

## Equity Strategies • Value Opportunities

The Value Opportunities portfolio is a concentrated portfolio of businesses that range in market capitalization. The companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that are trading at substantial discounts to intrinsic value and that have a near-term catalyst in which to unlock the value. The portfolio may have concentrations in both individual holdings and/or industries. The portfolio typically is comprised of 10-12 holdings and is expected to result in annual turnover of 75-100%. The portfolio is suitable for clients seeking an aggressive approach to generating capital appreciation.

### Portfolio Commentary

The S&P 500 Index posted returns of 12.6% in the first quarter, displaying continued strength in the equity markets that began in the fourth quarter of 2011. This was the second consecutive quarter of double-digit returns and offsets the third quarter 2011 loss of 13.9% for the S&P 500. The Value Opportunities portfolio generated solid numbers for the first quarter, up 23% (gross of fees), benefiting from the repositioning we completed late last year.

*(For detailed performance information and disclosures see: [www.confluenceim.com/equity\\_strategies#prod\\_41](http://www.confluenceim.com/equity_strategies#prod_41)).*

The strength in the portfolio was wide-spread with Landstar, Lowes, Microsoft, Waters Corp., Thermo Fisher Scientific and PF Chang's China Bistro posting 20%+ returns for the quarter, and NXP Semiconductors up 73%. There were no specific events occurring at the companies that drove results, but rather continued execution by the respective management teams and acknowledgement from investors.

During the quarter, we sold the shares of White Mountains Insurance and added Markel Corp. White Mountains was acquired at a deep discount to book value which, in our opinion, was unwarranted for a management team with a good history of underwriting and capital allocation skills. Over the holding period, management was extremely aggressive in closing the discount to book by using proceeds from the sale of one of their insurance lines at a premium to repurchase shares of their company

at a deep discount. It is seldom that a management team will shrink its base and put shareholders ahead of them. As shareholders, we are very grateful; however, in doing so, the shares had appreciated to levels such that the risk/reward ratio favored taking profits and exiting our position.

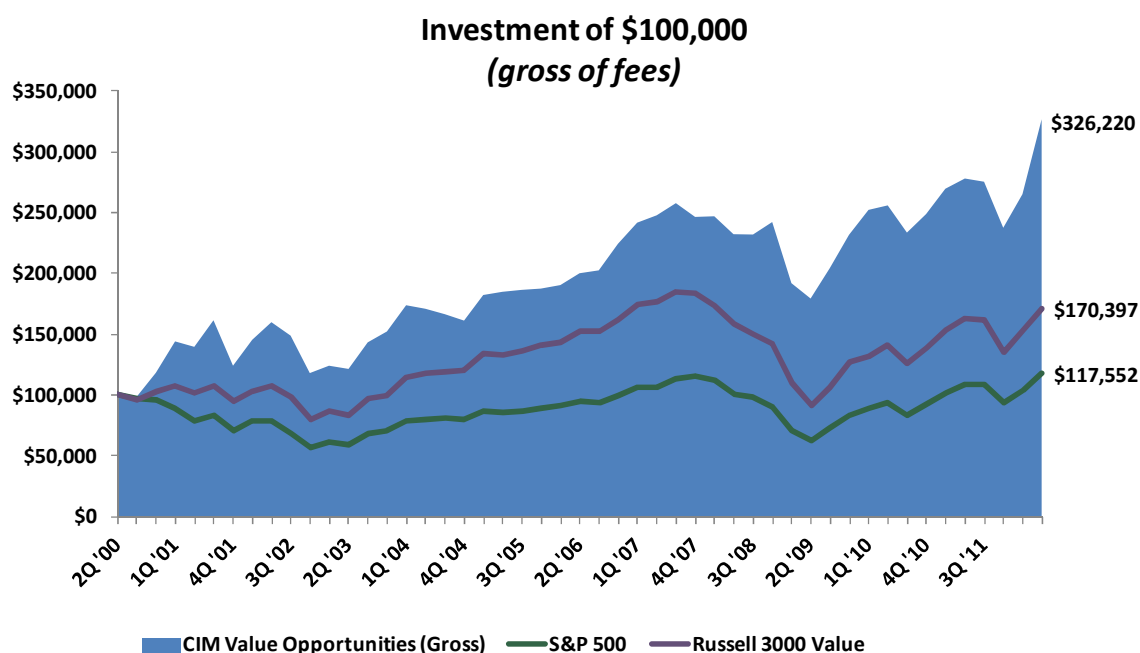
New portfolio company Markel Corp. is also in the insurance industry, albeit in specialty lines, but has a similar history of excellent underwriting and capital allocation skills. We acquired Markel at a very good valuation of price-to-book on an absolute and relative basis. While not likely to be as volatile as other holdings, Markel stands to benefit from solid execution and multiple expansion, and if the soft pricing in underwriting turns, shareholders will likely receive a boost in accelerating book value growth.

Looking forward, 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 have produced double-digits moves, four negative and six positive. At current levels, valuations are reasonable given the current uncertain outlook and we remain committed to finding great companies trading at bargain prices.

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Top 5 Portfolio Holdings (as of 3/31/12)

Company	Market Capitalization (\$ billions)	Portfolio Weight
NXP Semiconductors	6,699.1	11.6%
Landstar System Inc	2,696.7	10.9%
Lowes Companies	38,942.6	10.1%
Markel Corp.	4,333.6	9.5%
McGraw-Hill Cos.	13,489.6	8.8%



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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