Matarin Capital

Investing with Insight and Integrity

2011 Year-End Newsletter

Matarin aspires to be an investment management firm that is a symbol of stewardship within our industry. We are dedicated to delivering excellent investment performance through insight, passion, and diligence. We aim to build strategic alliances with our clients based on the highest ethical standards.

Commentary: U.S. Equities

The popular press has determined that 2011 was the "year of the dividend." In 2011, the stock market leaders generally belonged to more stable, income producing industries (utilities, pharmaceuticals, tobacco, staples, etc.). So, it should come as no surprise that dividend-based funds and ETFs were large outperformers and asset gatherers during the year. In 2011, the roughly 900 dividend paying stocks in the S&P 1500 index returned an average of +1.4%, while the roughly 600 non-payers returned -4.6% on average.

Many investors believe, and rightly so, that dividend-paying stocks have outperformed non-dividend-paying stocks over time. The outperformance of dividend-paying stocks should not be surprising given that these tend to be cash-flow generative companies (the money has to come from somewhere…right?). At Matarin, we believe that what really matters is whether the company has the ability to pay and sustain a dividend via internally generated cash flow, not necessarily whether or not they actually pay one.

To make this point, using data from 1994-2011, we have broken the S&P 1500 benchmark down into quintiles based on cash flow yield and then based on whether a company is a dividend payer or not. By doing this, we can analyze whether we should prefer dividend-paying stocks once profitability and "value" have been taken into account.

As you can see below, stocks trading at high cash flow yields have tended to outperform historically, while the expensive stocks, which have low or negative cash flow yields, have tended to underperform. You can also see below that cash flow generative, "cheaper" companies are more likely to pay a dividend. What's more interesting, is that within stocks that look cheaper based on cash flow yield, the non-dividend payers actually have slightly outperformed since Jan 1994. Bottom line: At Matarin, we focus on a company's ability to pay, not on the payout itself.

Average Forward 12-Month Return based upon Dividend Payment and Cash Flow Yield, Jan 94-Dec 11

Trailing Cash Flow Yield Quintile	Return for stocks that paid NO Dividend over prior 12 months	Return for stocks that paid a Dividend over prior 12 months	% of Stocks in Quintile that paid a Dividend
1 "*Cheap*"	15%	13%	70%
2	12%	10%	67%
3	10%	8%	41%
4	9%	7%	49%
5 "*Expensive*"	2%	4%	31%

Commentary: Global Markets

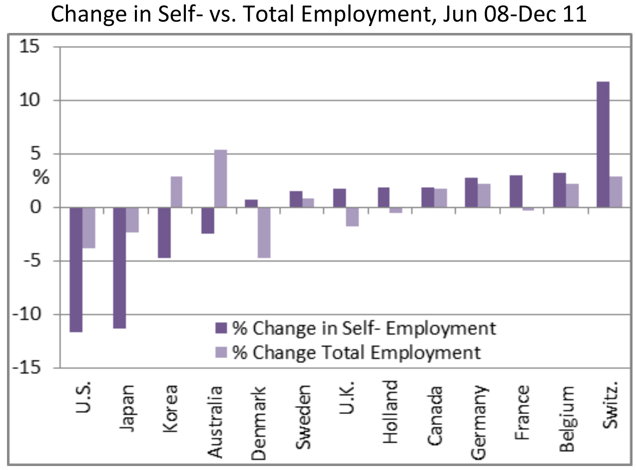
Digging into the unemployment reports coming out of Europe recently, one distinctive spot has stood out for us: favorable changes in self-employment numbers. In fact, most western-European countries which have shown gains in total employment since the emergence of the financial crisis have also shown positive growth in the numbers of the self-employed.

This is in contrast to many other OECD countries. For example, compare Western Europe (excluding the challenged periphery) with Australia and South Korea, which provide a strong counter-example in which positive changes in total employment figures have been characterized by a *shrinking* in the number of self-employed – which is to say that favorable employment trends have been driven by growth in the corporate workforce. Another contrast is the United States, where negative total employment trends have been driven by deep declines in the numbers of self-employed, a trend which has been led by a loss of construction jobs, an industry in which over a quarter of workers were self-employed in 2008.

You probably won't be reading many positive takes on the European economy to start off 2012, but at Matarin we believe that in the long run, once the dust from the sovereign-debt crisis has settled, the rising number of entrepreneurs in Europe may be a positive relative to competing countries that are not showing similar trends.

In the short run, of course, growth in "self-employment" may partially be a reflection of the true extent of under-employment in the labor market at this time. Without the option of self-employment, total unemployment figures would be much higher, indeed. But in a macroeconomic sense, we believe that the trend toward increased entrepreneurship in Europe – and that entrepreneurship in general – has the potential to represent a force for greater competition, job creation, innovation, and perhaps in the long run, real economic growth.

Change in Self- vs. Total Employment, Jun 08-Dec 11



Data sources: Compustat, FactSet, OECD