



Downside Protection, Dividends Enhance Returns, Control Risk in Volatile Markets

Stock market and bond market investors generally have different goals and objectives. Stock investors are normally optimistic, seeking to maximize gains, maintaining a 'how much can I possibly make?' philosophy. On the other hand, bond investors are normally more skeptical, focusing on "how much could I possibly lose?" understanding that under a best case scenario they will collect interest and ultimately the par value of their original investment. At Godsey & Gibb Associates, 2010 marks our firm's 25th year of balanced investing, combining the potential upside of the equity markets, but filtered through a risk managed selection process with the downside emphasis of fixed-income investing.

Our focus on downside protection was especially important as the broad equity markets, as measured by the S&P 500 Index, fell 57% from the high in October 2007 through the low in March of 2009. Since then, while the S&P 500 Index and global markets in general have rallied sharply, due to the arithmetic of loss and recovery, the markets' rebound doesn't mean the recovery is complete. For example, if a \$1,000 investment loses 50%, it drops to \$500. For the investment to return to its original \$1,000 level, it needs to gain 100%. For the S&P 500 Index to return to its October 2007 high, it would need to realize a gain of over 132%.

The arithmetic of loss and recovery highlight the importance of downside protection. While Godsey & Gibb's investment strategies may not be at the forefront in aggressive bull markets, by losing less ground during downturns, they can outpace the markets and peers over longer time periods.

Dividends also work to enhance returns and control risk. The improving economy is once again giving corporations the cash to compensate shareholders for holding their shares. After 78 S&P 500 companies cut or suspended their dividends in 2009, including almost half of all banks and finance companies, the prospects for dividends are improving in 2010. Bloomberg is forecasting that for the first time since the second quarter of 2004, no S&P 500 companies are expected to cut their dividends in the second quarter of 2010.

Dividends represent a large portion of the historic total return for equities and higher yielding stocks have persistently outperformed the market indices over nearly all longer time periods. The S&P 500 Index currently yields 1.9%, while dozens of well-regarded companies are even better income providers. The consumer and health-care sectors are particularly dividend rich, as are the traditional utilities and telecommunications sectors. Blue chips like Exxon Mobil, International Business Machines, Johnson & Johnson, PepsiCo, Procter & Gamble Co. and Wal-mart Stores, among others, recently increased their dividends.

Due to their predictable, often higher income stream, stock dividends have become an attractive bond alternative, with the added benefit of potential price appreciation. In order to minimize risk, and avoid so-called 'dividend traps', or companies that have fallen in price because the business is in trouble, Godsey & Gibb Associates believes that investing in companies with strong balance sheets, consistent earnings growth and a quality long-term business model that can continue to support a company's ability to keep increasing its payout is always important. We continue to believe that in a modest economic growth environment, companies that can thrive and prosper, and increase their dividends, will be rewarded by investors.

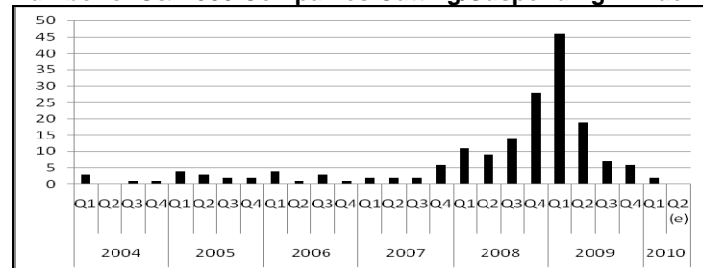
While the potential for rising taxes cannot be ignored with regard to dividends, it is important to remember that prior to the 2003 Tax Act, dividends had always been taxed at ordinary tax rates and dividend paying stock still outperformed non-dividend paying stocks. The administration has proposed a 20% tax rate on stock dividends, versus the 15% rate most taxpayers pay, but without congressional action qualified dividends will be taxed at full individual income-tax rates starting in 2011. Based on this, many companies may try to prepay dividends in the fourth quarter of 2010 in anticipation of such a change. Other cash-rich companies, Microsoft for example, could initiate one-time payouts later in the year.

The Arithmetic of Loss and Recovery

If your investment declines ...	To get back to break-even, you'll need a gain of ...
-10%	11.1%
-20%	25.0%
-30%	42.9%
-40%	66.7%
-50%	100.0%

Sources: The American Funds and Godsey & Gibb Associates

Number of S&P 500 Companies Cutting/Suspending Dividends



Sources: Standard & Poor's, Bloomberg and Godsey & Gibb Associates (e=estimated)

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