

## Equity Strategies • Equity Income

The Equity Income portfolio is focused on businesses across a broad range of market capitalizations that collectively generate an above-average stream of dividend income, while also providing for capital appreciation potential. The businesses are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that have the ability to either pay a high level of dividend income or grow the dividend stream over time. The portfolio typically is comprised of 30-35 holdings and is expected to result in low to moderate turnover. The portfolio is suitable for clients seeking total return from dividend income and capital appreciation.

### Portfolio Commentary

For the fourth quarter, the broad equity markets posted marginally negative results with the S&P 500 Index down 0.4%. A casual observer may conclude that nothing must have occurred during this period, which would be well off the mark. During the quarter there was a closely contested presidential election as well as the impending fiscal issues (tax increases and spending cuts) aptly termed the “fiscal cliff” which resulted in heightened anxiety amongst investors. In fact, the S&P 500, which was already trending downward leading up to the election, sold off sharply immediately following the outcome. By mid-November, the S&P 500 was down more than 6% on an intra-quarter basis. Meanwhile, investors were clinging to any bit of news from Washington regarding negotiations surrounding the fiscal issues and the impact they would have on the market. By year-end, a short-term resolution was in sight and the S&P 500 rallied to end the quarter essentially flat.

For the year, the S&P 500 generated very solid returns, up 16.0%, which is one of the strongest years of the last decade, surpassed only by the rebound years of 2003 and 2009. The strength was led by Financials, which are more focused on growth after years of being hampered by credit issues, and the Consumer Discretionary sector. Despite some hand wringing throughout the year, consumers are feeling more optimistic about their financial outlook. This is likely attributable to

abatement in the rising unemployment rate combined with a housing market showing signs of not only stabilizing but growing.

The Equity Income strategy posted solid returns for both the quarter and the year, up 2.4% and 17.8%, respectively (gross of fees). (For detailed performance data and disclosures see: [www.confluenceim.com/equity\\_strategies#prod\\_137](http://www.confluenceim.com/equity_strategies#prod_137).)

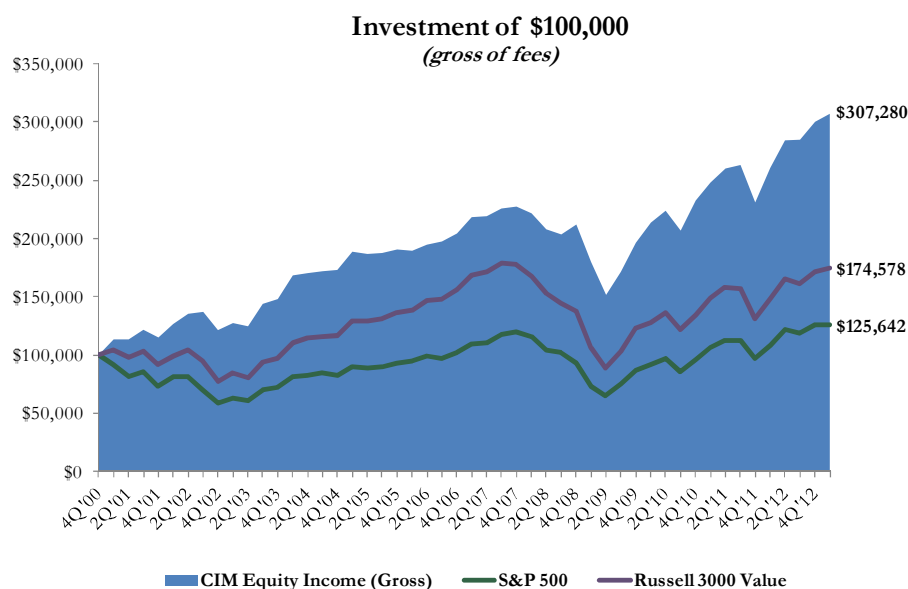
The Equity Income portfolio’s best performing holdings were: McGraw-Hill, Rayonier, and Fidelity National Financial. The majority of holdings posted double-digit returns for the year so strength was relatively broad-based. Only two holdings posted negative returns during 2012. They were Southern Company and Willis Group Holdings. There were no changes to the portfolio during the quarter as we remained comfortable with the valuations of the underlying businesses and the overall makeup of the portfolio.

Going forward, we expect the economy to grow below historical trend and unemployment to gradually improve as businesses and consumers continue to remain cautious following the balance sheet recession. The housing market and domestic energy production are providing positives to the economy and should be able to offset the headwinds coming from the fiscal policies from Congress. As always, our focus remains on finding and owning great businesses at bargain prices.

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Top 10 Portfolio Holdings (as of 12/31/12)

Company	Market Capitalization (\$ billions)	Portfolio Weight
Fidelity National Financial, Inc.	5.3	3.5%
McGraw-Hill Companies, Inc.	15.2	3.4%
HNI Corp.	1.4	3.3%
Franklin Street Properties Corp.	1.0	3.2%
Plum Creek Timber Co. Inc.	7.2	3.1%
Rayonier Inc.	6.4	3.1%
Ares Capital Corp.	4.3	3.1%
Lockheed Martin Corp.	29.9	3.1%
Martin Marietta Materials Inc.	4.3	3.0%
Chevron Corp.	211.6	2.9%



Confluence Investment Management LLC

Confluence Investment Management LLC is an independent, SEC Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics and geopolitical analysis with a value-driven, fundamental company-specific approach. The firm's portfolio management philosophy begins by assessing risk, and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.

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