QUARTERLY COMMENTARY Q1

Newsletter 04-02-12

Oh, What A Quarter!

Oh, What A Year! was the title of our Q4, 2012 commentary. The events of the summer and the fall were the cause of the exclamation. Phrases like “Arab Spring,” Congressional Gridlock,” and “stock market volatility” were on our minds at the time. Yet, 2011 was a bland year when the stock market indices were considered. The Dow Industrials were up a mere 5.53%, the S&P500 was essentially flat, and the NASDAQ was actually down 1.80%.

We are inclined to use the same title for Q1, 2012: *Oh, What A Quarter!* This time our exclamation is driven by strong performance of the same indices mentioned above. This time the Dow Industrials were the weakest year-to-date of the three, however the price-only performance was up 8.14%. The S&P500 was up 12.00% and the NASDAQ was up a sparkling 18.67%. We feel compelled to try to explain, at least in part, the reasons for so positive a market reaction. The fixed income sector has moved a bit towards higher yields. The ten-year US Treasury yields about 2.18% now but is still in artificially low territory. Perhaps some of the reason for the stock market action can be traced to the relatively low return available from fixed income securities, which has made common stocks more attractive.

The gradual improvement in the domestic economy is more likely behind the first quarter improvement. Fed Chairman Bernanke, in a speech given to the National Association of Business Economists on March 26, 2012, spent his entire time discussing the “Recent Developments in the Labor Market”. The speech read like a lecture given to graduate students at Princeton, but the topic is vital because employment is one of the most important issues facing the economy and the country today. How the Fed Chairman views the employment situation, and by inference the Federal Reserve in general, may shed light on how Fed policy will be formulated and implemented. In a nutshell, employment growth has improved but remains well below the level needed to return the employment rate to a healthy level. Reported unemployment of 8+ percent is still too high for there to be sustainable economic growth. Bernanke discussed Okun’s law as it pertains to the current employment situation, which suggests that “real GDP must grow approximately two percentage points faster than the rate of growth of potential GDP over that period.”

While we don’t always agree with the Fed Chairman, his organization does create important policy as it pertains to the economy. While there was no indication of policy direction buried in his speech, it was clear that he favored faster economic growth which in turn would be expected to improve the employment situation. Our review of the economic data covering the months of February and March suggests the Fed may feel the need to be pro-active.

Several of the Federal Reserve districts do surveys of manufacturing activity in their districts on a monthly basis. The March reports from the Chicago, Dallas, Kansas City, and Richmond (VA) districts showed somewhat slower activity than February’s. One month does not make a trend; however, it does give us something to pay attention to when April’s data is announced. We also note that after several months of improving housing data the numbers for February seemed to be flattening and the personal income and spending data released on March 30th for the month of February showed very modest income growth and somewhat more aggressive spending.

The equity markets’ direction from here may be decided by the international flow of news. European debt problems seem to have been solved for the time being, but the required level of austerity in Greece, Italy, Spain and Portugal is very unpopular with the populace of those countries. The nuclear ambitions of Iran are not in sync with their neighbors or the western world. Syria continues to be a sore spot. The Arab countries that went through dramatic change last year are still unsettled. North Korea also is in transition but seems to play the same old games. The rate of growth in China is slowing by government design.

While this litany of domestic and international issues might seem to be overwhelming, we believe that opportunities remain for investors. Almost three years have gone by from the end of the ‘Great Recession’ so it is logical to assume that economic growth would be somewhat slower. This is the time to stress companies with strong financial fundamentals. Among the items to be watching for in the first quarter earnings releases are slow-downs in revenue growth, increasing cost pressures for raw materials, foreign currency adjustments, increased pension expenses and deceases in the rate of growth of net earnings. Companies that have been able to generate consistent earnings and dividend growth over a number of years have showed their ability to operate in all kinds of economic conditions. We continue to have confidence in our universe of companies. We also note that our companies have been able to take advantage of the low interest rate climate to secure long term financing.

In our Q4 2011 newsletter we wrote about our continued confidence in the energy Master Limited Partners (MLPs). The first quarter 2012 was a disappointing one for MLPs. The Alerian Index, which is an index of 50 of the largest MLPs, had a total return of only 1.97% in the first quarter compared to 12.59% for the S&P500 Index. It is usually difficult to explain why a company, MLP, or sector performed the way it did, but there are several possible reasons for the first quarter. First, the development of the US energy industry has proceeded at a very rapid rate. New oil and gas fields are being developed requiring new capital assets to be put in place. The partnerships have had to raise a great deal of capital in order to pay for the new assets. The dilution of ownership takes a while for the projects financed by more units to be overcome by the income that the projects will deliver. Another possibility for the price weakness may the perception that interest rates are about to rise from the current, historically low interest rates. Approximately one-half of the capital needed for the business is provided for by bond issuance and bank lines of credit. The other half comes from new equity units. Finally, MLPs have had a long record of strong performance. It might be time for the sector to rest while others do some catch up. The Alerian Index is up 75.76% on a total return basis over the last five years compared to 10.48% for the S&P500.

This is our first quarterly edition under our new corporate name, Dividend Assets Capital. Our address and telephone number remain the same; however, our email and web addresses have been changed. For instance, if you want to reach our president by email it would be tshaver@dacapitalsc.com. Our web address is www.dacapitalsc.com. We are welcoming two new folks to our team: Jon Parrott is here from Boston as manager of operations, and Rachel Stanley is now covering the front desk. We also want to thank Jennifer Miles for her service at the front desk for the last year. We wish her success in her next endeavor.

DIVIDEND ASSETS CAPITAL, LLC

INVESTMENT ADVISORS

58 RIVERWALK BLVD, BLDG 2, SUITE A
RIDGELAND, SC 29936-8126
TOLL FREE 866.348.4769
FASCIMILE 843.645.9700
WWW.DACAPITALSC.COM

All data source: *Bloomberg*

Important Disclosures

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There are no guarantees that dividend paying stocks will continue to pay dividends. In addition, dividend paying stocks may not experience the same capital appreciation potential as non-dividend paying stocks. The past performance of the strategy is not an indicator of future performance; and investment results may vary.

An investment in a Master Limited Partnership (MLP) unit involves risks that differ from a similar investment in equity securities including ownership controls associated with the limited partnership structure, high debt to equity ratios, and certain tax risks.

Investments in international markets present special risks including currency fluctuation, the potential for diplomatic and political instability, regulatory and liquidity risk, foreign taxation and differences in auditing and other financial standards. Risks of foreign investing are generally intensified for investments in emerging markets.

The S&P500 Index is a widely recognized unmanaged index of equity prices and is representative of a broader market and range of securities than is found in individual client portfolios. The Alerian MLP Index (NYSE: AMZ) is a widely recognized, unmanaged index that includes a composite of the 50 most prominent energy (MLPs). The Index returns do not reflect the deduction of expenses, fees, and taxes and assumes reinvestment of all distributions. Individuals cannot invest directly in the Index; however, an individual can invest in exchange traded funds or other investment vehicles that attempt to track the performance of a benchmark index. Dow Jones U.S. Index is a broad-based but investable measure of the U.S. stock market, intended for use as the basis of investment products. The index aims to consistently represent the top 95% of U.S. companies based on float-adjusted market capitalization, excluding the very smallest and least-liquid stocks. This index assumes the reinvestment of dividends and the percentage changes in the benchmark represent the annual percentage change of the index for the period reported. NASDAQ Composite Index is a stock market index of all of the common stocks and similar securities (e.g. ADRs, tracking stocks, limited partnership interests) listed on the NASDAQ stock market, meaning that it has over 3,000 components. Since both U.S. and non-U.S. companies are listed on the NASDAQ stock market, the index is not an exclusively U.S. index.