CIO REPORTS
The Weekly Letter

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- **Shopping for Yield and Growth:** Within U.S. equities, we view Consumer Staples as an attractively positioned out-of-favor high-quality sector that is globally diversified and offers attractive dividend yields, as well as dividend growth and capital appreciation potential. We believe it will also benefit from lower oil prices on greater exposure to the lower-end consumer and offers a compelling recession hedge. In an environment of "lower for longer" rates and oil prices, the Consumer Staples sector's inverse correlation to both is compelling. Thus, we find this sector to be a good place to shop for both yield and growth.
- **Markets in Review:** Last week equities were down, with the S&P 500 Index down 0.6%, while international equities, as represented by the MSCI EAFE Index, fell 2.2%. Bonds rose on the week, with the 10-year Treasury yield at 1.90%, rising slightly from 1.87% in the prior week. Commodities overall, as measured by the Bloomberg Commodity Index, fell 1.9% last week, as WTI crude increased 0.1%, to $39.5 per barrel, while gold fell 3.1%, to $1,216.5 per ounce.
- **Looking Ahead:** In the U.S., anticipate a healthy 190,000 gain in nonfarm payrolls and the unemployment rate to hold at 4.9%, with hourly earnings posting a 0.3% month-over-month gain. In the eurozone, headline inflation is expected to remain negative year-over-year.

Shopping for Yield and Growth

We live in a yield-scarce world. The eurozone has roughly €3.6 trillion worth of negative-yielding fixed income outstanding, Japan recently introduced negative interest rates itself and, in the U.S., the 10-year Treasury yield has been in a steady decline since the beginning of the 1980s. In fact, the 10-year U.S. Treasury yield is meaningfully lower, at 1.90% (as of March 25), than when the Federal Reserve (Fed) hiked on December 16, 2015, when the yield was 2.29%.

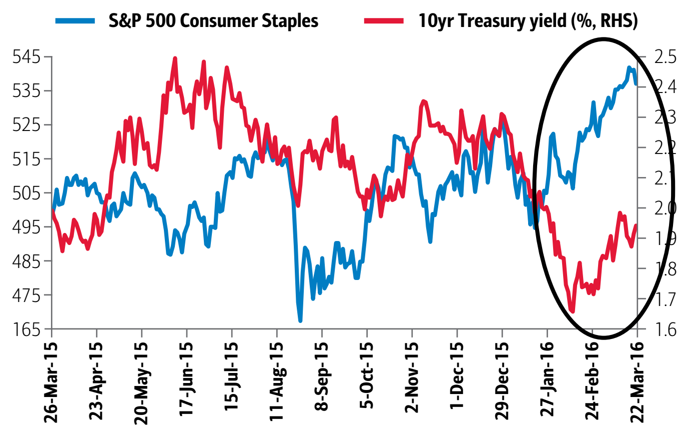
So, where should yield seekers consider going to satisfy income needs? We think U.S. Investment Grade corporate bonds stand to benefit from foreign investor inflows on relative yield pick-up trades, as well as from attractive valuations and improving fundamentals. Higher-quality municipal bonds also look attractive to us from a yield and tax advantage perspective.

What about investors seeking both yield and capital appreciation? What should they consider? In our view, sectors of the U.S. stock market may be an answer. U.S. Consumer Staples stands out as a sector that offers both, as it is underowned by fund managers, is high-quality, it tends to benefit from lower oil prices, and has held up well during this year's market turbulence.

U.S. Consumer Staples benefits from "lower for longer"

In a world of lower oil prices and interest rates, we believe the U.S. Consumer Staples sector is attractively positioned. Consumer Staples stocks historically are the most negatively correlated with oil prices, generally outperforming when oil prices fall. This is due to the sector's greater exposure to the lower-end consumer, who may enjoy long-term benefits from dollars saved at the pump or on energy bills relative to the middle-income or high-end consumer.

Exhibit 1: U.S. Consumer Staples rallies on lower rates



Source: Merrill Lynch Chief Investment Office and Bloomberg.

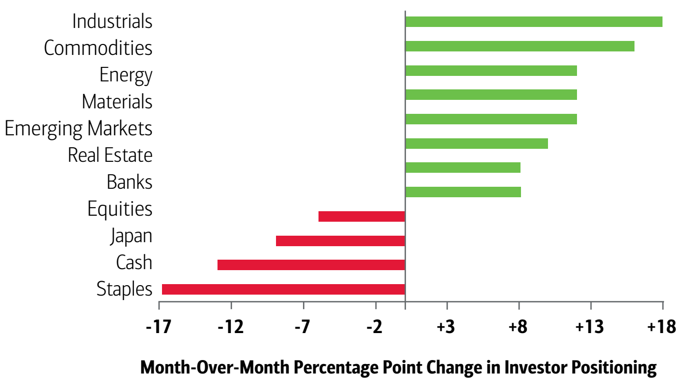
Global growth concerns, accompanied by significant market volatility, have prompted the market and the Fed to expect fewer interest rate hikes this year than initially anticipated. This has driven down U.S. Treasury yields to levels below those in December of last year, when the Fed hiked rates, which in turn has spurred a meaningful rally in the U.S. Consumer Staples sector (see Exhibit 1).

However, it is worth keeping in mind, if interest rates accelerate, that since at least 1990, the U.S. Consumer Staples sector has underperformed the broader market in periods of rising rates.

U.S. Consumer Staples is underowned

Several U.S. Consumer Staples companies were out of favor going into 2016, which dovetails with the finding of a BofA Merrill Lynch (BofAML) Global Research fund manager survey that the sector is significantly underowned by investors (see Exhibit 2). In our view, this is potentially a desirable situation, as the investment is not yet crowded and therefore might be poised for further rallies as investors become more constructive on the sector. We also think the recent U.S. dollar weakness is a tailwind and provides an earnings cushion for many larger Consumer Staples companies, which derive a significant portion of their revenues from abroad.

Exhibit 2: U.S. Consumer Staples is significantly underowned



Source: Merrill Lynch Chief Investment Office and BofA Merrill Lynch Global Fund Manager Survey, March. Note: Change is from February to March.

Non-durables driving performance

Non-durable consumer goods are chiefly driving Consumer Staples performance (see Exhibit 3). The top five contributors to sector performance, which include well-known tobacco, soft drink, and packaged food companies, account for as much as 73% of the sector's performance. These companies also have an average trailing-12-month dividend yield of 3.3%.

Exhibit 3: Non-durables driving performance

S&P 500 Consumer Staples	Average Weight (%)	Contribution To Return (%)
Consumer Non-Durables	74.00	11.60
Distribution Services	1.26	0.26
Process Industries	1.51	-0.35
Retail Trade	23.23	-2.09
Total	**100.00**	**9.42**

Source: Merrill Lynch Chief Investment Office and FactSet. Data for year ended March 23.

Defensive leadership

Telecom (15%), Utilities (14%), and Consumer Staples (4%) are among the best-performing sectors so far this year (as of March 25)—a defensive leadership message from the market. In our view, defensive positioning, in addition to a need for yield, coincides with stress from the credit market. We believe that Consumer Staples will continue to be part of the defensive leadership among S&P 500 sectors, as long as interest rates and oil prices remain subdued.

Portfolio Strategy: Within U.S. equities, we view Consumer Staples as an attractively positioned out-of-favor high-quality sector that is globally diversified and offers attractive dividend yields, as well as dividend growth and capital appreciation potential. We believe it will also benefit from lower oil prices on greater exposure to the lower-end consumer and offers a compelling recession hedge. In fact, the sector saw earnings growth in every recession except that of 2007-09, according to BofAML Global Research. Furthermore, in an environment of "lower for longer" rates and oil prices, the Consumer Staples sector's inverse correlation to both is compelling.

On the flipside, the sector appears expensive, as it trades near an all-time high on Enterprise Value-to-EBITDA[1]. If interest rates and inflation pick up, the sector is bound to see headwinds due to its bond-like nature of negative correlation with interest rates. Furthermore, if the U.S. dollar strengthens, multinationals are likely to face revenue declines on adverse currency translation effects. The scale of merger-and-acquisition activity is anticipated to slow down in 2016, with fewer large deals, as companies integrate 2015 actions. However, we still expect corporate actions such as share buybacks to be a factor in efforts to boost earnings per share. Thus, share buybacks rose 39%, to $16 billion, in the last quarter of 2015, from $12 billion a year earlier, according to BofAML Global Research.

Finally, in an income and growth portfolio where the primary objective is total return, we believe that an allocation of around 12% of the equity portion of a portfolio to U.S. Consumer Staples is appropriate. We would look for stocks that combine income and dividend growth for inflation protection and earnings growth for wealth accumulation. While no minimum yield is required in such a portfolio, we would favor stocks that provide a regular, secure dividend, and stocks with potential dividend growth.

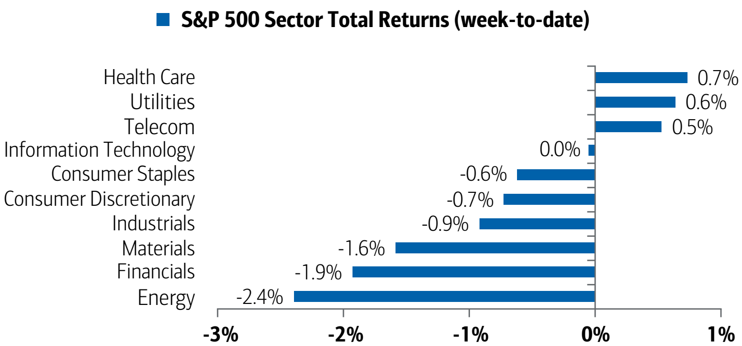
[1] EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization.

Markets in Review

Trailing Economic Releases

- New home sales rose 2.0%, to a seasonally adjusted 512,000, in February, coming in line with expectations of 510,000. January and December were revised higher, by 12,000.
- On Friday, an upward revision to seasonally adjusted quarter-over-quarter growth of 1.4%, from 1.0%, was posted with the third release of fourth-quarter 2015 gross domestic product growth. Stronger residential investment is likely the main driver, while revisions in other categories may be modest.
- Eurozone consumer confidence came in at -9.7 for March, versus -8.8 in February.

S&P 500 Sector Returns (as of last Friday's market close)



Equities

	Level	Total Return in USD (%) WTD	MTD	YTD
DJIA	17,515.7	-0.5	6.2	1.2
NASDAQ	4,773.5	-0.5	4.8	-4.4
S&P 500	2,035.9	-0.6	5.5	0.1
S&P 400 Mid Cap	1,413.9	-1.1	6.1	1.5
Russell 2000	1,079.5	-2.0	4.5	-4.7
MSCI World	1,623.7	-1.3	5.1	-1.9
MSCI EAFE	1,623.4	-2.2	4.5	-4.9
MSCI Emerging Mkts	812.3	-1.7	9.9	2.6

Fixed Income

	Yield (%)	Total Return in USD (%) WTD	MTD	YTD
ML US Broad Market	2.21	0.0	0.3	2.5
ML 10-Year US Treasury	1.90	-0.1	-1.0	3.6
ML US Muni Master	2.09	0.1	0.0	1.2
ML US IG Corp Master	3.34	0.2	1.9	3.1
ML US HY Corp Master	8.39	-0.7	4.1	2.9

Commodities & Currencies

	Level	Total Return in USD (%) WTD	MTD	YTD
Bloomberg Commodity	159.8	-1.9	4.4	1.0
WTI Crude $/Barrel[1]	39.5	0.1	16.9	6.5
Gold Spot $/Ounce[1]	1,216.5	-3.1	-1.8	14.6
Level	**Current**	**Prior Week End**	**Prior Month End**	**2015 Year End**
EUR/USD	1.1	-0.9	2.7	2.8
USD/JPY	113.1	1.4	0.3	-5.9

Source: Bloomberg.[1] Spot price returns. All data as of last Friday's close.
Past performance is no guarantee of future results.

Looking Ahead

In the U.S., anticipate a healthy 190,000 gain in nonfarm payrolls and the unemployment rate to hold at 4.9%, with hourly earnings posting a 0.3% month-over-month gain. In the eurozone, headline inflation is expected to remain negative year-over-year.

Upcoming Economic Releases

- On Friday, a healthy 190,000 gain in nonfarm payrolls is anticipated, compared to 265,000 last month and a consensus estimate of 202,000. The unemployment rate is expected to hold at 4.9%, in line with consensus expectations.
- On Friday, the ISM Manufacturing Index is expected to be 51.0 for March, an increase from last month's figure of 49.5 and above consensus estimates of 50.6 for March.
- On Thursday, eurozone headline and core inflation are expected to be at -0.2% and 1.0% year-over-year, respectively, in March.

BofA Merrill Lynch Global Research Key Year-End Forecasts

S&P 500 Outlook	2016 E
Target	2,000
EPS	$120.00
Real Gross Domestic Product	**2016 E**
Global	3.2%
U.S.	2.0%
Euro Area	1.5%
Emerging Markets	4.2%
U.S. Interest Rates	**2016 E**
Fed Funds	0.88%
10-Year T-Note	2.00%
Commodities	**2016 E**
WTI Crude Oil $/Barrel	$45.00
Gold $/Ounce	$1,250

All data as of last Friday's close.

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