

## Equity Strategies • IDEA

The Increasing Dividend Equity Account (IDEA) portfolio is focused on high quality companies with long track records of distributing earnings to shareholders through dividends. These companies tend to be established companies that generate free cashflow and have management teams committed to growing the dividend. The portfolio is selected from a universe of stocks meeting minimum criteria of paying and increasing dividends over the last 10 years. The portfolio typically is comprised of approximately 50 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 had a rough start to the year, declining almost 10% through mid-February but then rebounding to finish the quarter up 1.3% year to date. The IDEA portfolio outperformed the S&P 500 over the same period with a return of 4.5% (gross of fees).

*For detailed performance data and disclosures see:*

[http://www.confluenceinvestment.com/equity\\_strategies#prod\\_42](http://www.confluenceinvestment.com/equity_strategies#prod_42)

This outperformance was driven overall by strength in dividend-paying stocks from falling interest rate expectations, but also by a few holdings in particular. Polaris (off-road vehicles) returned 36% following a timely purchase in late January, and Graco (industrial flow control) and Nordstrom (retail) both rebounded after weak returns in 2015. Our health care holdings posted solid outperformance and the portfolio was not impacted by the decline in biotech stocks, which generally don't meet our IDEA criteria. Our financial holdings on average declined in Q1, primarily from concerns about lower interest rates weighing on profits.

The stock market posted one of the worst starts on record to begin 2016 when recession fears grew from expectations of Federal Reserve rate increases and a strong dollar in conjunction with a weak global economy and a severe recession in the energy industry. But as the quarter progressed, fear gave way to fundamentals and the market recovered as the economy continued to bump along, U.S. job growth kept pace, oil prices rebounded and the Federal Reserve reiterated a "low and slow" approach to increasing interest rates.

In January, Polaris was purchased to replace Chubb (insurance) after it was acquired by ACE (which was already held in IDEA and subsequently re-named Chubb Limited). Polaris has a long history of quality products, innovation and good management that have driven solid earnings and dividend growth. Polaris was previously owned in the IDEA portfolio, but was sold in April 2011 after excitement about growth increased the valuation to the point where we thought there was little margin of safety. That excitement moved the stock to a high in 2015 before concerns about a recession took the stock to its recent lows in early 2016. Our patience was rewarded as we were able to buy the company in IDEA at a valuation significantly below where we sold it in 2011. The stock could retest its lows if recession fears reemerge, but Polaris should be a solid investment over the long term.

Volatility will surely resurface as the Federal Reserve continues on a path toward normalized interest rates. Over the past 30 years, markets and economies have become increasingly dependent upon the belief that monetary policy can fix anything, the latest iteration being central banks in Europe and Japan experimenting with negative interest rates to induce activity. This dependency seems to be approaching the end of the road as monetary stimulus has lost its effect and has little more to give. The transition back to more normalized monetary policy will be slow and turbulent, so it is especially important to stay focused on owning high-quality businesses with solid management teams and growth prospects, trading at valuations that provide a margin of safety.

Annual Dividend Statistics for IDEA Portfolio at 12/31

Year	Holdings	Avg. Yield	Dividend Change from Prior Year*					Years*			
			# of companies with			Avg. Growth	Indexed Growth**	# of companies with			Avg. 10 yr Growth
			Increase	Flat	Decrease			10 years	9 years	< 9 years	
2009	49	2.8%	45	4	0	8.1%	\$1,081	38	6	5	13.3%
2010	49	2.8%	45	4	0	8.0%	\$1,167	38	3	8	12.6%
2011	49	2.8%	46	3	0	9.6%	\$1,279	38	4	7	12.5%
2012	48	3.1%	46	2	0	9.1%	\$1,395	39	5	4	12.8%
2013	49	2.3%	48	1	0	10.0%	\$1,535	41	3	5	13.1%
2014	49	2.4%	48	1	0	10.3%	\$1,693	39	3	7	12.7%
2015	49	2.8%	47	2	0	9.7%	\$1,857	40	3	6	11.9%

\*Excludes impacts of special dividends and spin-offs.

\*\*The Indexed Growth column is an estimate of the cumulative growth of \$1,000 in dividends beginning 12/31/2008. It does not represent actual results.

Top 10 Portfolio Holdings (as of 3/31/16)

Company Name	Ticker	Weight	Company Sector	Yield
Chubb Limited	CB	2.8%	Financials	2.2%
Home Depot, Inc	HD	2.5%	Consumer Discretionary	2.1%
Microsoft Corporation	MSFT	2.4%	Information Technology	2.6%
Polaris Industries Inc	PII	2.4%	Consumer Discretionary	2.2%
TJX Companies, Inc	TJX	2.4%	Consumer Discretionary	1.3%
New Jersey Resources Corporation	NJR	2.4%	Utilities	2.6%
Stryker Corporation	SYK	2.3%	Health Care	1.4%
McDonald's Corporation	MCD	2.3%	Consumer Discretionary	2.8%
Clorox Company	CLX	2.3%	Consumer Staples	2.4%
Becton, Dickinson and Company	BDX	2.2%	Health Care	1.7%

Portfolio Statistics

# of Holdings	49
Average Dividend Yield	2.5%
Average Price to Earnings-LTM	21.5
Average Price to Book	5.4

Sectors

Consumer Discretionary	13.1%
Consumer Staples	10.0%
Energy	5.9%
Financials	16.9%
Health Care	11.6%
Industrials	18.0%
Information Technology	10.3%
Materials	4.1%
Telecom Services	0.0%
Utilities	8.0%

Market Capitalization

Large Cap	75%
Mid Cap	23%
Small Cap	0%
Weighted Average (\$ billions)	76.4
Largest	436.8
Median	40.0
Smallest	3.1

Portfolio Changes in 1Q 2016

Chubb and ACE Limited merged  
Bought Polaris (PII)

Confluence Investment Management LLC

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