

MARKET OVERVIEW: THE UPSIDE OF DIVIDENDS

MLP STRATEGY

A high-yielding portfolio (with tax-deferred income) primarily composed of pipelines and energy facilities we feel have strong prospects for growth of distributions. Revenues are derived from durable and stable business assets that generate attractive yields to the unit holders while allowing for long-term organic growth.

There is considerable hysteria about dividends in the media at the moment, but journalists and investors have not been very diligent about peeking under the headline numbers to see what's really happening. Indeed, the number of dividend decreases has risen sharply, and the increase-to-decrease ratio has declined (though it's still above 3 to 1). But the changes of late have been quite narrowly focused: on financial companies (oh really?), companies that rely on financing, and companies that are most sensitive to declines in economic activity. The "silent majority" continues to pay dividends from current cash flows, and with over 1,700 dividend increases last year there are obviously a good many companies whose straits are hardly as dire as General Motors or the money center banks. The "big name" dividend cuts such as the money center banks, insurance majors, General Electric, Pfizer, and Dow Chemical are testament to the difficult economic conditions we face today. But at the same time, we have seen dividend *increases* across all of our portfolios. Sectors such as health, consumer nondurables, pipelines, telecommunications, and utilities continue a regular course of dividend increases as though existing in a different world, a world of ample cash flow.

Historically, dividend stocks have performed extremely well after bear markets in general and after recession-induced bear markets in particular. To be sure, there are moments when it will seem that the only game in town is reflected in big daily jumps among the stocks most beaten down, but the data tells us this does not last. We reviewed the performance of the higher-yielding deciles after four key bear markets commencing in 1974, using the Fama-French data set. As you can see from the graphs on page 2, historically year 1 of recovery may or may not see excess return from higher dividend stocks. But as the holding period lengthens, so has the excess return of higher dividend stocks versus the broad market. Note that the 10-year period after the October 1990 bottom ends right in the teeth of the tech bubble—one of the few times when dividend-oriented portfolios seriously lagged—though dividend stocks picked up their trend of excess performance almost immediately. If you believe that a new tech bubble is imminent, dividend stocks might not be the way to go, but in most cases they have eventually emerged victorious after market bottoms.

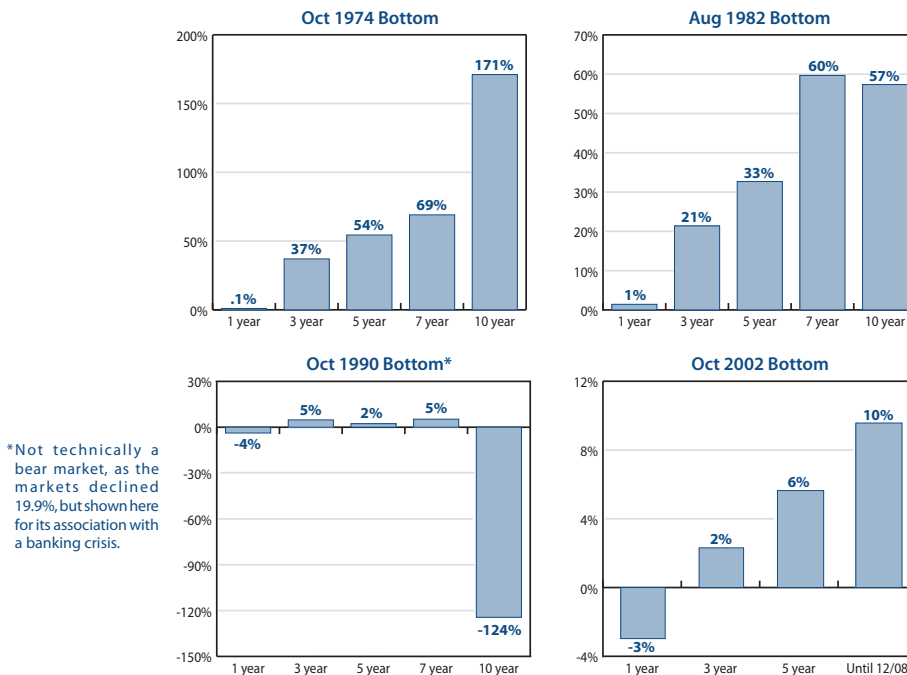
DIVIDEND STABILITY AND DIVIDEND GROWTH

Obviously, in order to replicate these kinds of results in a less inimical future, we need to insure dividend stability now, in these difficult times, as well as seeking the dividend growth that creates the sort of long-term compounding we strive to generate in our portfolios. Below we review some of the principles we have in place to evaluate dividend stability in our portfolios. Thresholds may vary somewhat depending on market conditions, but the principles have stood the test of time.

[more ▶](#)

“...as the holding period lengthens, so has the excess return of higher dividend stocks versus the broad market.”

Cumulative “Excess” Return of High Yield Stocks vs. S&P 500 (1, 3, 5, 7 & 10 Years from Bear Market Bottom)



Returns for both High Yield Stocks and S&P 500 are total returns. “High Yield Stocks” comprises deciles 6 to 10 from the data set created by Eugene Fama and Kenneth French called “Portfolios Formed on Dividend Yield,” in which they separate stocks into deciles based on their dividend yield. Their file was created by CMPT_DP_RETs using the 200901 CRSP database. We have utilized the value-weighted returns for this study. They compute D/P (in percent) breakpoints at the end of each June.

SELECTED INDICES

	1 st Qtr 09	1 Yr
S&P 500	(11.0)%	(38.1)%
Equity Inc	(10.6)%	(37.5)%
Util Fund	(10.7)%	(34.3)%
BC Long	(5.3)%	13.1%
R3UTIL	(9.5)%	(27.0)%
R1000	(10.5)%	(38.3)%
R3000	(10.8)%	(38.2)%
R3000Val	(17.0)%	(42.1)%
DVY	(23.1)%	(41.9)%

S&P 500 = Standard & Poor’s Index
 Equity Inc = Avg Equity Income Fund (Lipper)
 Util Fund = Avg Utility Fund (Morning Star)
 BC Long = Barclays Capital US Treasury Long
 R3UTIL = Russell 3000 Utilities
 R1000 = Russell 1000
 R3000 = Russell 3000
 R3000Val = Russel 3000 Value
 DVY = iShares Dow Jones Select Dividend ETF

Cash Flow. Dividends are paid from a company’s cash flow, so we need to be sure that cash flow after all necessary expenses adequately covers the dividend, with a margin of error to accommodate contracting economic times. With some exceptions, we’d like to see cash flow covering the dividend by about 3 to 1.

Interest Coverage. No company is going to pay a dividend if they’re having trouble paying fixed charges such as interest on debt, so coverage here must be ample. We prefer that interest charges are covered at least 4 to 1 by EBITDA.

Payout Ratios. The analysis for some companies, especially those with high depreciation, focuses on cash flow. But ultimately most companies pay dividends out of earnings. Except for utilities and a few others, we hope to see earnings at 2 to 1 relative to dividends.

Future Debt Obligations. The world has changed in this way: Companies that used to rely on refinancing of debt as part of the normal course of business can’t necessarily do that today. If substantial debt is due soon,

the company may be inclined to hoard cash—including cash that would otherwise be paid as a dividend—as a tool to pay off debt or make refinancing easier. Now, more than ever before, we need to know the schedule of debt due and the current resources available to pay it.

Reliability of Earnings and Cash Flow. This entails an evaluation of the basic business premise or model. How sensitive is it to economic conditions? Does the company make parts for domestic auto companies or does it sell groceries?

Herding. Some sectors, especially those with heavy financing needs such as REITs, have begun to withhold or reduce dividends prophylactically. As we’ve seen with the banks, in any given industry there always seems to exist pressure to manage in the way that your competitor is managing. Some companies may cut if all those around them are cutting.

Management Commitment. Many companies have an established formal dividend policy; others periodically affirm their commitment to their dividends. Would they cut dividends in order to acquire a weaker competitor

Bear Markets Since 1950

□ Recession-Induced Bear Markets highlighted

Top	Bottom	Decline	Months
8/2/56	10/22/57	-22%	14
12/12/61	6/26/62	-28%	6
2/9/66	10/7/66	-22%	8
11/29/68	5/26/70	-36%	18
1/11/73	10/3/74	-48%	21
11/28/80	8/12/82	-27%	21
8/25/87	12/4/87	-34%	4
3/24/00	10/9/02	-49%	31
Avg of All Bear Markets		-33%	15
Avg of Recession-Induced Bear Markets		-40%	20

Price return only. Bear markets are identified as periods during which the market declined 20% or more. Recession-induced bear markets are defined as periods where generally recognized "recession" periods overlapped the bear markets we've identified. Source: Commodity Systems, Inc. (CSI) and Bloomberg

Recoveries from Bear Markets Since 1950

Bottom	Top	Rise	Months
10/22/57	12/12/61	86%	50
6/26/62	2/9/66	80%	44
10/7/66	11/29/68	48%	25
5/26/70	1/11/73	74%	32
10/3/74	11/28/80	126%	73
8/12/82	8/25/87	229%	60
12/4/87	3/24/00	582%	147
10/9/02	10/9/07	102%	60
Avg of Bear Market Recoveries		166%	61

"...when a company raises dividends today, in an environment where there is so little competitive or peer pressure to raise, we think it speaks volumes about the company's true situation, its true prospects, its true view of shareholders, and the decisiveness and boldness of management."

in these unique times? Would they rather buy their own discounted debt? Can they afford to pay the dividend and also expand? Do they have a long history of paying? Increasing? We look and listen carefully to what management says and how they say it.

Special Factors. We keep abreast of how government regulations such as those under TARP may cause companies to cut dividends and to refrain from increasing them. Unrealized (book) losses on investments may require companies to increase reserves to make up for mark-to-market charges. New tax rulings may influence how a company views its dividends.

Dividend Growth. Last but far from least, we are alert as never before to companies that offer increasing dividends. These have always been the companies we favor, but today they are simply rarer—they are "standouts." Dividend increases tell us more about how business is going and how management feels about its prospects than any analyst or journalist ever can. Managements and boards hate to cut dividends—it is a kind of defeat—so increasing a dividend always involves a measure of bravery (as well as a recognition that the shareholders own the company and deserve some of the current profits). But when a company raises

dividends today, in an environment where there is so little competitive or peer pressure to raise, we think it speaks volumes about the company's true situation, its true prospects, its true view of shareholders, and the decisiveness and boldness of management. It is only the genuine Bravehearts that raise today.

GIPS Disclosure Information

Results are shown in US dollars. Included in the results are all unrestricted portfolios that have been managed for at least one full quarter, including those accounts no longer with the firm. Past performance is not indicative of future results. All composites contain fully discretionary accounts. Gross returns have been reduced by transaction costs and include the reinvestment of all income. Net return assumes a 3% annual advisory fee, charged quarterly, which includes wrap program fees. Other than brokerage commissions, this fee may also include portfolio monitoring, consulting services, custodial services, and investment management fees. Actual investment advisory fees incurred by clients may vary. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Miller/Howard Investments Inc. is an independently registered investment advisor specializing in multi-cap, core equity management and dividend strategies.

Miller/Howard Investments Inc. claims compliance with the Global Investment Performance Standards (GIPS®). Compliance with the GIPS standards has been verified for the period of January 1, 2000, through December 31, 2006, by Ashland Partners & Company LLP. Results prior to January 1, 2000, have not been verified. To receive a complete list and description of Miller/Howard Investments' composites and/or a presentation that adheres to the GIPS standards, contact Marilyn Marecek at 845-679-9166, or write Miller/Howard Investments, PO Box 549, Woodstock, NY 12498, or marilyn@mhinvest.com.

Annual ADV Update

If you would like a copy of our current ADV Part II, please contact Marilyn at:

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The ADV will be mailed to you, free of charge.

INTRODUCING
OUR NEW
MLP
STRATEGY

OUR INVESTMENT PHILOSOPHY

- + High quality stocks
- + High dividend yield
- = High growth of distribution
- Opportunity for high total returns

Our current cash distribution yield is approximately 10%. We anticipate this distribution may rise 6% during 2009.

We welcome questions and comments.

For further discussion and our thoughts regarding tax aspects of MLPs, see the executive summary available on our website.

www.mhinvest.com

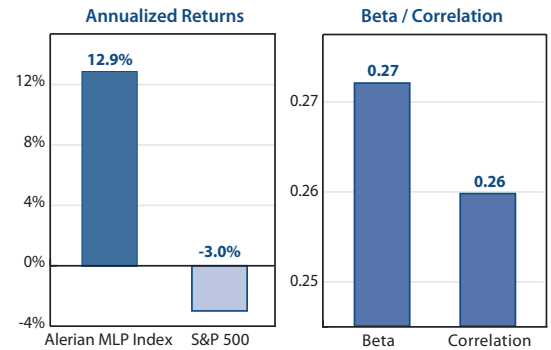
As investors in our other strategies know, we have invested in the MLP (Master Limited Partnership) universe since our first acquisition of Kinder Morgan Energy Partners in 1998. Over the years we’ve come to appreciate the enterprises that make up the pipeline and associated industries that dominate the MLP sector, and we’ve come to view them as among the ideal candidates for our investment philosophy (see sidebar).

MLPs fall into several categories, all associated with bringing energy from production site to the end user. These “stocks” trade actively just like regular corporations. They are characterized by the features we look for wherever we invest: established market demand (we think of MLPs as “utilities without walls”); long-life assets; limited competition; reliable revenues; long-term contracted streams of cash flow; foregrounded cash distribution policy—a true “partnership” with unit holders; potential for growth of distribution and of underlying business assets; and alignment of management and owner interests (General Partners also own Limited Partnership units).

Energy-related MLPs (there are a few non-energy MLPs that are “grandfathered” exceptions) generally are *transporters* of natural gas and petroleum products. In recent years a new generation of gas and oil *producing* MLPs has come to market, but these have played little role in our approach to MLPs, and have little weight in the Alerian MLP Index (the accepted benchmark for this asset class). So in general, while many databases include MLPs in the “energy” sector, there is almost no exposure to the ups and downs of energy prices. Pipelines are the “truck” that carries products, and space capacity is sold many years in advance, so revenues don’t fluctuate with energy prices (and in that sense they don’t really belong in the energy sector).

MLPs have historically been one of the best performing sectors since inception of the Alerian MLP Index in terms of risk-adjusted return as well as absolute returns, and have performed substantially better than the broad market indices. They also show a low correlation to other types of investments.

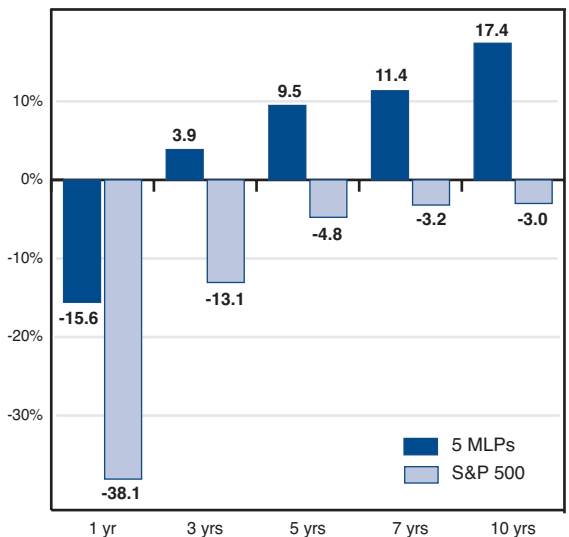
Alerian MLP Index vs. S&P 500
(10 Year as of March 31, 2009)



The Alerian MLP Index is a composite of the 50 most prominent energy master limited partnerships calculated by Standard & Poor’s using a float-adjusted market capitalization methodology. The S&P 500 Index consists of 500 stocks designed to be a leading indicator of US equities. It is meant to reflect the risk/return characteristics of the large-cap universe.

In our Income-Equity Strategy we have typically held 15–20% of MLP exposure. Though it’s not really fair to separate the MLPs from their context in an overall portfolio, the graph below shows how the MLPs we currently hold in that portfolio have performed over those same 10 years (we’ve held most of them for most of that time at variable weights).

Proforma Example for 5 MLPs
(Annualized Performance as of 3/31/09)



This proforma example shows the gross performance of 5 MLPs that we have used in our Income-Equity Strategy for several years. (EEP, EPD, ETP, KMP, OKS) Dividends were assumed reinvested. It is for illustration purposes only and is supplemental to the performance disclosure on page 5. These securities are not representative of all the securities bought or sold. There is no guarantee that future performance will replicate the past.

In our ideal world, the MLP Portfolio will replicate the success we’ve had with Kinder Morgan Energy Partners. When we first acquired KMP, through a takeover of a pipeline we owned, our adjusted price was about 12.

The current yield at the time was a little under 7%. At this point our units (shares) have roughly quadrupled, and the current yield is about 9%. That means the distribution has gone up more than fourfold, and the stock—even at today's bear-market depressed prices—has done nearly the same. We have 20 stocks in our all-MLP portfolio. Give us 20 of those; we'll be dedicated holders!

Can this kind of growth continue? Each time a new natural gas field develops there is a need for gathering and processing assets, and connecting to an interstate line that may or may not have enough space to handle it. Recently leases for long-distance shipping have been renewed at higher rates—one of the few situations in the world where rents are going up. Though investors have recently been concerned about MLP access to capital in these financially tight times, the major players have continued to raise both equity and debt all through the financial crisis, including this year, and to us financial concerns seem a red herring. If anything, it increases the likelihood that new projects will go to the strong players, the companies we believe we are holding. Longer term, price and environmental considerations continue to favor the growth of gas as an energy source, and the majority of MLP transportation is gas. Continuing growth is an issue we think it's important to watch closely, but it is not an issue of great concern today.

Our portfolio generally follows the industry weightings in the Alerian Index at the present time, though our individual security weightings vary greatly. We hold about 80% of interstate pipelines, with the remainder in gathering, coal, propane, and a small exposure to “upstream”—which includes producing fields. In 2008 all of our MLPs raised distributions, and so far in 2009 half the portfolio has raised distributions. Historically, the average yield on the Alerian has been about 7.5% (it has been both higher and lower), implying a price change of about 35% on the underlying securities should the current yield of 10.34% regress to the long-term average.

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Annual ADV Update

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