

Equity Strategies • Large Cap Value

The Large Cap Value portfolio is focused on seasoned companies that generally have capitalizations above \$10 billion. These companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess substantial competitive advantages and that are trading at discounts to intrinsic value. The portfolio typically is comprised of 23-25 holdings and is expected to result in low to moderate turnover. The portfolio is suitable for clients whose primary objective is capital appreciation and whose secondary objective is dividend income.

Portfolio Commentary

In our last update we spoke about the rewards of investing during periods of pronounced fear, such as the one experienced last fall. Much of that fear has dissipated given improvements in: consumer confidence, unemployment statistics, financing costs for stressed borrowers and Euro zone ring fencing, to name a few. Consequently, the S&P 500 Index rose by 12.6% during the first quarter of 2012, marking its best Q1 performance in over a decade. The Confluence Large Cap Value portfolio matched the performance of the S&P 500 over this period, also gaining 12.6% (gross of fees). *(For detailed performance data and disclosures see: www.confluenceim.com/equity_strategies#prod_40.)*

In just six months the S&P 500 index is up over 24%. Based on the average annual return over the last 100 years, that's equivalent to 2.5 years of returns in just six months. While most investing conversations tend to concentrate on "the market," we focus on individual companies, their competitive advantages, financial wherewithal and future growth prospects. This bottom-up approach provides a sense of calm during tumultuous markets because businesses can grow intrinsic value regardless of changes in stock prices. It may take time for a company's value to be reflected in its stock, but we can cope with uncertain timing given an attractive risk/reward profile. Indeed, this is required to achieve long-term investing success.

As we enter the second quarter, corporate profits remain strong as do balance sheets. Nevertheless, impediments to growth remain. Some of these, such as Euro zone economic and debt concerns and slower growth out of China, have been with us for some time, whereas others are more emergent. We view a continued escalation in the price of gasoline as the most likely catalyst for a near-term disruption in domestic growth. This could potentially take some wind out of consumers' sails, which have been the primary driver of economic growth in recent months.

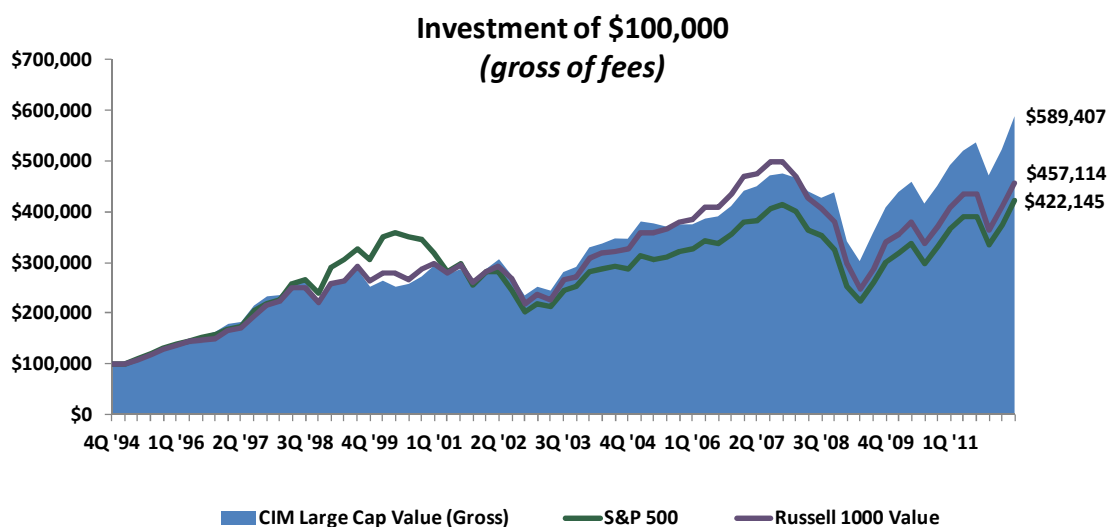
Bottom line, the economy, while not bad, is far from robust. We would not be surprised to see a short-term pullback in the market prior to the next move higher. At the moment, several of the portfolio names are not buyable as they trade slightly above our targeted entry points. Our expectation is that most of these positions would fall into a buyable range upon a mid-single digit correction in the broader market.

Looking back at how individual portfolio positions performed during Q1, there were few that declined on an absolute basis. Relative underperformance was generally a function of investor rotation out of the most stable sectors, utilities and consumer staples, and into sectors with more economic sensitivity. Halliburton, PepsiCo and Johnson and Johnson were the weakest performers in Q1. The strongest gains came from Thermo Fisher Scientific, Waters Corporation and Microsoft.

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Top 10 Portfolio Holdings (as of 3/31/12)

Company	Market Capitalization (\$ billions)	Portfolio Weight
TJX Companies Inc	29.7	5.2%
Bed Bath & Beyond Inc	15.9	4.4%
Diageo (Adr 1:4)	60.3	4.4%
American Express	67.6	4.3%
Discovery Communications Inc. (Series C)	12.6	4.3%
Lowe's Companies	38.9	4.2%
Google Inc	208.6	4.2%
Waters Corp.	8.3	4.2%
WR Berkley Corp.	5.0	4.2%
Illinois Tool Works Inc.	27.5	4.1%



Confluence Investment Management LLC

Confluence Investment Management LLC is an independent, SEC Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics and geopolitical analysis with a value-driven, fundamental company-specific approach. The firm's portfolio management philosophy begins by assessing risk, and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.

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