

## Fund In Focus: JPMorgan Equity Income

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JPMorgan Equity Income is one of the premier funds in the large-cap value category. The fund has posted some of the category's strongest returns on an absolute and risk-adjusted basis, under the helm of lead portfolio manager, Clare Hart. Before joining the Equity Income fund, Clare worked at Salomon Smith Barney in their equity research division as a research associate covering Real Estate Investment Trusts. She started her career at Arthur Andersen as a public accountant.

Hart aims to provide current income, along with capital appreciation, in this fund. A target company must have a dividend yield of at least 2% at the time of purchase to be considered for inclusion in the portfolio, but may fall below 2% after initial purchase. The strategy is not singularly-focused on dividend yield, however. Equal emphasis is placed on the "payout ratio". The payout ratio is the proportion of earnings paid out as dividends to shareholders. Hart prefers the payout ratio to be low because companies may overextend themselves by paying dividends that are too high. Moreover, using free cash flows towards dividends may come at the expense of using these cash flows to reinvest in the business and spur future growth.

Aside from dividend yields, Hart looks for high-quality companies, which are defined by consistent sales and earnings (to provide a buffer in economic downturns), strong return on invested capital, a healthy balance sheet (defined in part by low overall

debt-to-capital levels), and finally, prudent management teams.

Hart keeps an eye on valuations and uses metrics such as free cash flow to sales, free cash flow to enterprise value, and price to earnings, among others, to evaluate the attractiveness of a particular stock. Historically, Hart has not compromised reasonable valuations for the sake of yield when evaluating an investment. A recent example of Hart's investment discipline in this regard is a portfolio underweight to REITs, a sector that has experienced soaring valuations in the era of near-zero interest rates. Other income-oriented sectors such as consumer discretionary and utilities are underweighted relative to the benchmark for the same reason.

Hart's balanced approach to portfolio management, namely combining long-term capital appreciation with current income, has resulted in an impressive track record. Since taking the helm of the strategy in August 2004, Hart has outperformed both the primary prospectus benchmark (Russell 1000 Value Index) as well as the Large Value peer group handily, while assuming less risk, as measured by standard deviation. On a trailing five-, ten- and fifteen-year basis, the fund has exhibited a positive upside to downside capture ratio, another indicator implying a favorable risk-reward profile for the fund.

JPMorgan Equity Income has flexibility when it comes to position sizing and sector

weighting relative to the Russell 1000 Value Index. The fund is allowed to over- or underweight sectors by up to 10% relative to the benchmark. Furthermore, the fund is not constrained relative to the benchmark with respect to position size. The fund is a true large-cap portfolio, with just under 15% of holdings categorized outside of the large-cap bracket, all of which are mid-cap stocks. The portfolio has traditionally maintained low cash balances; the cash percentage is just below 3% as of March 31, 2017. The top ten holdings comprise approximately one quarter of the portfolio, which is not unusual for a large-cap fund. Normally, the portfolio has about 100 holdings, with an annual turnover of 20%.

The fund's thoughtful approach to portfolio construction has resulted in excellent downside protection. More specifically, the fund ranked in the top decile of the large-cap value peer group and outperformed the benchmark by approximately 700 basis points during the market turmoil of 2008. In 2011, another tough year for equities, the fund performed similarly well, ranking in the top decile. However, investors in this fund should expect to underperform during low-quality market rallies like the one in 2009, as the fund maintains a high-quality portfolio.

The focus on high quality companies with steady earning streams and income results, in a portfolio with attractive total returns and an inherent buffer during periods of market volatility, makes this fund a solid option for investors seeking large-cap value exposure. Management fees are reasonable relative to the large-cap value peer group, which is another positive attribute of the fund, making it a good all-around fit for retirement plans.

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