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WELLS FARGO ADVISORS

High Yield Equity Income List Strategy

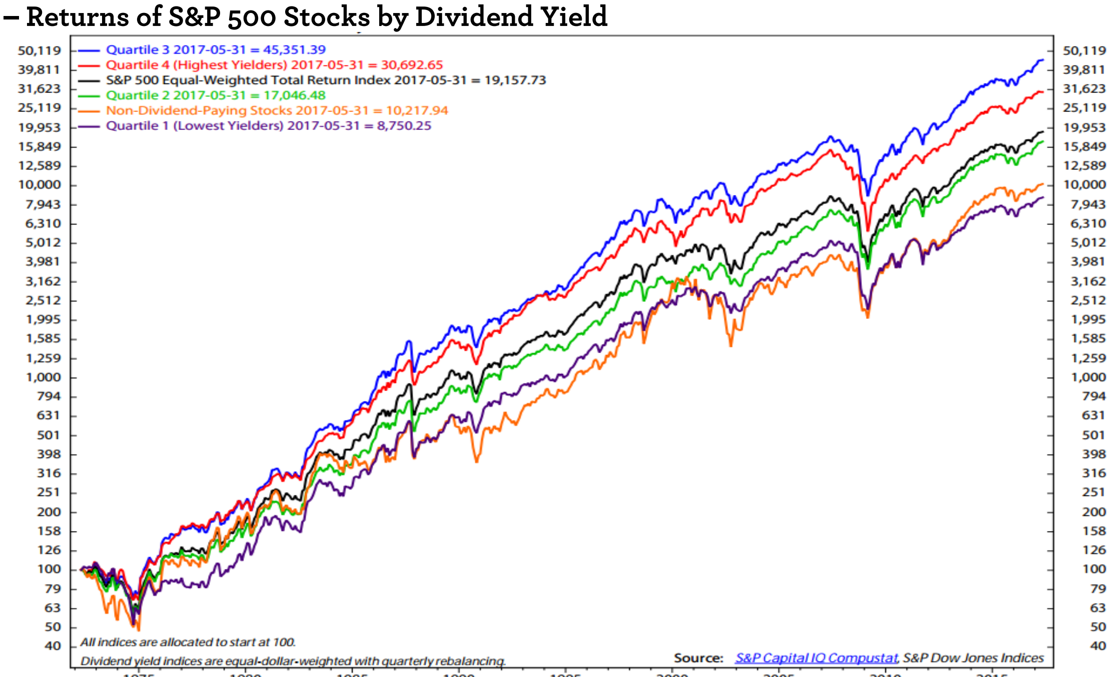
2017 Concept Review

The High Yield Equity Income List Strategy seeks to emphasize companies with notably higher dividend yields than the broader market as measured by the S&P 500. Our objective is to offer a list of stocks for investors seeking a higher level of income and willing to accept a higher level of risk. Client risk tolerance and suitability should be considered when participating in this strategy.

Why own high yield stocks?

Many investors prefer stocks that provide at least some sort of income. The reasons vary, of course, but the most common seems to be that the income is needed to fulfill daily spending needs, and that from a return perspective, potential dividend income can only be positive and therefore you're not completely reliant on capital appreciation for portfolio growth. Focusing on the return aspect, Ned Davis Research has studied S&P 500 returns with the index constituents segregated by yield. The results are quite interesting in that since 1972 when the data set begins, stocks in the third (blue line, second highest yielding group) and fourth (red line, highest yielding) quartiles produced the highest cumulative total returns relative to lower yielding stocks and non-dividend paying companies. We believe the reason for third quartile outperforming the fourth quartile stocks is likely due to the perceived risk of a dividend cut with respect to the absolute highest yielders. The chart below shows how all four quartiles as well as non-dividend payers and the overall index fared.

Figure 1 – Returns of S&P 500 Stocks by Dividend Yield

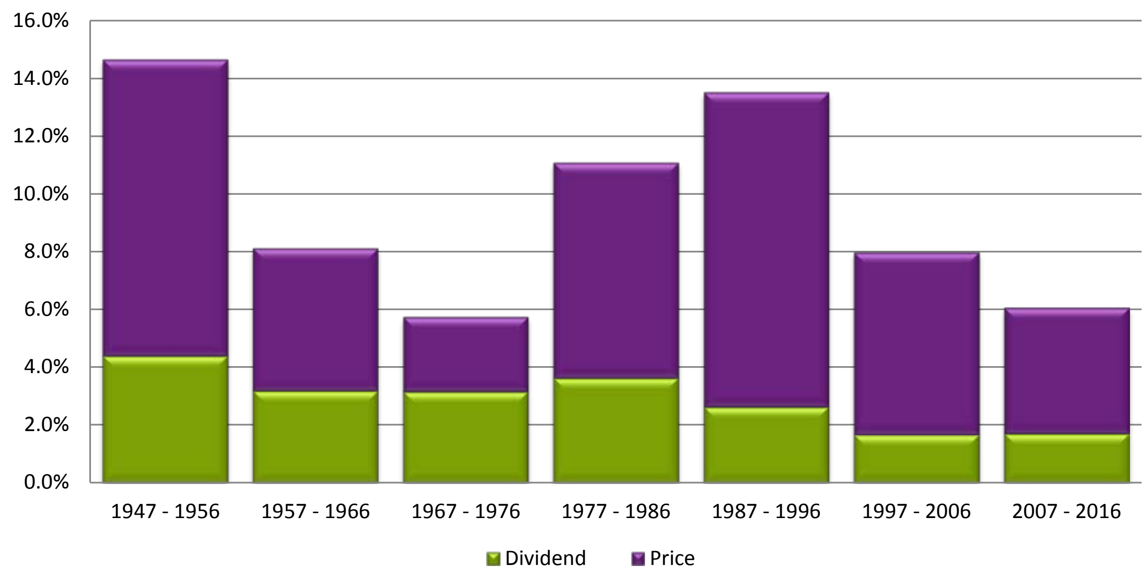


Sources: S&P Capital IQ Compustat; Ned Davis Research. Monthly data 3/31/1972-3/31/2017. Past performance is no guarantee of future results. An index is unmanaged and not available for direct investment. There is no guarantee that dividend-paying stocks will return more than the overall stock market. Dividends are not guaranteed and are subject to change or elimination. All indices are allocated to start at 100. Dividend yield indices are equal-dollar-weighted with quarterly rebalancing.

Please see page 4 of this report for Disclaimers

Taking a small step back, dividends in general are a very important component of total return over long investment horizons. Over the ten-year period ending in 2016, cumulative per share dividends of the S&P 500 totaled approximately $321. During this same timeframe, the index value increased by about $770. Adding those two pieces together gives a total return of $1,091; 29% of which would be from dividend income and the remaining 71% from capital appreciation. Stated differently, from 2007-2016, the S&P 500 returned 6.1% with 1.7% from dividends and 4.4% from price appreciation. The preceding example assumes an investor spent the dividend income along the way rather than reinvesting those dividends. Reinvesting dividends would have increased the overall proportion of total return attributable to dividends due to compounding growth. Figure 2 shows the separation of returns between income and price for the S&P 500 over the past few decades. We believe the highlight of the chart is the relatively narrow band of the dividend returns (green bar) between about 2% and about 4%, and of course, the lack of negative entries.

Figure 2 – Dividend Contribution to Total Return



Source: S&P, FactSet, Wells Fargo Advisors. Past performance is no guarantee of future results.

High Yield Equity Income List Strategy methodology

The High Yield Equity Income List Strategy is managed using a portfolio approach. Under most circumstances, the list will contain 33 stocks, each equally weighted at 3.03%. When we remove a name, we will replace it with another. The list emphasizes companies with notably higher dividend yields than the broader market as measured by the S&P 500. Our objective is to offer a list of stocks for investors seeking a higher level of income and willing to accept a higher level of risk. Complementing the high yield component, we believe a portfolio should also contain dividend growth stocks which can help mitigate inflation pressures. Although we are mindful of the allocation of our benchmark, the S&P 500, due to our focus on yield, the list may overweight income-centric sectors. On average, we strive to generate double the dividend yield of the S&P 500.

When selecting individual equities for the High Yield Equity Income List Strategy we utilize a philosophy and methodology that focuses upon finding companies that offer attractive current yields underpinned by sustainable dividend rates. Our initial screen program evaluates stocks on numerous factors including:

- Stable business models with acceptable cash flow trends to support the dividend;
- A notably higher than average dividend yield;
- Dividend sustainability screens as measured by 5-year dividend per share growth rate;
- Reasonable liquidity in terms of market capitalization; and,
- Insider ownership.

Ideally, we would only need to remove a stock from the list after its dividend yield falls below what we believe to be attractive for high-yield investors due to price appreciation. We will also, however, replace a stock due to sector weighting considerations, what we believe to be outsized risk of a dividend reduction, or simply because we view the prospects of another high-yield stock to be superior to an incumbent position.

How can you participate?

From an investor's perspective, the list can be viewed as a complete recommended portfolio, or as a shopping list from which an investor and financial advisor can pick and choose stocks to build a portfolio or complement an existing one. When picking and choosing, we recommend investors select stocks from at least six to eight sectors of the S&P 500, spread across several industry groups. Although diversification is an important tool for helping to reduce risk, having a large number of individual stocks in your portfolio makes it increasingly difficult to keep track of each security's progress. In addition, if one stock represents only a small fraction of the value of your portfolio, it may have little impact on the total return of your portfolio. Diversification of course does not guarantee a profit or protect against loss. An investor and his or her financial advisor should determine whether a particular stock is suitable for an account, keeping in mind how the stock will fit into an existing portfolio and the investor's risk appetite.

Suitability

The High Yield Equity Income List Strategy is considered appropriate for investors with a moderate to high risk tolerance seeking notably higher than average dividend income supplemented by potential growth of principal through capital appreciation. The stocks on the High Yield Equity Income List Strategy are considered appropriate for investors who intend to hold the shares for at least 12-18 months.

Risks

As with any investment style, there is a risk that high yield names fall out of favor in the marketplace. For example, rising interest rates may reduce demand for income producing equities since an income investor could potentially receive a similar level of income from a fixed income or other security with less risk. Consequently, there may be a shift toward growth focused names that may not pay dividends. Generally, stocks with high yields tend to perform well on a relative basis in sideways and down markets. In rapidly rising markets in particular, High Yield Equity Income List Strategy stocks may underperform on a relative basis. While we strive to avoid dividend cuts, it is possible that a company could reduce or eliminate its dividend which often has negative implications for the stock price as well.

Disclaimers

All investing involves some degree of risk, whether it is associated with market volatility, purchasing power or a specific security. Stocks offer long-term growth potential, but may fluctuate more and provide less current income than other investments. Also, bear in mind that dividend rates cannot guarantee a rate of return.

An index is unmanaged and not available for direct investment.

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