

Research Portfolios

Equity Income Portfolio Quarterly Spotlight

Bank of America
Merrill Lynch

Portfolio Strategy

12 April 2017

A focus on yield and dividend growth

The Research Income Portfolio Model is designed for moderately conservative investors who seek to generate an ongoing and growing income stream from stocks considered to have low relative price volatility, with some emphasis on principal protection. Dividend growth and the percentage of earnings that is paid out as dividends (payout ratio) are important considerations for stocks in this model. In line with the objective of an increasing income stream, most stocks in the model raised their dividends in 2016 or are expected to do so in the next 12 months. See Chart 1 and Table 5 for historical dividend growth rates. For further details on the model's construction, see the following report: [US Portfolios Primer 28 November 2016](#).

Income-oriented sectors dominate the model

The Income Model's sector weightings differ substantially from those of the overall market. Sectors that are associated with higher levels of income and/or dividend growth—Consumer Staples, Financials, Energy, Industrials and Utilities—have double digit weights in the model. Other sectors are included for risk management through diversification, but representation is limited. Sector weights remain fairly constant and are changed infrequently.

Table 1: Income Portfolio Performance and Metrics

	Income	S&P High Yield Div Aristocrats	Income Portfolio Metrics	
Q1 2017	4.29%	3.79%	Dividend Yield	3.73%
2017	4.29%	3.79%	Est. Dividend Growth	6.75%
12 Months	14.18%	14.25%	Est. EPS Growth	9.42%
3 Year	10.93%	11.30%	Forward P/E	16.7
5 Year	12.27%	13.60%	Forward P/CF	10.4
10 Year	8.26%	6.62%	5 year Beta	0.92
2016	16.53%	20.40%	5 year Sharpe Ratio	1.40
2015	2.65%	-0.40%	12 Month Turnover	27.64%
2014	11.70%	14.01%	Average Market Cap	122,803 MM
2013	23.44%	30.23%	5 year Standard Deviation	8.65%
2012	9.02%	11.67%		
2011	13.80%	7.46%		
2010	14.55%	16.42%		
2009	16.98%	17.98%		
2008	-27.40%	-22.46%		
2007	7.27%	-6.06%		

Source: S&P Compustat, Bloomberg, BofA Merrill Lynch Research Portfolios

Note: Est. Dividend growth and EPS growth are the average of current and expected over a multi-year period. Forward P/E measure excludes stocks with negative earnings. Forward P/CF excludes Financials for whom cash flow per share is not relevant.

Beta measures the volatility of the portfolio vs. the S&P High Yield Dividend Aristocrats Index by aggregating betas of individual portfolio positions. A beta exceeding 1.0 implies greater volatility than the market. Sharpe Ratio measures the return of a portfolio per unit of risk; higher ratios imply greater risk-adjusted returns.

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Equity Income portfolio

The primary objective is to obtain an ongoing secure income stream from what we view as dependable sources, with some emphasis on protection of principal. This list is a representation of the Income Portfolio Model as of April 11, 2017. Please see the latest "US Portfolio Update & Holdings" for the current portfolio constituents.

Table 2: Equity Income

Sectors/Target Weights	Symbol	Proposed Weight	Price		Yield †	QRQ Rating	Footnote
			Close 4/11/17	Average Cost			
Consumer Discretionary (6%)							
Carnival	CCL	2.0%	57.78	\$45.22	2.77%	XRWW	Bbijopsw
McDonald's Corp	MCD	4.0%	131.20	\$92.67	2.87%	B-1-7	Bbgjopsw
Consumer Staples (17%)							
Kimberly-Clark	KMB	3.0%	132.63	\$67.31	2.93%	A-2-7	BObijopsw
Coca Cola	KO	3.0%	42.66	\$40.45	3.47%	A-1-7	Bbijopsw
Procter & Gamble	PG	4.0%	89.80	\$77.79	3.07%	A-1-7	Bbgjopsw
Kraft Heinz	KHC	3.0%	90.83	\$58.79	2.64%	B-1-7	BObijopsw
Philip Morris Intl	PM	4.0%	113.42	\$80.98	3.67%	B-2-7	Bbw
Energy (12%)							
Royal Dutch Shell B	RDSB	4.0%	56.82	\$55.75	6.62%	A-1-7	Bbijopsw
Occidental	OXY	4.0%	64.98	\$80.90	4.68%	B-1-7	BObgjopsw
Enbridge	ENB	4.0%	42.19	\$28.53	4.23%	B-2-7	Bbgjopsw
Financials (13%)							
MetLife Inc.	MET	3.0%	52.77	\$40.48	3.03%	B-2-7	BObijopsw
JP Morgan Chase	JPM	3.0%	85.73	\$43.01	2.33%	B-1-7	BObijopsw
CME	CME	3.0%	117.07	\$106.74	5.03%	B-1-7	Bbijopsw
TD Bank	TD	4.0%	49.62	\$38.68	3.61%	B-1-7	Bbgjopsw
Health Care (8%)							
Pfizer Inc.	PFE	4.0%	33.93	\$30.97	3.77%	XRWW	BObgjopsw
AstraZeneca	AZN	4.0%	30.18	\$34.69	4.74%	B-1-7	Bbijopsw
Industrials (12%)							
Lockheed Martin	LMT	4.0%	270.27	\$149.45	2.69%	B-1-7	BObijopsw
General Electric	GE	4.0%	30.04	\$22.93	3.20%	B-1-7	Bbijopsw
PACCAR Inc	PCAR	4.0%	67.53	\$45.63	2.31%	B-1-7	Bbijopsw
Information Technology (8%)							
IBM	IBM	4.0%	170.58	\$144.25	3.28%	B-1-7	BObijopsw
Intel	INTC	4.0%	35.74	\$24.27	3.05%	B-1-7	BObgjopsw
Materials (0%)							
Real Estate (6%)							
Ventas Inc.	VTR	3.0%	65.47	\$52.63	4.73%	B-1-7	BObijopsw
Digital Realty Trust	DLR	3.0%	109.42	\$60.95	3.40%	B-1-7	Bbgjopsw
Telecomm. Services (8%)							
Verizon Comm	VZ	4.0%	48.70	\$37.79	4.74%	A-1-7	BObgjopsw
AT&T	T	4.0%	40.31	\$31.40	4.86%	A-1-7	BObijopsw
Utilities (10%)							
PPL Corp.	PPL	3.0%	37.35	\$30.24	4.23%	A-2-7	Bbijopsw
American Elec Power	AEP	3.0%	67.39	\$49.29	3.50%	A-1-7	BObijopsw
Dominion	D	4.0%	77.48	\$72.98	3.90%	A-1-7	BObgjopsw
Cash (0%)							
		0.0%					
		100.0%			3.73%		

Source: BofA Merrill Lynch Global Research

†: Investors should be aware that foreign governments sometimes withhold a percentage of dividends paid to US shareholders, which may adversely impact an investor who is following the portfolio. This may affect the yield received when compared to the stated yield for the Research Portfolios. XRWW=extended review

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Table 3: Equity Income Portfolio changes since end of last quarter

Date	Action	Ticker	Company Name	Rationale
2/21/2017	Sell	TRI	Thomson Reuters	Stock stalled as sales growth turned negative; macro European headwinds
2/21/2017	Add	CME	CME Group	Increase the dividend yield in the Financial sector
2/21/2017	Add	TD	TD Bank	Increase the dividend yield in the Financial sector

Source: BofA Merrill Lynch Research Portfolios

Equity Income Portfolio Commentary

This portfolio returned 4.3% in the quarter, above its benchmark index return of 3.8%, but lagging growth-oriented portfolios. We are not surprised, as we had written that if the market's bias shifted toward growth/cyclicals with expectations for higher growth from tax cuts and fiscal spending, this portfolio was likely to lag higher growth alternatives. The portfolio has a large commitment to Consumer Staples, a sector that is currently expensive on a relative basis. And although the sector could potentially be punished should border taxes be enacted that create more restrictive global trade, Consumer Staples remains a key source of dividend yield. However, in Q1, the drag on performance came from stock selection in Energy and Telecom, the only sectors that had negative returns in the quarter. Looking forward, Fed-induced interest rate increases and/or increases in bond yields may cause added volatility for higher income-producing stocks over the near term. Nonetheless, a dividend yield of 3.7% and double digit dividend growth (see Chart 1) are likely to continue to be attractive to conservative investors in search of a steady income stream.

Table 4: Q1 2017 attribution details for the Equity Income Portfolio

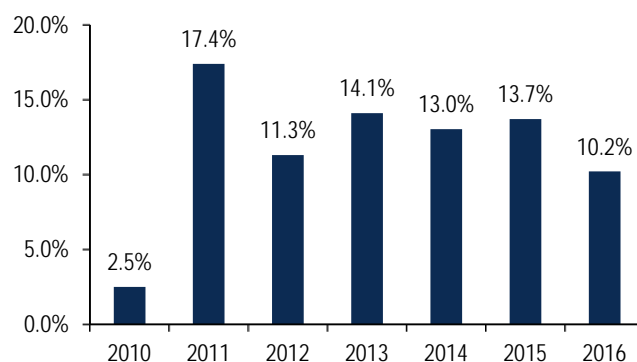
Top 5 Contributors to Return	PM	Philip Morris Intl
	AZN	AstraZeneca
	KMB	Kimberly-Clark
	LMT	Lockheed Martin
	CCL	Carnival
Bottom 5 Contributors to Return	OXY	Occidental
	VZ	Verizon Comm
	GE	General Electric
	RDSB	Royal Dutch Shell B
	T	AT&T

Source: Bloomberg, BofA Merrill Lynch Research Portfolios

Table 5: Historical Dividend Yield of Equity Income Portfolio

Year end	Dividend Yield
2010	3.8%
2011	3.9%
2012	3.8%
2013	3.6%
2014	3.6%
2015	4.0%
2016	3.6%

Source: BofA Merrill Lynch Research Portfolios

Chart 1: Historical Dividend Growth of Equity Income Portfolio

Source: BofA Merrill Lynch Research Portfolios

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