

Alternative Investments • Specialty Finance BDC

This portfolio is focused on a niche of the financial sector known as business development companies, or BDCs. BDCs lend to and invest in the private debt and equity markets. The majority, if not all, of holdings in this portfolio are in BDCs, typically involving 20-30 positions with a moderate level of turnover. The BDC portfolio is suitable for clients seeking alternative investment exposure to the private markets, one that involves high levels of income from an equity portfolio with above-average volatility. Most of the portfolio income will be in the form of non-qualified dividends.

Portfolio Commentary

The Specialty Finance BDC Portfolio posted a strong quarter, capping off an excellent year. The composite returns were 5.7% and 22.1% for the fourth quarter and year (gross of fees), respectively, compared with 5.4% and 24.4% for the Wells Fargo BDC Index benchmark over the same periods, respectively.

For detailed performance data and disclosures see:
<http://www.confluenceinvestment.com/products-performance/alternative-investment-strategies>

The positive returns were a welcome turnaround for BDC investors, who endured challenges from the equity index exclusions in 2014 and misplaced association with the high yield market in 2015.

Although the return for the portfolio in 2016 outpaced the broader equity market, it was below the benchmark return. A significant portion of the lower relative performance was a result of not owning one of the largest constituents in the benchmark, Prospect Capital. This BDC experienced a partial recovery of its valuation in 2016 after having sharply declined in the previous two years. We have not held a position in this BDC due to our concerns regarding risk in its portfolio. Also detracting from relative performance

were THL Credit and TriplePoint Venture Growth, two companies that underperformed due to portfolio concerns. Looking forward, we believe both companies have a constructive path in front of them, even as THL recently lowered its dividend.

Portfolio holdings that contributed to relative performance included Stellus Capital, Solar Capital and OFS Capital, three companies that benefited from valuation improvements. In addition, the portfolio's top holdings in Golub Capital, New Mountain Finance, Ares Capital and TCP Capital also performed well. We believe these are high-quality BDCs, led by management teams with solid track records of delivering returns to shareholders.

In 2016, the portfolio delivered attractive returns with a focus on well-managed BDCs. These companies may not always deliver the highest returns, but we believe their quality and consistency can help address portfolio risk, particularly during times when markets aren't as friendly as they were in 2016. As we look forward, we believe the industry can continue its recovery in valuations, while providing meaningful income, principally derived from the private debt markets.

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Top 5 Portfolio Holdings (as of 12/31/16)

Company	Market Capitalization (\$ billions)	Portfolio Weight
New Mountain Finance Corporation	1.7	8.0%
Golub Capital BDC, Inc	1.0	7.6%
Solar Capital Ltd.	0.9	7.1%
Ares Capital Corporation	5.2	7.1%
TCP Capital Corp.	0.9	6.7%

BDC Dividend Statistics at 12/31

Year	Holdings	Port. Yield	Dividend Trends*				Initiated
			Increase	Flat	Decrease	Special**	
2014	29	9.8%	5	14	1	8	5
2015	25	10.8%	2	21	2	4	0
2016	22	9.2%	0	19	2	2	0

* Some BDCs were in more than one category. Trends reflect actions during holding period.

** Special dividends paid by companies that have maintained or increased their dividends.

Confluence Investment Management LLC

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