Alley Company Commentary
Dividend Investing

Over the past several weeks and months – since the height of the financial crisis in late 2008/early 2009 – we have met with a variety of investors, and despite their differences – individuals to institutions, bullish to bearish, taxable to non-taxable – we have found a common appreciation for our message on the *timeliness* of dividend investing.

One probably has to look no further than the table below, which illustrates yields across major asset classes, to understand why investors would tend to agree that dividend investing is appealing in the current environment. The fact remains that bond yields are at unattractive levels on an absolute basis and cash and their equivalents yield next to nothing (literally!). The **Alley Company Dividend Portfolio** (managed in a separate account format), by contrast, offers the opportunity to lock in an attractive yield with companies that also have the potential to *grow* their dividends over time.

Current Yield Environment

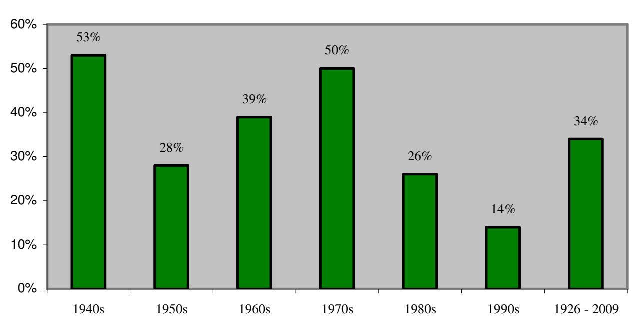
Money Market	0.01%
1-Year CD	0.65%
10-Year Treasury Bond	3.87%
Alley Company Dividend Portfolio	**4.22%**

Source: Charles Schwab and Alley Company. Data as of 3/31/10.

The Importance of Dividends

Historically, dividend income has been an important part of total return for stock investors. In periods when price appreciation is above normal, dividends become a lower component of total return (e.g., the 1990s). Over the long term (e.g., from 1926 through 2009), however, dividend income has accounted for more than one-third of the monthly total return for the S&P 500.

S&P 500
Dividend Income as a Percent of Total Return



Source: Standard & Poor's

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Three considerations as to why dividend income could play an increasingly important role in generating total return over the next several years are as follows:

- The stealth market recovery from March 2009 has in some cases been led by the "risk trade," i.e. higher beta or riskier companies and asset classes have made spectacular rebounds from uncertain financial condition. When this trade runs out of steam, high-quality companies, including consistent dividend payers, may come back into vogue.
- Currently, both U.S. household and government debt are at levels that require deleveraging. A by-product of this process is the likelihood of slower economic growth where the steady payout of dividends from high-quality companies may become more sought after.
- The baby boom generation is desirous of generating more income from their investments. Corporations have the opportunity to endear themselves to this large investor base by raising their dividend payout ratios, the percentage of earnings paid out to shareholders, over time.

Alley Company Investment Philosophy

In managing dividend portfolios for clients, our investment philosophy focuses on high-quality companies. Too often, investors have been tempted by high dividend yields without fully understanding the fundamental position of a company. Our focus is on the *balance* between attractive current yield and future dividend growth. We avoid "reaching" for a higher current yield only to sacrifice quality. Our stock selection process seeks out companies with proven track records of dividend payout, which in many cases stretch over multiple years or even decades. In addition, our portfolio holdings have strong balance sheets and durable competitive advantages in their businesses. ***Together, we expect these factors to contribute to the Alley Company Dividend Portfolio's ability to produce a rising income stream for our clients over time***.

> Through the height of the financial crisis and beyond, the Alley Company Dividend Portfolio has incurred minimal dividend reductions and several dividend increases. Specifically, from March 2009 until present, one (1) portfolio holding has reduced its dividend while twenty-three (23) have increased their dividends. This is a particularly strong record given the wave of dividend reductions that occurred in the broad market during this period. The average rate of dividend increase in the portfolio during this period was +5.9%.

Attractive Characteristics

Stepping back from Alley Company's *specific* investment philosophy and stock selection process, there are also *general* characteristics of dividend-paying companies that we find desirable, including:

1. When dividends are distributed to shareholders (typically on a quarterly basis), we believe it provides an important and tangible reminder to the executives and board of directors as to who actually owns the company (the shareholders!).

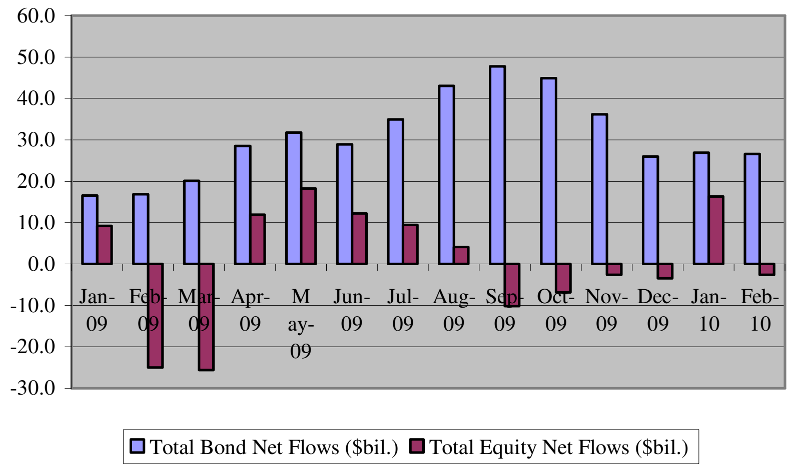
2. Companies that have the *ability* to pay sustainable and growing dividends tend to have durable competitive advantages in their businesses.
3. The *discipline* of consistently paying out dividends can foster a shareholder-friendly culture within a firm, which we believe can lessen the risk of squandering capital on low-potential projects, ill-advised acquisitions, or egregious or unwarranted executive compensation.

Dividend Investing in the Context of Asset Allocation

At the core of an investment management program is the agreed upon long-term asset allocation policy (often referred to as the *"strategic"* asset allocation), which reflects the optimal long-term standard around which future asset class mixes might be expected to vary.

Over the past year, we have witnessed imbalances develop relative to many investors' *strategic* asset allocation policies: ***over allocation to cash and bonds and under allocation to stocks.*** The "flight to safety," or crowding into the bond market that has occurred and is depicted in the chart below corroborates the development of these imbalances.

Mutual Fund
Net New Cash Flows



Source: Investment Company Institute

For investors that continue to find themselves in an out-of-balance position, we believe that a portfolio of high-quality dividend stocks is an attractive and timely choice to facilitate the shift back toward equities. In particular, with the **Alley Company Dividend Portfolio**, this choice can preserve or even enhance current income while also adding the potential for future growth.

Alley Company is an independent money management firm that provides separate account investment management for a limited number of select individual and institutional clients. In addition to managing high-quality dividend portfolios for clients, we provide:

- ***core equity portfolio management***
- ***fixed income portfolio management***
- ***asset allocation advice and implementation***
- ***management of concentrated stock positions***
- ***management of covered call writing programs***
- ***other customized services and general financial advice***

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