

## 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

The S&P 500 Index gained 32.4% during 2013, its best annual performance in over 15 years. The Equity Income portfolio returned 26.1% (gross of fees) in 2013. *(For detailed performance data and disclosures see: [www.confluenceim.com/equity\\_strategies#prod\\_137](http://www.confluenceim.com/equity_strategies#prod_137)).*

Equity returns were stronger than we anticipated and while we continue to be optimistic about investment prospects, we caution readers not to expect similar returns in 2014.

Historically, stock market gains of such magnitude aren't driven by corporate earnings. Rather, they come when investors recalibrate expectations and decide to pay a higher price for a dollar of corporate earnings. In 2013, P/E expansion accounted for the majority of the index's return. We believe the Federal Reserve's monetary policy played a leading role in driving the P/E ratio higher, but that is not to say the revaluation in stocks was irrational. In our estimation, the stock market is more or less fairly valued at today's level. The antipathy for stocks dissipated last year; 2013 was the first year since 2006 that investors, in aggregate, made net contributions to equities, halting what had been substantial reductions to equity holdings in the last five years.

Admittedly, we liked the antipathy in the market as it allowed us to pick up bargains with regularity. As we look at the investment landscape today, wholesale bargains no longer

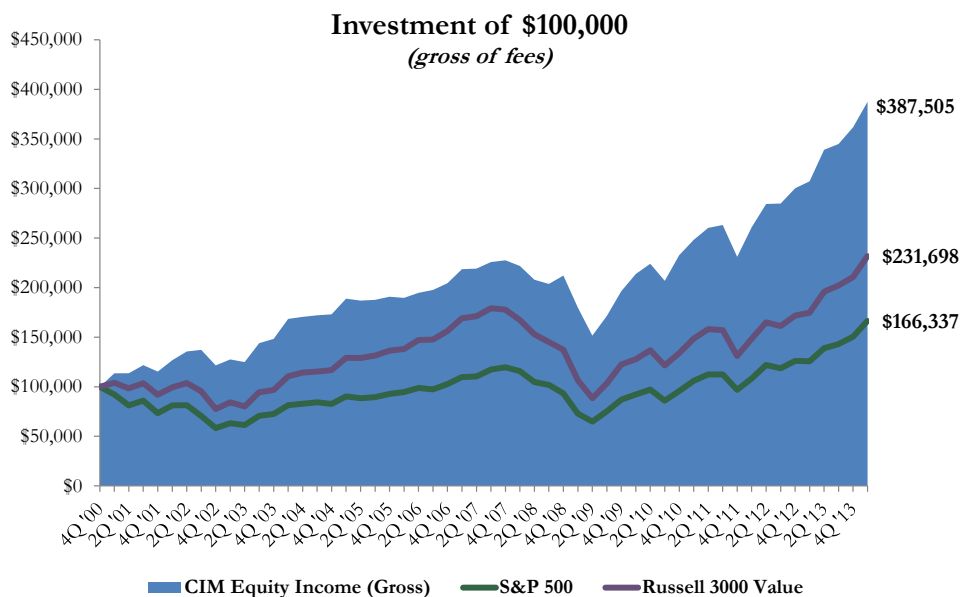
exist, but economic conditions have improved modestly and corporations are in remarkably strong financial positions. The current environment still suits our fundamental bottom-up investment approach.

During the 4th quarter, Northern Trust was added to the portfolio. Northern Trust is a high quality financial franchise with operations in trust services, asset management, wealth advisory and banking. We've admired this company for many years, but it has always been a bit expensive relative to its growth prospects. The company's stock valuation has improved and, in our opinion, the stage is being set for a stronger operating environment whereby the company will be able to accelerate its earnings growth. Although we expect to be in a low interest rate environment for some time, the December decision by the Fed to taper its bond buying activity should begin the journey to a more normalized interest rate environment, which would benefit the shares of Northern Trust. We also like the fact that we were able to obtain exposure to a higher interest rate environment without taking on too much credit risk. The credit risk within Northern Trust's operations is considerably less than it is for its broader peer group of commercial banks.

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Top 10 Portfolio Holdings (as of 12/31/13)

Company	Market Capitalization (\$ billions)	Portfolio Weight
Lockheed Martin Corp.	47.6	3.9%
Broadridge Financial Solutions Inc.	4.7	3.9%
Fidelity National Financial Inc.	8.1	3.6%
3M Company	93.3	3.5%
Du Pont E.I. De Nemours & Company	60.2	3.3%
Emerson Electric Company	49.5	3.3%
Kohl's Corp.	12.2	3.1%
Microsoft Corp.	312.3	3.1%
Iron Mountain	5.8	3.1%
Chevron Corp.	240.2	3.0%



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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