Investors Alley

The Dividend Hunter

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Time to Get Excited About This Market

Fellow Investor,

Barry Sternlicht is excited, so I am excited. Sternicht is the CEO of **Starwood Property Trust, Inc. (NYSE: STWD)**, one of the initial stock recommendations of The Dividend Hunter.

In This Issue

Starwood's CEO is excited because the recent market disruptions are providing potentially very profitable investment opportunities for the company he runs. I feel the same way about higher-yield stocks and the companies behind them. On most earnings conference calls, Sternlicht focuses his remarks on how he wants to make sure that Starwood continues to conservatively manage the company's businesses and investment portfolio. He made these points again in the recent 2015 fourth quarter and year-end earnings call, but he also made several remarks about his excitement in the current environment to make both commercial mortgage investments and commercial property investments. Here are a few quotes from the call:

"So, I actually love this environment, fantastic for the largest player in the space (commercial mortgage servicing), which is us, two times the size of anyone else."

"We really feel good about what we own going [into] what should be a really fun time for us, this is the fifth time in the five years we've been operating that the markets have backed up. This time feels worse. Feels worse probably because of long-term changes to the credit market coming from changes in risk retention rules and other capital rates that are being forced on banks. That [is] actually all good for us, all that stuff creates better opportunities for us to deploy capital at higher spreads."

"We're pretty excited about the opportunities the disruption [can] create for a company that can have more than a couple of billion dollars to invest over the next 18 months..."

"And, real estate is in much better shape than the other asset classes and we do believe that what happened in the CMBS conflicts is more of a result than what happened to other areas of financing world...there hasn't been to date any deterioration in the fundamentals of real estate assets... As you know we (meaning Starwood Capital, Sternlicht's private real estate investment firm) own 85,000 apartments, we own more than a 1,000 hotels, we own 30 malls. We have a pretty good view of what's going on in the world, and while it may be slowing, it’s surely not going negative."

"We continue to look for Interesting things to do.... And take advantage of the marketplace today because I think it is actually a lot more fun for us to invest in these kinds of markets than it was probably in the market of the summer."

"...everyone needs yield, whether it is an insurance company or sovereign wealth fund. I mean people are desperate for yield."

He also discussed how lower interest rates are good for property. There is not much new supply being built, due to both uncertainty about the economy and a lack of willingness by banks to make construction loans.

The comments from Sternlicht reinforce my conclusions about the stock market. The commercial real estate sector is strong, and quality REITs have a lot of value at the current share prices and yields. I have listened to numerous earnings conference calls and read hundreds of earnings press releases. What I have seen/heard is that for quality, well-managed companies focused on owning, managing, or financing tangible assets, businesses are doing OK to well and will continue to grow and generate cash flow to pay and increase dividends. These business sectors include equity REITs, commercial finance REITs, aircraft and ship leasing companies, and the energy infrastructure companies. These sectors are also where we find most of the universe for high-yield stocks.

Although I hate to use the term, it does "feel" like the market may be finding a bottom from what is now a four month long sell-off. The S&P 500 has climbed by about 6% over the last two plus weeks. However, as income stock investors, we need to remember to stay focused on stable and growing dividend payments. This current market continues to be an opportunity to buy or add shares to lock in higher yields.

If you're following the Monthly Dividend Paycheck Calendar be sure to get the March update; just **CLICK HERE to get a copy.**

Land, Fly or Die,

Tim Plaehn
Editor
The Dividend Hunter

P.S. I primarily focus on income with our strategy for The Dividend Hunter. If you'd like to find out more about a pure total returns strategy I suggest you take a moment to check out my 30 Day Dividends service: CLICK HERE.

A REIT Serving The Most Financially Secure Customer in the World

Easterly Government Properties Inc. (NYSE:DEA) is a new public REIT that lives up to its name and owns properties that are leased to federal government agencies. Easterly plans to aggressively grow its portfolio of facilities, and this growth should lead to a rewarding combination of attractive current yield, dividend growth, and share appreciation.

Background

Easterly Government Properties was formed in 2011 by a group of executives with an average of 25 years of commercial real estate management experience. The company went public with a February 2015 IPO. At the time of the IPO, Easterly owned 29 properties that were 100% leased, with 26 leased by federal agencies.

The company's goal is to acquire properties to lease to government agencies. Criteria include buying buildings that are less than 20 years old (the average government facility is almost 50 years old) and put them on 10 to 20 year leases with built in rent increases. The General Services Administration (GSA) sets up almost all government leases and is moving the federal government away from owned facilities. GSA leased square footage has grown by 29% since 1998 with owned asset size staying flat over the same period. Changing missions and technologies are also pushing agencies into newer buildings that better support department requirements.

Leasing to the GSA takes a high level of expertise to work through the government contracting process. Currently, no landlord owns more than 3% of GSA leased properties and the top 10 own about 15% of government-leased properties. The handful of REITs operating in the government buildings sector has stable portfolios but little growth potential.

Investment Potential

Easterly, however, has come into the government-leasing sector with more aggressive growth plans. The goal is to acquire $75 million to $125 million of properties per year to the portfolio to lease to government agencies. With a current enterprise value of about $750 million, that target equates to 10% to 15% annual growth.

Easterly currently carries a low debt balance that equals 15% of enterprise value. Its peer REITs have debt levels of 40% to 50%. This means that Easterly can fund property acquisitions with more debt, which will increase the cash flow per equity share. Right now, the company could buy up to $350 million in new assets before it would need to issue more shares to keep the balance between equity and debt financing in line with what is prudent for a publicly traded REIT.

The fact that Easterly has its long-term leases with the world's most financially safe client allows the use of moderate to high debt levels while still maintaining a secure balance sheet.

The Easterly management team is forecasting that annual FFO per share will grow by 36% from $0.88 per share as of the 2015 third quarter through the end of 2016. I am looking for the current $0.22 quarterly dividend to be increased by at least 10% over the next year. The DEA shares now yield 5.1%.

My expectations are that the combination of long-term government guaranteed leases with an attractive growth profile will catch the investing markets attention as Easterly Government Properties builds a track record. This level of growth plus safety could result in the market pushing the share price up and the yield down. If the yield goes to less than 4% we would see a mid-$20's share price.

Recommendation: Buy and accumulate DEA shares as long as the yield is about 5%. That gives a share price buy up to of $18.00 with the current dividend rate.

Stock Market Returns to Disappoint Over the Next Decade

While I spend most of my time in the research of individual companies and stocks, I also carve out time to research and keep an eye on expert forecasts for longer-term economic and market trends. What I am seeing are more and more indicators that the overall stock market returns for the next decade will not live up to investor expectations, or more importantly, financial planning needs.

I want to state up front that I do not expect to be a great long-term market forecaster, and I do not think there are many "experts" who will end up with accurate forecasts when we get a decade down the road. However, I am good with data, numbers, and percentages. I look at what has happened historically and try to apply what I find to what I see in today's economy. Here is some of the information I have gathered over the last six months.

In September, I watched a Bloomberg interview of Ray Dalio. He is the founder and director of the largest hedge fund in the U.S. In the interview, Dalio noted that even if interest rates move up significantly, a bond investor who buys now is locked in to a return equal to the current yield until the bond matures. Trading bonds between now and the maturity will not change that outcome. With the 10-year bond yield now at about 2%, a high-quality bond portfolio or fund will produce single digit returns for the next decade.

Dalio also predicted that the major stock indexes will earn 3.5% to 4% more than the bond yield. That gives us average stock market returns of 5.5% to 6% over the next decade, well below the longer-term 9% to 11% average annual returns.

I recently attended another seminar on return assumptions for retirement planning. Historical data provided showed that over the last 90 years, long-term government bonds had produced a return 2.6% greater than inflation and stocks had averaged 5% to 6% above the long-term bond return.

Currently, we have a slow, slightly less than 2% per year growth economy. The official inflation number is running at about 1.4%. The stock market has experienced a strong bull market from the bottom of the last bear market in March 2009 through October 2015. That bull was the reaction to the recovery from the combination of the Great Recession and the resulting bear market.

Now, with slow growth hitting much of the global economy, it seems very possible that corporations will have trouble growing their net profits by much more than 2% to 4% per year on average. That level of profit growth does not point to double-digit stock market gains. These facts are another indicator of 5% plus or minus stock market returns for the foreseeable future.

If we follow the traditional asset allocation model of a balanced portfolio of bonds and stocks using ETFs, we are likely to generate average annual returns of 3% to 5%. (2% to 3% from bonds plus 4% to 7% from stocks dividend by two). If these returns are actually realized, especially at the low end of the range, the current savings and retirement plans for many investors will not work out. Those currently in the accumulation phase will reach retirement age with much less money than planned. Current or near to retirement individuals will not be able to withdraw the needed income amounts at a sustainable level.

For me, these facts and forecasts reinforce the idea that a higher-yield, dividend-focused investment strategy may very well end up as the better investment strategy for at least the next decade. The average yield in The Dividend Hunter recommendations list is 10%. That is already well above the 3% to 5% discussed above.

If there is some moderate dividend growth (which there will be) and you reinvest all or at least part of those dividend streams, this strategy will produce at or above double-digit annual returns over a 10-year period. That high-yield dividend stream also gives us better visibility on the return potential compared to the traditional strategy of trying to forecast corporate profit growth levels.

Stag Industrial Revisited

I added **Stag Industrial (NYSE: STAG)** to The Dividend Hunter recommendations list in January 2015. While that was near the most recent REIT valuation peak and the share price is down significantly from that time, this 4 1/2 year old REIT continues to build itself a profitable niche in the industrial real estate space. The record of steady growth combined with monthly dividends still makes STAG an attractive addition to an income focused stock portfolio.

Stag owns and leases single tenant industrial properties. The company uses a proprietary relative value, risk assessment model to select properties for purchase and ownership. The model often leads STAG to investments located in what are called secondary markets. These are the real estate markets outside of the 30 largest in the U.S. In this usage secondary does not mean second class. Industrial property markets that fall into the secondary classification have 25 million to 200 million square feet of industrial building space. An important factor is that secondary markets are less competitive for investment. This allows STAG to earn higher returns than on properties located in primary markets.

STAG is a growth-focused REIT. Here, “growth” means a continuous program of searching for and acquiring industrial properties. As a company presentation states, STAG's assessment model "allows us to evaluate all markets, all industries, and all tenants in search of relative value." STAG will invest in properties that the model shows will provide quality real estate for long-term ownership. The result of the company's acquisition program has been annual portfolio growth greater than 25% since STAG went public in 2011. The property ownership growth rate matches the company's stated growth goal.

As of the end of the 2015, STAG owned 291 properties. Of the total, 223 were warehouse properties, 47 were for light manufacturing, and 21 were classified as flex/office buildings. 56 properties were located in the primary markets, 181 were in secondary markets, and 54 were located in tertiary markets. The properties contained 54.7 million square feet, and STAG owns properties in 38 states.

The financial management team of STAG is conservative compared to its REIT peers in the industrial and commercial space. Debt is just 37% of the total enterprise value. The debt to EBITDA (earnings before interest, taxes, depreciation and amortization) ratio is 5.6 times, a full turn lower than the average of its peers. STAG has an investment grade credit rating. These measures of financial strength show us that this REIT will not be forced to reduce its dividend if business gets tougher in the commercial real estate markets or interest rates go higher.

Investors owning shares of STAG have been rewarded with a growing dividend rate. The company has increased the dividend rate by 33.6% since its 2011 IPO. The dividend rate has been increased twice by a total of 2.9% over the last year. The current dividend has been declared for the first six months of 2015 and dividends are paid on about the 15th of every month. Based on the new dividend rate and the current $17.50 share price, STAG yields 7.9%.

The STAG story is not a complicated one. The company is growth focused using a conservative property evaluation system to constantly add to its portfolio of commercial properties. Over the course of 2015, the company acquired 49 buildings for $427 million. Six buildings were sold for $22 million. The majority of properties are located in secondary markets where there is less competition for purchases and clients have less opportunity to leave a property when a lease expires. The acquisitions and management of expiring leases have allowed STAG to pay an attractive and growing dividend to investors.

Recommendation: Continue to buy or add shares of STAG.

Portfolio Update

Many of The Dividend Hunter portfolio stocks have released their 2015 fourth quarter and year end earnings reports. In almost all cases, business operations and financial results have come in at or above my expectations. Business for these companies remains good, even if some of the share prices are down quite a lot.

The one large question mark in the portfolio is with **Williams Companies Inc. (NYSE: WMB)**. The merger with **Energy Transfer Equity LP (NYSE:ETE)** is supposed to close in the second quarter. The share values of both WMB and ETE have fallen by about 60% since the merger was announced. At this point it is impossible to put a real value on the shares (although I am sure they are worth much more than the current trading price) until the merger goes through or does not. I would like to see ETE and WMB figure out a way to get out of the merger, but from what I read the contract is pretty air tight. WMB shareholders can still vote down the transaction. I think if the merger was officially canceled, the WMB share value would double overnight.

Now for the good news! There were two dividend increases in the portfolio since the last issue.

Macquarie Infrastructure Corp (NYSE: MIC) announced a $1.15 per share dividend to be paid on March 8. The rate is up 2 cents from the last dividend and up 14.7% in the last year. Management provided guidance of 12% dividend growth for 2016.

If you haven't yet, read my report on the power of stocks that consistently increase their dividends in my report: The Easy Money Manual

CyrusOne Inc (NASDAQ:CONE) increased its dividend by 21%, to $0.38 per share quarterly. The company reported year-over-year revenue growth of 30% and per share FFO growth of 27%.

In March, the **RBC Yorkville MLP Distribution Growth Leaders ETN (NYSE:YGRO)** will pay a $0.15675 per share dividend. This is down from $0.1917 paid the previous quarter. The growth focused MLP index tracked by YGRO was reformulated in the third quarter. Index components are now more focused to higher growth rate MLPs. I recommend this fund for the total return potential, which was enhanced by the index changes.

If you have any questions about the stocks in the portfolio or anything we covered in this month's issue feel free to write to me directly. My personal email adderss is tim.plaehn@investorsalley.com.

Current Portfolio: Buy / Accumulate

Stock	Entry Date	Entry Price	Recent Price	Status	Div. Earned	Current Yield	Cash Return
Easterly Government Properties (DEA)	03/01/2016	$17.50	$17.50	Buy	$0.00	5.1%	0.0%
VTTI Energy Partners LP (VTTI)	01/04/2016	$20.71	$17.87	Buy	$0.30	5.7%	1.46%
Jernigan Capital (JCAP)	12/01/2015	$15.37	$14.67	Buy	$0.35	9.3%	2.28%
Reaves Utility Income Fund (UTG)	11/02/2015	$29.95	$27.94	Buy	$0.60	7.0%	2.02%
Aircastle Limited (AYR)	9/30/2015	$20.61	$20.31	Buy	$0.48	4.7%	2.33%
Ventas, Inc. (VTR)	8/31/2015	$55.02	$57.57	Buy	$0.73	5.1%	1.33%
MLP Distribution Growth Leaders (YGRO)	7/30/2015	$14.60	$8.96	Buy	$0.53	6.9%	3.63%
CyrusOne (CONE)	6/30/2015	$29.45	$40.44	Buy	$0.63	3.4%	2.14%
Williams Companies (WMB)	5/29/2015	$51.10	$16.54	Buy	$1.87	9.8%	3.66%
Hercules Tech. Growth Capital (HTGC)	4/30/2015	$13.90	$11.23	Buy	$0.93	10.2%	6.69%
RLJ Lodging Trust (RLJ)	3/31/2015	$31.31	$21.72	Buy	$0.66	6.3%	2.11%
InfraCap MLP ETF (AMZA)	3/31/2015	$21.51	$8.43	Buy	$2.05	17.9%	9.53%
Lexington Realty Trust (LXP)	3/02/2015	$10.78	$8.02	Buy	$0.68	8.6%	6.31%
Blackstone Mortgage Trust (BXMT)	1/31/2015	$41.05	$25.59	Buy	$2.28	9.3%	7.81%
Stag Industrial (STAG)	12/31/2014	$24.50	$17.87	Buy	$1.60	7.6%	6.52%
EPR Properties (EPR)	10/30/2014	$55.64	$63.59	Buy	$4.84	6.2%	8.70%
New Residential Investment (NRZ)**	7/30/2014	$12.16	$10.41	Buy	$2.48	15.2%	20.39%
Main Street Capital (MAIN)	6/27/2014	$32.51	$29.71	Buy	$4.31	7.4%	13.24%
Macquarie Infras. Company (MIC)	5/30/2014	$61.48	$61.63	Buy	$6.26	6.5%	10.18%
Ship Finance International (SFL)	5/30/2014	$18.52	$13.51	Buy	$2.97	11.1%	16.04%
Starwood Property Trust (STWD)	5/30/2014	$24.39	$18.12	Buy	$3.36	9.4%	13.78%

Current Portfolio: Hold

Kinder Morgan (KMI)	1/31/201	$29.20	$18.11	Hold	$1.61	1.2%	3.91%
ONEOK (OKS)	12/01/14	$41.39	$29.24	Hold	$3.95	8.7%	9.54%
Arc Logistics Partners (ARCX)	07/30/14	$25.10	$12.11	Hold	$2.94	7.0%	11.69%

Recent price is determined by the last "Ask" price at the closing of the market on the day before publication; most recent update 03/01/16

Closed Positions

Stock	Entry Date	Entry Price	Close Price	Close Date	Div Earned	Total Return	Cash Return
Hannon Armstrong Sust. (HASI)	08/28/14	$14.69	$17.46	12/01/15	$1.26	29.19%	8.7%
Legacy Reserves (LGCY)	09/30/14	$29.68	$2.95	12/01/15	$2.06	-72.8%	6.9%
LinnCo LLC (LNCO)	04/30/15	$12.75	$1.68	12/01/15	$0.52	-82.74%	6.94%
Memorial Production (MEMP)	09/30/14	$22.02	$3.48	12/01/15	$2.50	-83.1%	11.4%
TCP Capital Corp. (TCPC)	10/30/14	$16.51	$16.22	05/29/15	$0.77	2.9%	4.7%
Ventas (VTR)	05/30/14	$66.80	$80.52	01/30/15	$1.45	22.7%	2.17%
Oaktree Capital Group (OAK)	05/30/14	$49.98	$54.14	02/09/15	$1.17	10.7%	2.3%
Salient Midstream & MLP Fund (SMM)	08/28/14	$31.23	$21.67	03/31/15	$0.93	-27.6%	3.0%

Notes:

Entry price is determined by the last "Ask" price at the closing of the market on the day before publication. Recent price is determined by the last "Ask" price at the closing of the market on the day before publication; most recent update 03/01/16. Status denotes whether you should continue to accumulate shares, listed as “Buy” or should hold but not accumulated any more shares, listed as “Hold”. Annual Div is the dividend payment as declared by the company and made publicly available. It is as of the closing of the market on the day before publication. Current yield reflects the yield of the regular annual dividend payments (monthly or quarterly depending on the stock) in relation to its share price at thetime of publication. We make no guarantee that any company in the portfolio will continue dividend payments. For a more detailed look at the portfolio, log on at www.investorsalley.com.

** NRZ entry price adjusted for 1 for 2 split on 10/20/14. Original entry price on 07/30/14 was $6.08.