drawdowns and Volatility

When the market starts to feel a little queasy, companies that raise dividends tend to suffer less.

In fact, looking at the peak-to-trough periods in each of the past 12 years, SDY, a dividend growth ETF, experienced about 82% of the downside seen by the market.

SDY also outperformed 67% of the time. 3 of the 4 times it underperformed, it was around 1%. So, for all intents and purposes, 2009 was the only significant underperformance.

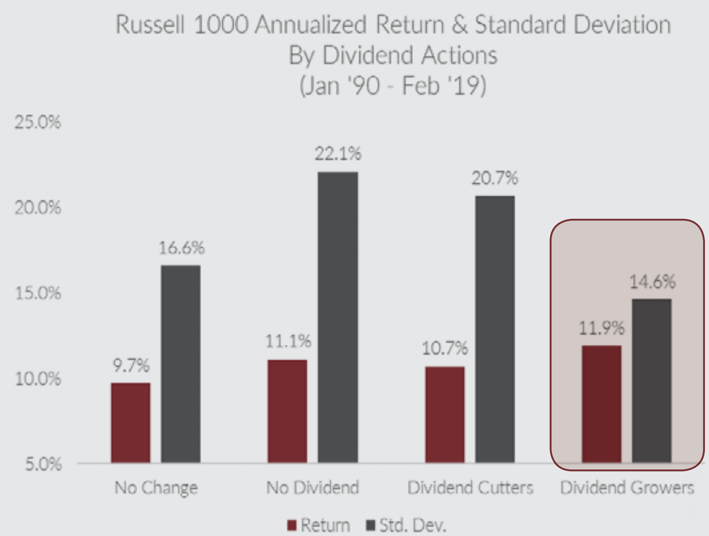
Shown another way in the chart below – dividend growers generally produce better returns with less volatility.

Peak	Trough	S&P 500	SDY	Downside Capture	Beat?
Oct-07	Nov-07	(9.8%)	(10.6%)	108.39%	
Jan-08	Nov-08	(46.7%)	(34.0%)	72.73%	1
Jan-09	Mar-09	(25.0%)	(32.5%)	130.09%	
Apr-10	Jul-10	(15.6%)	(11.9%)	76.48%	1
Apr-11	Oct-11	(18.7%)	(13.5%)	72.47%	1
Apr-12	Jun-12	(9.2%)	(6.1%)	65.98%	1
May-13	Jun-13	(4.9%)	(6.0%)	121.84%	
Sep-14	Oct-14	(7.2%)	(4.6%)	63.70%	1
Jul-15	Aug-15	(11.6%)	(8.4%)	71.90%	1
Jan-16	Feb-16	(9.0%)	(2.3%)	25.12%	1
Feb-17	Apr-17	(1.5%)	(2.0%)	136.45%	
Sep-18	Dec-18	(19.3%)	(14.2%)	73.84%	1
Average		**(14.9%)**	**(12.2%)**	**82%**	**67%**

Since 10/10/07 - Start Date for Above Chart

	S&P 500	SDY
Total Return	134.8%	162.5%
Per Annum	10.0%	13.0%

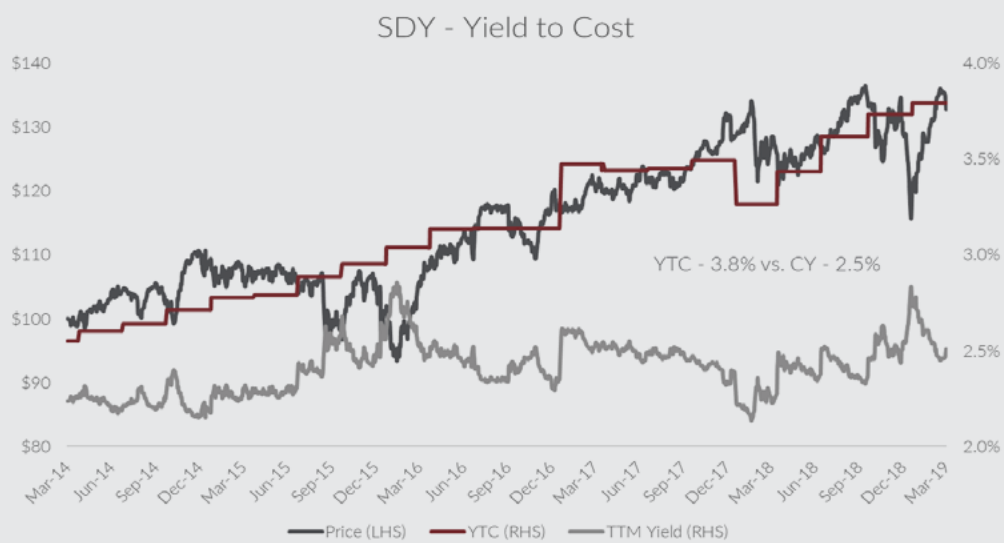
Data from Bloomberg



Data from Strategas Research Partners

This is not a recommendation for SDY. SDY is used as an example only. No assurance of investment success is offered. Investing involves risk including the loss of principal. If requested, we will provide a list of all recommendations made by Capital for an immediate preceding period of not less than one year. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the listed security.

Dividend Growers — A Nice Way to Combat a Low Interest Rate Environment



Data from Bloomberg

1,000 SDY Shares Bought on 3/7/13 —
YTC Currently is 3.8% (Capital Appreciation = 51%)

	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19
Initial Investment	$64,340	$73,283	$77,607	$77,607	$88,550	$93,154	$97,439
Income		$1,640	$1,786	$1,954	$2,236	$2,100	$2,441
Yield		2.2%	2.3%	2.5%	2.5%	2.3%	2.5%
Yield to Cost		2.5%	2.8%	3.0%	3.5%	3.3%	3.8%

Data from Bloomberg

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Summary

Dividend Growers

Positives

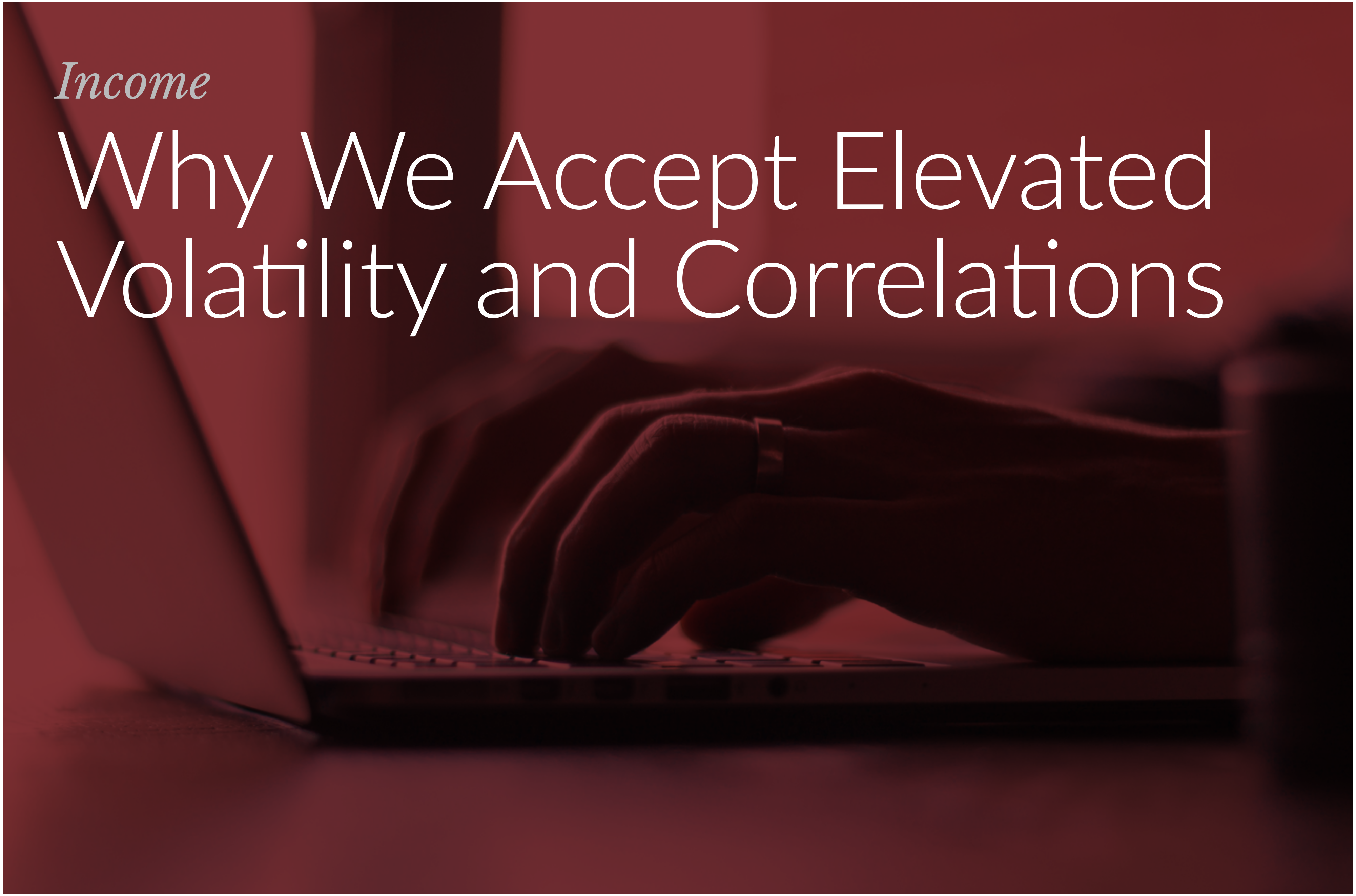
- Generally better long-term returns: 12.7% equal weighted versus the S&P 500's cap weighted at 10.4%.
- Typically lower volatility: 12% – 33% lower than other stocks.
- Muted downside in market drawdowns: 82% over past 12 years.
- A way to combat low yields over time through dividend growth.

Negatives

- Can lag in big up years due to more mature nature of companies:
  - 2017, for example – S&P +22%; SDY +16%

Income

Why We Accept Elevated Volatility and Correlations



Let's Start with Two Key Facts About CIA's Income Allocation

TWO THINGS TO NOTE:

1. A large portion of our income allocation is strongly positively correlated to U.S. stocks.
2. Many pieces are **more** volatile than U.S. stocks.

	Correlation to S&P 500
REITs	73%
Closed-End Funds	73%
High-Yield Bonds	70%
MLPs	62%
Preferreds	55%
Aggregate Bond Index	1%

15 years

	Volatility
MLPs	25%
REITs	24%
Preferreds	20%
Closed-End Funds	17%
S&P 500	**16%**
High-Yield Bonds	11%
Aggregate Bond Index	3%

15 years

Data from Bloomberg

Why do we accept this? **Let's discuss.**

Closed-End Funds — A Corner of the Market Where a Dollar Often Sells for 90 Cents

What is a Closed-End Fund (CEF)?

- Essentially, a mutual fund that doesn't take on additional capital after IPO.
- Given no new capital, the price fluctuates around the Net Asset Value (NAV), unlike a mutual fund which prices at NAV each day.
- CEFs typically use leverage to boost yield and/or returns.
- CEFs can own all types of assets — bonds (High-Yield, investment-grade, muni), stocks, MLPs, etc. CEFs just act as a wrapper.

Why Does CIA Invest in Closed-End Funds?

- We believe we have know-how in a high-yielding portion of the market that institutional money can't exploit. This allows CIA to potentially generate additional yield and alpha while attempting to mitigate risk to a degree.
- Why is this the case? For two primary reasons:
    1. The CEF market is relatively small, clocking in at approximately $300 billion.
    2. The small size means institutional money typically cannot invest due to the size of the market, leaving a market largely owned by retail investors (80%).

Discount/Yield is the Driving Factor for CEFs

	Premium/ Discount	Total Yield	Relative Premium/ Discount	Average Daily Volume	Leverage %	Earning Coverage Ratio %	UNII	Average
	Forward 1-Year Total Return							
1	7.9%	5.6%	5.4%	5.3%	4.7%	3.8%	3.3%	5.1%
2	7.4%	6.2%	5.1%	5.0%	4.2%	2.9%	3.9%	5.0%
3	5.9%	4.7%	3.7%	3.0%	3.3%	2.8%	3.1%	3.8%
4	5.9%	5.6%	3.9%	4.9%	5.6%	3.2%	3.8%	4.7%
5	2.6%	5.4%	4.2%	4.1%	5.5%	4.0%	3.6%	4.2%
6	2.3%	3.0%	4.3%	4.6%	4.2%	4.6%	3.8%	3.8%
7	3.3%	2.9%	5.5%	3.7%	3.1%	6.5%	5.1%	4.3%
8	2.3%	2.9%	4.3%	5.2%	2.6%	3.9%	4.9%	3.7%
9	1.7%	2.6%	3.8%	4.6%	3.3%	7.0%	4.8%	4.0%
10	3.4%	4.0%	2.7%	2.6%	4.5%	4.2%	6.2%	3.9%
Average	4.3%	4.3%	4.3%	4.3%	4.1%	4.3%	4.2%	4.3%
Top Decile Difference	3.7%	1.3%	1.1%	1.0%	0.6%	(0.5%)	(1.0%)	0.9%

Data from Bloomberg, CEF Advisors

Basic Example Of Why Yield Is A Function Of Discount

Example 1: (14% higher yield due to discount)

	Mar-18	Mar-19	
NAV	$10	$10	Prem / (Disc)
Price	$10	$9	(12%)
Distribution	$0.7	$0.7	Dividend Chg
Yield	7.0%	8.0%	14%

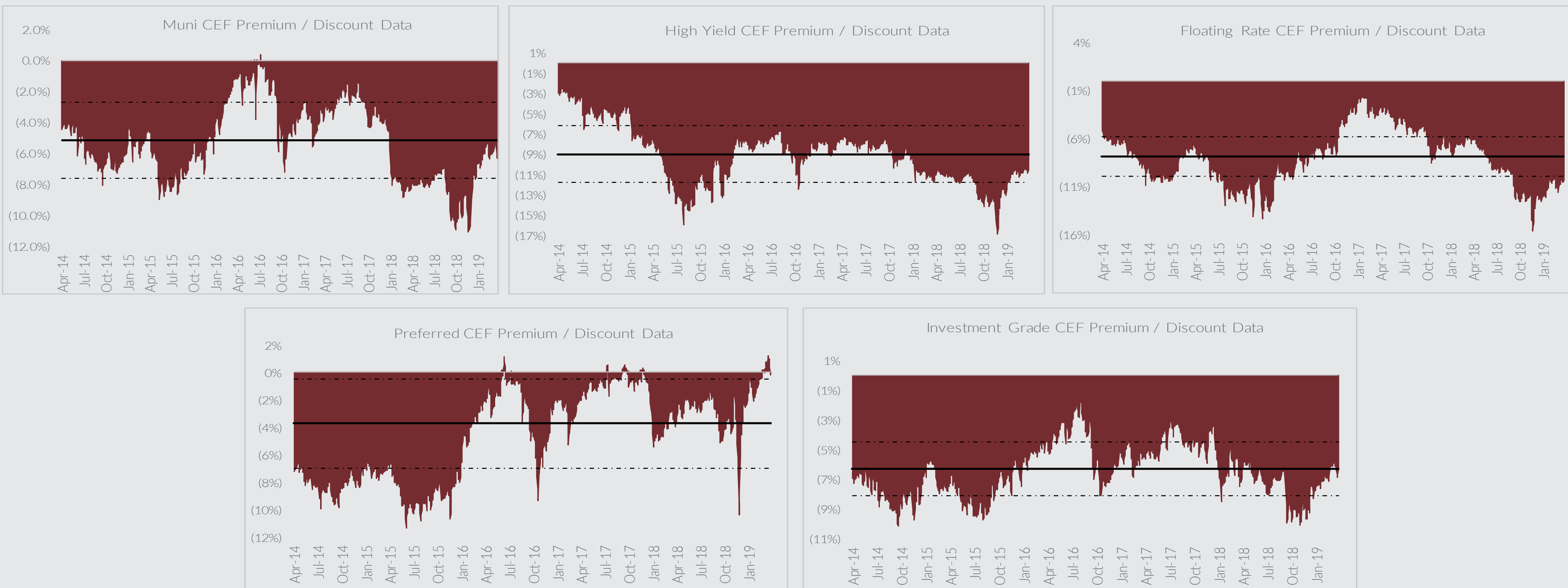
Example 2: (11% lower yield due to premium)

	Mar-18	Mar-19	
NAV	$10	$10	Prem / (Disc)
Price	$10	$11	12%
Distribution	$0.7	$0.7	Dividend Chg
Yield	7.0%	6.3%	(11%)

The information reflected in the chart is from years 2012 to 2018. The chart reflects all closed-end funds ranked by decile based on premium/discount, premium/discount relative to a three-month average, fund leverage percentage, undistributed net investment income (UNII), distribution yield, earnings coverage ratio, average 30-day trading volume, and sum of current premium/discount and relative premium/discount. After ranking all closed-end funds by decile, the forward one-year total return for each fund was averaged together by decile, data point and year. Please note, for premium/discount and fund leverage, the top decile has the lowest numbers; for UNII, distribution yield, earnings coverage ratio and trading volume, the top decile has the highest numbers.

CIA's "Guiding Light" for Attractiveness of CEFs – Discounts!

5 Year CEF Summary Sheet (as of 04/24/19)



Data from Bloomberg

Summary

CEF

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Positives	Negatives
• Generally produce above average yield – targeting 6% – 8% range. • Potential for better than average returns stemming from both yields and capital appreciation. • Potential to lower volatility by buying at a discount.	• More volatile than underlying asset classes due to price component + leverage. • More volatile than most open-ended funds. • Depending on the amount of leverage, the risk of loss can be magnified.

	Correlation to S&P 500
Closed-End Funds	73%

	Volatility
Closed-End Funds	17%
S&P 500	16%

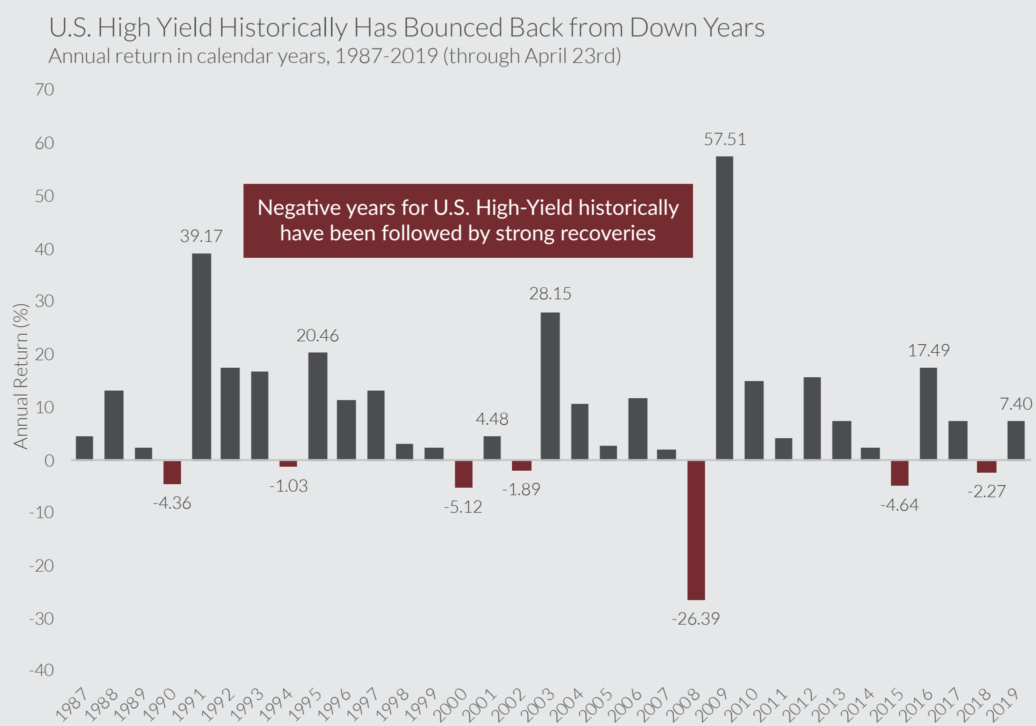
Fixed Income – Credit, but Let's Focus on High-Yield

Since 2000, High-Yield has carried an average 8.25% yield versus a comparable treasury at 2.7%.

Since 2009, 6.5% versus a 1.6% yield for the comparable treasury.

But, it's not just the yield.

Historically, High-Yield has performed well. In fact, only 7 of the past 33 years (21%) have been negative. And the upside isn't that much lower than stocks.



Data from Lord Abbett, ICE Data Indices

High-Yield Has the Potential to Come with Better Risk Adjusted Returns than the Stock Market

High-Yield as an asset class gets approximately 80% of the S&P's return with roughly 60% of the volatility on a total return basis. This generates higher risk/adjusted returns over time.

It also beats the Barclay's Aggregated Bond Index (AGG) by roughly 2.0%, which makes the volatility worth it.

But, as a typical CIA client experiences it (they spend the income generated and don't re-invest), High-Yield generates roughly 90 bps in incremental return for ~3.5x the risk!

Given this, spreads are key.

Dividends Reinvested	06/30/2007 - 01/31/2019		
Asset Performance (As of 01/31/19)	Return	Standard Deviation	Sharpe Ratio
HYG	5.4%	11.9%	0.4
VWEHX	6.0%	11.1%	0.5
AGG	3.9%	3.3%	1.0
IVV	7.4%	17.5%	0.39
Vanguard HY as a % of IVV	82%	64%	126%
Vanguard HY as a % of AGG	154%	336%	49%

Data from Bloomberg

Dividends not Reinvested	06/30/2007 - 01/31/2019		
Asset Performance (As of 01/31/19)	Return	Standard Deviation	Sharpe Ratio
HYG	3.7%	10.6%	0.3
VWEHX	4.3%	10.2%	0.4
AGG	3.4%	2.9%	1.0
IVV	6.5%	17.2%	0.3
Vanguard HY as a % of IVV	66%	59%	105%
Vanguard HY as a % of AGG	125%	351%	37%

Data from Bloomberg

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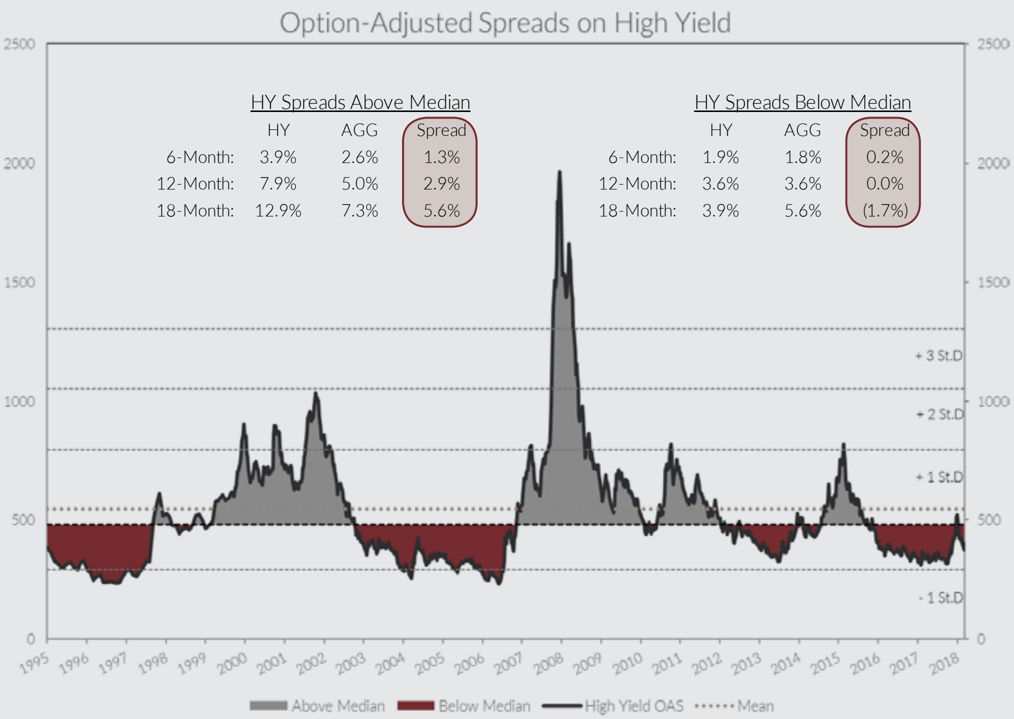
The Cyclical Nature of High-Yield

To highlight the way we think about High-Yield, see the below chart.

- Better than AGG returns when spreads are wide.
- AGG or worse returns when High-Yield is below the median.



Data from Bloomberg

Summary

High-Yield Debt

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Positives	Negatives
• Generally generates above average income. • Solid risk adjusted return over time due to equity-like returns with lower volatility.	• More volatility of traditional fixed income. • High-Yield entry and exit points are volatile and impact return.

	Correlation to S&P 500
High-Yield Bonds	70%

	Volatility
High-Yield Bonds	11%
S&P 500	16%

MLPs and REITs — Obligated to Pay High Levels of Income

Publicly Traded Real Estate Investment Trusts (REITs)	Masted Limited Partnerships (MLPs)
Required by law to pay out 90% of taxable income as distributions.	While not required by law, must follow their operating agreements which generally state a payout of distributable cash flow in the range of 60% or higher.

This leads to above average yields for both MLPs and REITs (1996 - present):

- MLP average yield = 7.3%
- REITs average yield = 5.5%
- U.S. Treasury = 3.9%
- S&P 500 = 1.9%

MLPs and REITs — Both Can Provide Investors with Tax Benefits

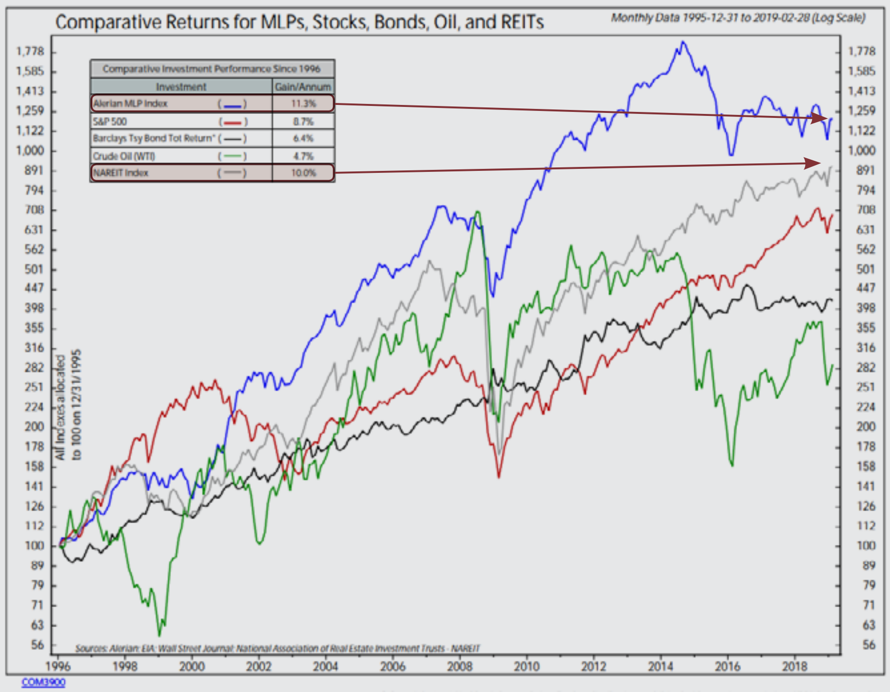
REITs	MLPs
• Pass-through income, so not taxed at the corporate level. • Shareholders can now deduct 20% of dividend income (ETFs/ Mutual Funds now included as well as individual REITs) – Effectively reducing the top tax rate from 37% to 29.6%.	• Pass-through income, so not taxed at the corporate level. • Dividends are treated as tax-deferred distributions, meaning you do not pay taxes until you sell. These distributions reduce your cost basis in the MLPs. • This makes the step-up in basis for heirs upon a unitholder's death potentially more beneficial.

MLPs and REITs — Historical Returns for MLPs & REITs Are Strong

MLPs are the best performing asset class over the past 20+ years.

2nd place? REITs.

In sum, over time, these structures have historically worked for investors.



Data from NDR

Summary

MLPs and Publicly Traded REITs

Positives

- Generally produce above average income.
- Superior historical long-term returns.
- Offer tax advantages to individual investors.
- Slightly lower correlations than traditional equities.

Negatives

- More volatile than the S&P 500 and significantly more volatile than the AGG.
- While less correlated, still strongly positive.
- K-1 tax reporting for MLPs.

	Correlation to S&P 500
REITs	73%
MLPs	62%

	Volatility
REITs	24%
MLPs	25%
S&P 500	16%

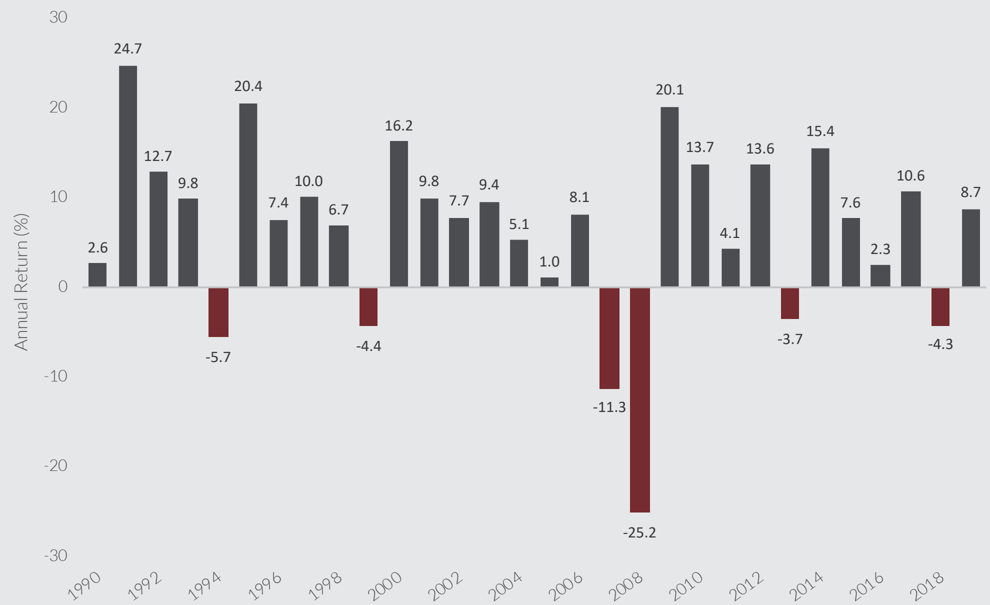
Preferreds — A Lower Correlated Way to Potentially Generate High Levels of Income

The long-term track record for Preferreds is a consistently strong one (only 6 down years in last 29 and up almost 7% per annum).

	Correlation to S&P 500
REITs	73%
Closed-End Funds	73%
High-Yield Bonds	70%
MLPs	62%
Preferreds	55%
Aggregate Bond Index	1%

15 years

Preferred Securities Calendar Year Total Returns
1990-2019 (through April 23rd)



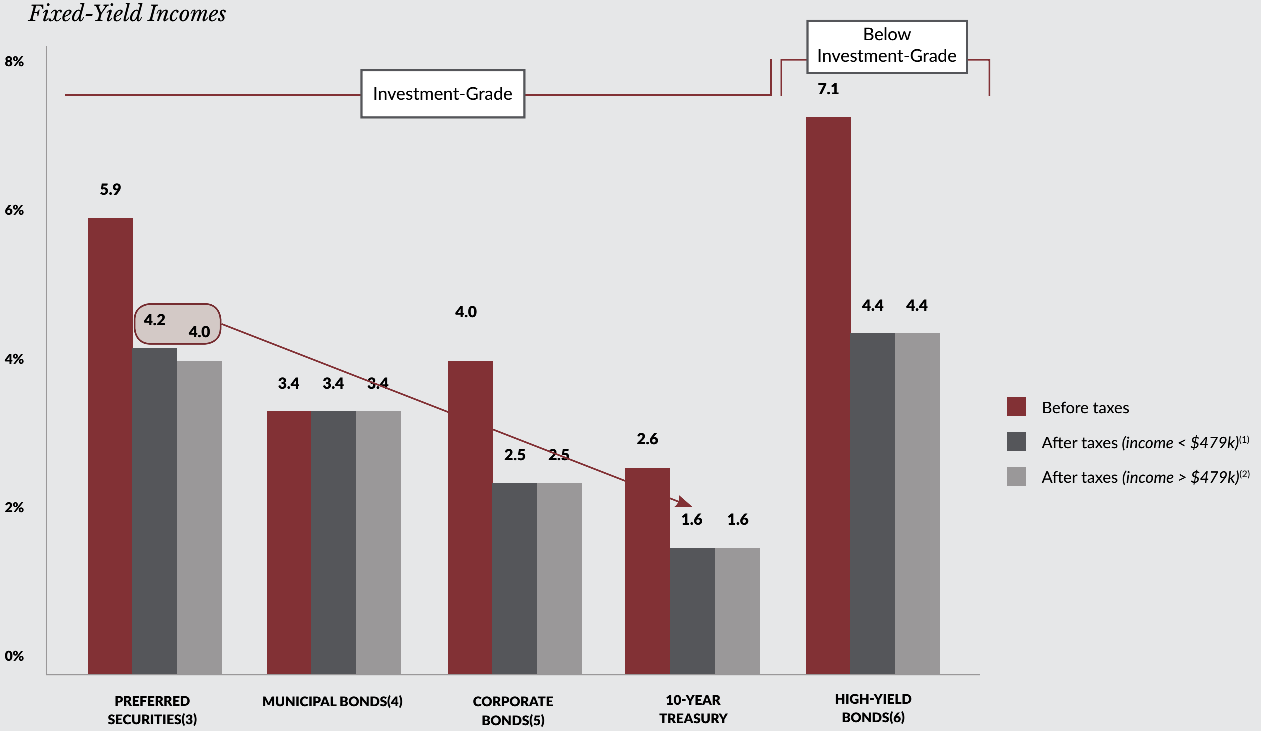
Data from Cohen & Steers, ICE Data Indices

Preferreds — Tax Considerations for Preferreds

Preferred Equities are the highest yielding investment-grade asset class, generating near High-Yield-like returns after adjusting for taxes.

However, it's worth remembering that they are still Equities. Meaning, in a liquidation scenario, Preferred holders get paid after all bond holders (secured, unsecured, etc.). Hence, volatility above the S&P.

Fixed-Yield Incomes



Data from Cohen & Steers

Ordinary Income Tax Rate	*Qualified Dividend Tax Rate*
10%	0%
12%	0%
22%	15%
24%	15%
32%	15%
35%	15%
35%	20%
37%	20%

*Qualified Dividend Tax Rate jumps from 15% to 20% with AGI of $488,851 MFJ

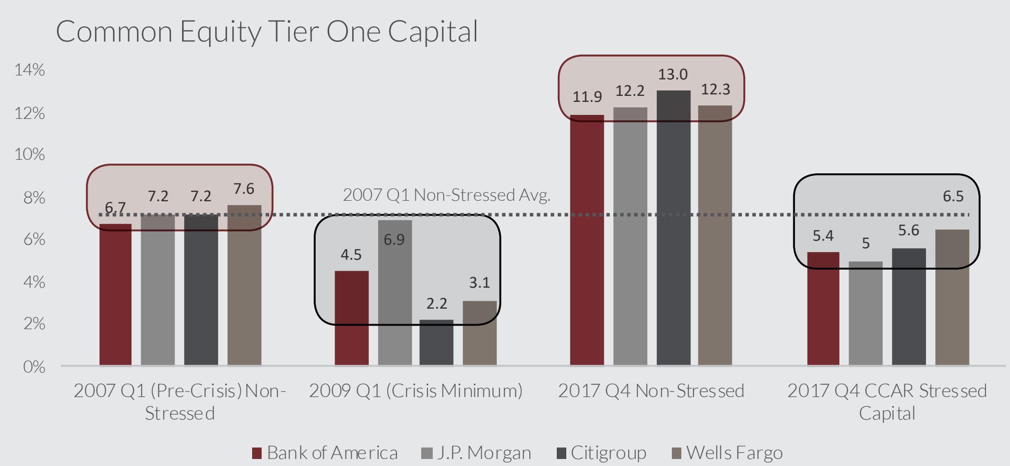
Data from IRS

Financials Health Key to Preferreds Given Exposure (~70%) and Place in Capital Stack

WHAT IS THE STRESS TEST?

UNEMPLOYMENT RATE	REAL ESTATE		STOCKS	TREASURY RATES
Equals 10% with inflation below 1%	30% decline in residential (down ~25% in '08/'09)	40% decline in commercial (down ~35% in '08/'09)	Down 65% (down 57% in '08/'09)	0 short-term

Even in an event worse than the Great Recession, capital ratios would still be well in excess of prior crisis lows.



Data from Cohen & Steers

Summary

Preferred Equities

Positives	Negatives
• Above average income for comparable investment-grade assets. • Lower correlation to stocks than other high income-generating vehicles. • Financials are in much better shape than prior to last recession.	• Preferreds have a lower placement in the capital structure than traditional corporate bonds • Limited upside potential • Lack of dividend growth

	Correlation to S&P 500
Preferreds	55%

	Volatility
Preferreds	20%
S&P 500	16%

Summary

CIA's Style

Equities

- We like dividends – particularly those that grow.
  - They tend to represent strong cash flow, balance sheet, etc. In other words: good businesses for cash flow.
- Lower volatility which helps ease the pain of market swoons.

Income

- We accept higher levels of correlation and volatility than many other RIAs due to our belief that one can attain better levels of income and return over time. We're also not blind to the issues and prudently manage around the negatives within each space.
- Some examples:
  - **CEFs** – We solely focus on ones at a discount. This boosts yield, lowers volatility and skews returns to the upside.
  - **High-Yield** – Obsess over compensation (spreads) as we're keenly aware how returns look when spreads are tight or wide.
  - **MLPs** – Carefully pick managers and/or MLPs that have defensible business models able to consistently pay and raise distributions.
  - **REITs** – Focus on cheap, out of favor, large REITs to limit downside and boost income.
  - **Preferreds** – Focus on an area that isn't overly exposed to long duration. In fact, one of our core holdings sports a duration of 4.4 years. This limits risk in a low-rate environment.

Disclosure

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