All Cap Value • Value Equity Strategies

All Cap Value is focused on companies that range in market capitalization to create a diversified portfolio of businesses with capital appreciation potential. These companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess substantial competitive advantages and are trading at discounts to our estimate of intrinsic value. The portfolio typically comprises 30-35 holdings and is expected to result in low to moderate turnover. The strategy is appropriate for clients whose primary objective is capital appreciation and whose secondary objective is dividend income.

Market Commentary

In the first quarter of 2024, the equity markets saw a continuation of the Santa Claus rally that ended 2023, with the S&P 500 Index posting a rare back-to-back quarterly gain in the double-digits. The rally was sparked in late October 2023 when the Federal Reserve signaled the end of policy tightening as the downward trend in inflation (aka disinflation) was expected to continue toward the Fed's target of 2.0%. In short order, market participants were pricing in six interest rate cuts for 2024 (see *Figure 1*), which increased the probability of a soft landing. And although recent datapoints indicate that elevated levels of inflation may be sticky (see *Figure 2*), hence the reduction during the quarter in the number of expected rate cuts to three, the equity markets continued to rally.

Why would stocks remain strong when elevated inflation data is pointing to the possibility that the Fed will keep rates higher for a longer period? There are a handful of possible reasons, but we suspect it is the belief that the Fed is bluffing on its inflation target. More specifically, investors doubt the validity of the Fed maintaining its stated 2.0% inflation target, believing the Fed will instead settle for a higher inflation target and move forward with rate cuts despite inflation stalling at levels well above 2.0%. This would clearly benefit the economy near-term and support revenue and earnings growth. As a result, we are seeing a continued tailwind for stocks, with the S&P 500 up 10.6% in the first quarter and 28% from the low in late October 2023.

Figure 1 **U.S. Interest Rate (%)**

(Source: Financial Times, 3/19/2024)

Unlike much of the past several years, recent returns have been broader-based. Both large caps and small caps, as measured by the Russell 1000 and 2000 indexes, respectively, are up approximately 30% off the October low. Although growth has outperformed value, the gap was much narrower than the recent past as Apple (AAPL) was up only 2% and Tesla (TSLA) posted a loss of 15.2%, which helped narrow the gap to "only" 5.3%, with the Russell 1000 Growth up 31.4% versus the Russell 1000 Value up 26.1%.

Figure 2 **Consumer Price Index, Change From a Year Earlier**

(Source: Wall Street Journal, 4/10/2024)

See GIPS Report on pages 4-5.

Market Commentary continued...

There are still pockets of excess speculation specifically around artificial intelligence (AI) and cryptocurrency, perhaps best evidenced by two "small cap" names, Super Micro Computer (SMCI) and MicroStrategy (MSTR), which are up +320% from the October low and now sport market capitalizations of $60 billion and $30 billion, respectively. And yet these two companies are still included in the Russell 2000 Index, a small cap index with a median market cap of approximately $956 million, and are impacting the index's returns. Both companies also have checkered histories as SMCI was delisted from the NASDAQ in 2019 for accounting irregularities, while MSTR leader Michael Saylor has used the company's balance sheet to acquire bitcoin (and, more recently, issued stock and convertible bonds to acquire even more bitcoin), all while actively selling his own shares. This revival of bitcoin and the recent Reddit IPO lends further credence to the sense that speculation still abounds.

On the other hand, fixed income markets were more sanguine in light of the recent inflation datapoints, giving back some of their recent gains. Recall that the 10-year Treasury yield fell from 4.98% in late October 2023 to 3.88% by year-end, providing a boost to financial assets and the Santa Claus rally. However, during the first quarter of 2024, the 10-year Treasury yield rose to 4.20% (see *Figure 3*). With inflation remaining at elevated levels, the backup in yields was rather muted and has some pundits pointing to the limited supply of longer-term notes as the Treasury Department shifted refunding to favor short-term bills. This shift helped suppress long-term yields which aided longer-duration bonds as well as stocks. At current levels, the 10-year Treasury is trading more in line with levels preceding the Great Financial Crisis in 2008-09 and provides a real rate of return that has been absent for much of the past 15 years and has benefited financial engineering over operating acumen.

Figure 3 **Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity**

(Source: Federal Reserve Economic Data, 3/31/2024)

Outlook

Thus far, the economy has avoided a recession in the face of a sharp rise in interest rates, while employment has remained strong and inflation levels have been trending downward. This environment has benefited the equity markets; however, the disinflation of the past year and a half appears to be stalling. Thus, the primary focus remains on inflation and how future datapoints will impact the timing and magnitude of Fed actions. While the broadening of the equity markets over the past few months is a positive sign, the strength has outpaced earnings growth which has pushed up valuations and leaves equities susceptible to a pullback. Given the spotlight on inflation, the geopolitical backdrop, with conflicts in Russia/Ukraine, the Middle East, and China/Taiwan, and elections occurring in 2024 for half of the world's population, we anticipate some added volatility which also means opportunities for long-term investors. Of course, we will continue to stay focused on our investment philosophy which has always been centered on business and valuation analysis.

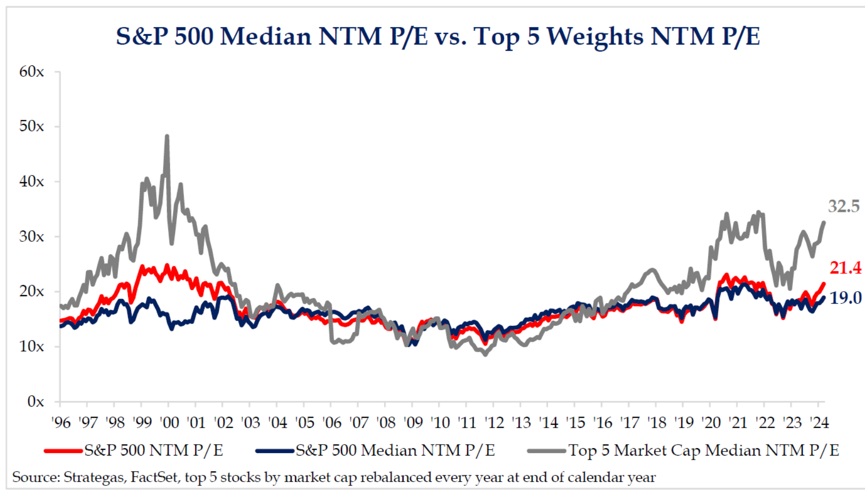
Strategy Commentary

The year-end 2023 stock market rally due to hopes of interest rate cuts and AI excitement continued through the first quarter of 2024. In fact, according to the *Wall Street Journal*, as of mid-February the S&P 500 had been up 14 of the previous 15 weeks — something that had not happened since March 1972, which coincidentally was another period of elevated inflation and concentrated market leadership. Furthermore, with the resurgence of bitcoin and the $10 billion IPO of Reddit (the birthplace of meme stocks), it appears that speculation is still alive and well.

As we discussed last quarter (and as this valuation chart does a good job of demonstrating, see *Figure 4*), the top tech growth stocks (the gray line) lifted off in 2017, peaked in 2021, rolled over in 2022, and have now rebounded to near-peak valuations and all-time-high stock prices. In the first quarter of 2024, this continued to be reflected in the growth versus value imbalance, with the Russell 3000 Growth up 11.2% and the Russell 3000 Value up 8.6%, while the S&P 500 returned 10.6%. By comparison, the Confluence All Cap Value strategy was up 9.5% (gross of fees) in the first quarter. [*The strategy's net-of-fees return for the same period was 8.7% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Year-to-date, the All Cap Value strategy has kept pace with the S&P 500 as companies outside the Magnificent Seven tech stocks are showing some signs of life given a healthy economy. In particular, All Cap Value outperformed in Financials, due to our insurance holdings, and in Health Care, with a strong performance by Stryker. This was partially offset by underperformance in Communication Services, as we do not own Meta, which continues to surge on AI; Consumer Staples, which are currently out of favor in this bull market; and Industrials, as cyclical companies in the sector have outperformed high-quality, steadier growing industrial companies year-to-date.

Figure 4



(Source: Strategas, 4/1/2024)

As a result, the top contributors to performance during the first quarter were Progressive (auto insurance), Vontier (convenience store technology and mechanic tools), Brown & Brown (insurance broker), Berkshire Hathaway (insurance-focused holding company), and Stryker (medical devices). The weakest contributors year-to-date were Dun & Bradstreet (commercial credit data), Dollar Tree (low-price retail), Keurig Dr. Pepper (beverages), S&P Global (credit ratings and financial data), and Starbucks (beverage retail). [*See contribution table on next page.*]

There were no changes to the All Cap Value portfolio during the quarter following several opportunistic purchases (Charles River Labs, Keysight, Hershey, and Vontier) in 2023. We believe this portfolio of quality businesses is well-positioned for continued growth and compounding while we patiently await additional buying opportunities for companies on our watchlist.

Outlook

In 2024, markets will most likely be focused on interest rate cuts (or lack thereof) relative to current expectations and follow through on very high hopes for everything AI-related. With a resilient economy, if rates do stay "higher for longer," then this could pressure leveraged companies and commercial real estate loans as both are counting on lower rates to help rollover loans that are coming due in 2024 and 2025. At Confluence, we continue to stay focused on owning conservatively financed companies with proven business models , which we view as great businesses with good management teams purchased at a discount to intrinsic value.

While large/growth/tech stocks continue to outperform, this creates an imbalance that we expect to even out over the long term, as it has historically. In the meantime, we continue to patiently own a portfolio of quality businesses at reasonable prices, which we believe should minimize the risk of permanent loss and maximize total return over the long term.

Contribution[1]

(YTD as of 3/31/2024)

The top contributors and detractors for the portfolio in 2024 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Progressive Corp.	4.54	1.29
Vontier Corp.	3.20	0.93
Brown & Brown Inc.	3.66	0.80
Berkshire Hathaway Inc. (Class B)	4.39	0.76
Stryker Corp.	3.54	0.67
Bottom 5		
Starbucks Corp.	2.43	(0.11)
S&P Global Inc.	3.59	(0.12)
Keurig Dr. Pepper Inc.	1.68	(0.15)
Dollar Tree Inc.	2.28	(0.15)
Dun & Bradstreet Holdings Inc.	1.06	(0.16)

(Contribution data shown from a sample account, based on individual stock performance and portfolio weighting)

Performance Composite Returns[2] (For Periods Ending March 31, 2024)

	Since Inception**	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
All Cap Value *Pure Gross-of-Fees[3]*	10.1%	14.7%	11.7%	13.3%	8.6%	24.0%	9.5%	9.5%
Max Net-of-Fees[4]	6.9%	11.3%	8.4%	9.9%	5.4%	20.3%	8.7%	8.7%
S&P 500	10.1%	15.6%	12.9%	15.0%	11.5%	29.9%	10.6%	10.6%
Russell 3000 Value	7.9%	13.0%	8.8%	10.1%	7.7%	20.2%	8.6%	8.6%

Calendar Year	Pure Gross-of-Fees[3]	Max Net-of-Fees[4]	S&P 500	R3000 Value	Difference (Gross-S&P500)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	S&P 500 3yr Std Dev	R3000V 3yr Std Dev	Composite Dispersion
2005	2.4%	(0.4%)	4.9%	6.9%	(2.5%)	242	$27,603		N/A	N/A	N/A	0.5%
2006	14.4%	11.3%	15.8%	22.3%	(1.4%)	224	$26,916		N/A	N/A	N/A	0.6%
2007	4.6%	1.8%	5.5%	(1.0%)	(0.9%)	220	$27,835		6.9%	7.7%	8.3%	0.7%
2008	(26.9%)	(28.9%)	(37.0%)	(36.2%)	10.1%	19	$1,778	$291,644	13.9%	15.1%	15.5%	N/A
2009	26.8%	23.0%	26.5%	19.8%	0.3%	33	$11,558	$533,832	18.6%	19.6%	21.3%	2.8%
2010	9.7%	6.4%	15.1%	16.3%	(5.4%)	41	$13,980	$751,909	21.0%	21.9%	23.5%	0.5%
2011	3.6%	0.5%	2.1%	(0.1%)	1.5%	40	$14,294	$937,487	18.4%	18.7%	21.0%	0.6%
2012	18.0%	14.5%	16.0%	17.6%	2.0%	40	$11,654	$1,272,265	14.6%	15.1%	15.8%	0.3%
2013	35.3%	31.3%	32.4%	32.7%	2.9%	73	$22,893	$1,955,915	11.2%	11.9%	12.9%	0.7%
2014	14.7%	11.3%	13.7%	12.7%	1.0%	119	$34,036	$2,589,024	8.8%	9.0%	9.4%	0.4%
2015	0.1%	(2.9%)	1.4%	(4.1%)	(1.3%)	207	$50,568	$3,175,419	10.0%	10.5%	10.7%	0.6%
2016	14.2%	10.8%	12.0%	18.4%	2.2%	345	$91,109	$4,413,659	9.7%	10.6%	11.0%	0.6%
2017	15.7%	12.3%	21.8%	13.2%	(6.1%)	649	$167,342	$5,944,479	8.7%	9.9%	10.3%	1.1%
2018	(5.2%)	(8.0%)	(4.4%)	(8.6%)	(0.8%)	689	$168,742	$5,486,737	10.1%	10.8%	11.1%	0.6%
2019	35.6%	31.6%	31.5%	26.2%	4.2%	818	$262,167	$7,044,708	11.7%	11.9%	12.0%	1.1%
2020	17.3%	13.8%	18.4%	2.9%	(1.1%)	953	$333,804	$6,889,798	18.5%	18.5%	20.0%	0.9%
2021	23.4%	19.7%	28.7%	25.3%	(5.3%)	1,084	$422,786	$7,761,687	17.5%	17.2%	19.3%	0.6%
2022	(16.2%)	(18.7%)	(18.1%)	(8.0%)	2.0%	1,065	$342,473	$6,931,635	20.5%	20.9%	21.5%	0.7%
2023	18.8%	15.3%	26.3%	11.6%	(7.5%)	1,046	$385,449	$7,200,019	16.9%	17.3%	16.7%	0.7%

**Average annualized returns* ***Inception is 1/1/2005* *See performance disclosures on last page.*

Portfolio Benchmarks

S&P 500® Index – A capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Russell 3000® Value Index – A capitalization-weighted index designed to measure performance of those Russell 3000® Index companies with lower price-to-book ratios and lower forecasted growth values. *(Source: Bloomberg)*

Confluence Value Equities Investment Committee

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Disclosures

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Indexes: The S&P 500 and Russell 3000 Value are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only & do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

[1] **Contribution—**Table showing the top 5 contributors/detractors reflects the strategy's best and worst performers (net), based on each holding's contribution to the sample account for the period stated.

[2] **Performance Composite Returns—Confluence Investment Management LLC claims compliance with the Global investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Confluence Investment Management LLC has been independently verified for the periods August 1, 2008, through December 31, 2022. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards.**

Verification provides assurance on whether the firm's policies and procedures related to composite maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

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The All Cap Strategy was incepted on January 1, 2005, and the current All Cap Value Composite was created on August 1, 2008. Performance presented prior to August 1, 2008, occurred while the Portfolio Management Team was affiliated with a prior firm and the Portfolio Management Team members were the primary individuals responsible for selecting the securities to buy and sell. Confluence Investment Management LLC is an independent registered investment adviser. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Past performance is not indicative of future results. The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of all fees and include the reinvestment of all income.

[3] Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

[4] Net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly (2.75% prior to 7/1/08). This fee includes brokerage commissions, portfolio management, consulting services and custodial services. The Confluence fee schedule for this composite is as follows: 0.60% on the first $500,000; 0.55% on the next $500,000; and 0.50% over $1,000,000. There are no incentive fees. Clients pay an all-inclusive fee based on a percentage of assets under management. The collection of fees produces a compounding effect on the total rate of return net of fees. Bundled fee accounts make up 100% of the composite for all periods. Actual investment advisory fees incurred by clients may vary. Wrap fee schedules are provided by independent wrap sponsors and are available upon request from the respective wrap sponsor.

A complete list of composite descriptions is available upon request. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. The annual composite dispersion is an equal-weighted standard deviation, using gross-of-fee returns, calculated for the accounts in the composite for the entire year. The three-year annualized standard deviation measures the variability of the composite gross returns over the preceding 36-month period. The All Cap Value Composite contains fully discretionary All Cap Value wrap accounts. All Cap Value is a value-based, bottom-up portfolio that utilizes stocks from all market capitalizations.

N/A-Composite Dispersion: Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year. N/A-3yr Std Dev: Composite does not have 3 years of monthly performance history.