

Equity Strategies • Small Cap Value

The Small Cap Value portfolio is focused on companies that generally have capitalizations below \$3 billion. These companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess competitive advantages and that are trading at substantial discounts to intrinsic value. The portfolio typically is comprised of 30-35 holdings and is expected to result in low to moderate turnover. The portfolio is suitable for clients whose primary objective is capital appreciation.

Portfolio Commentary

The first quarter results displayed continued strength in the equity markets that began in the fourth quarter of 2011 as the Russell 2000 and Russell 2000 Value posted returns of 12.4% and 11.6%, respectively. The quarter marked a path of positive sentiment as investors remained focused on the U.S. economy and looked past the European sovereign debt issues. This was evidenced by the strong performance of the more cyclical areas of the economy during the quarter. The Small Cap Value portfolio posted positive results for the quarter generating gains of 8.3% (gross of fees). *(For detailed performance information and disclosures see: www.confluenceim.com/equity_strategies#prod_41).*

For the quarter, the consumer discretionary and financial services sectors were the biggest detractors to relative performance. The sectors with positive relative contributions were materials & processing and utilities; our lack of exposure to the utilities sector benefited the portfolio as it was the only sector to post negative performance in the first quarter.

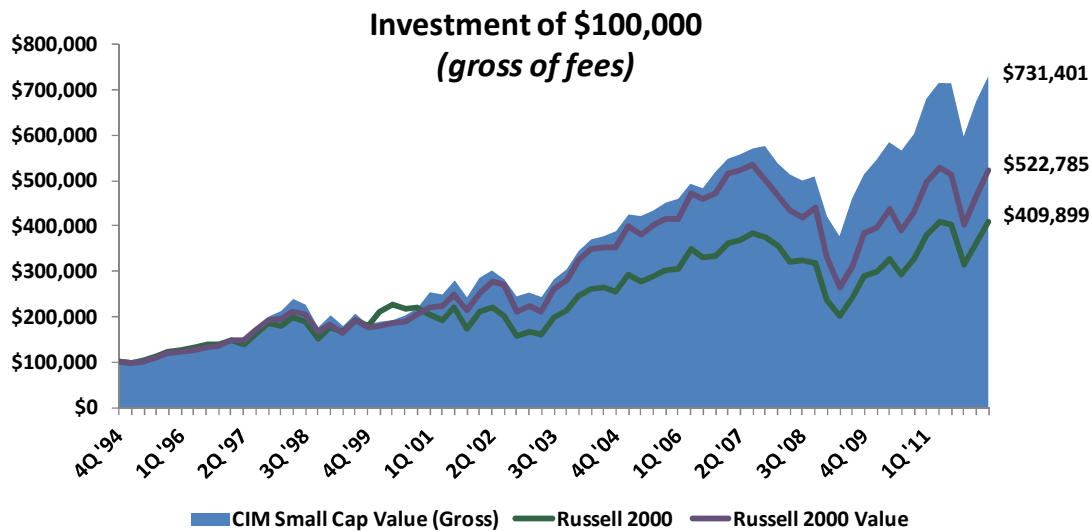
During the quarter, we sold Hibbett Sports and added two new companies to the portfolio. Hibbett Sports operates in the consumer retail arena specializing in sporting goods and apparel. We have long been a fan of Hibbett, and still are, but the shares were trading at very lofty valuations given the recent strength in their underlying business which allowed us to take profits and exit our position.

We added Cubic Corp. and Hittite Microwave to the portfolio. Cubic operates in two niche areas: building/managing public transportation systems and military training/asset movement. Hittite Microwave operates in the analog semiconductor space, specializing in the microwave frequency. The company operates a fabless model, i.e., outsources its manufacturing, which leads to above average margins and solid cash flow. The management team is experienced and focused, and the shares are reasonably valued.

Volatility remains elevated as the economy continues to grow below trendline, leaving investor sentiment more susceptible to economic data releases. Much as it is easier to keep balance on a fast moving bicycle relative to a slow moving bicycle, a slow moving economy can fall off track easier than a fast-paced one. This view has kept investors skittish as evidenced by the sharp quarterly moves in the equity markets; 10 of the last 14 quarters produced double-digits moves, four negative and six positive. As long-term investors who are focused on analyzing businesses and determining their worth, we view the volatility as an opportunity to take advantage of others' emotions by buying cheap and selling dear. At current levels, valuations are reasonable given the current uncertain outlook and we remain committed to finding great companies trading at bargain prices.

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

Company	Market Capitalization (\$ billions)	Portfolio Weight
Generac Holdings, Inc.	1.67	4.0%
Landstar System Inc.	2.70	3.9%
Graco Inc.	3.18	3.7%
Affiliated Managers Group	5.79	3.6%
Haemonetics Corp.	1.75	3.3%
Morningstar, Inc.	3.16	3.3%
P.F.Chang's China Bistro, Inc.	0.84	3.3%
Sanderson Farms, Inc.	1.18	3.3%
Rayonier Inc.	5.40	3.3%
HNI Corp.	1.26	3.2%



Confluence Investment Management LLC

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