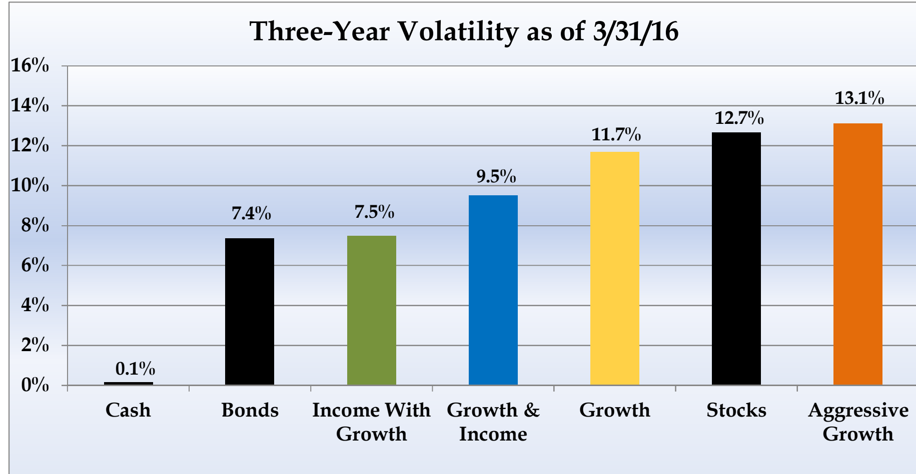
ASSET ALLOCATION QUARTERLY
Second Quarter 2016

Asset allocation is a portfolio management process where various asset classes (stocks, bonds, commodities, etc.) are combined in one portfolio. Diversification helps to avoid having 'all eggs in one basket.' Risk and return are considered for the entire portfolio as opposed to evaluating individual securities or investments.



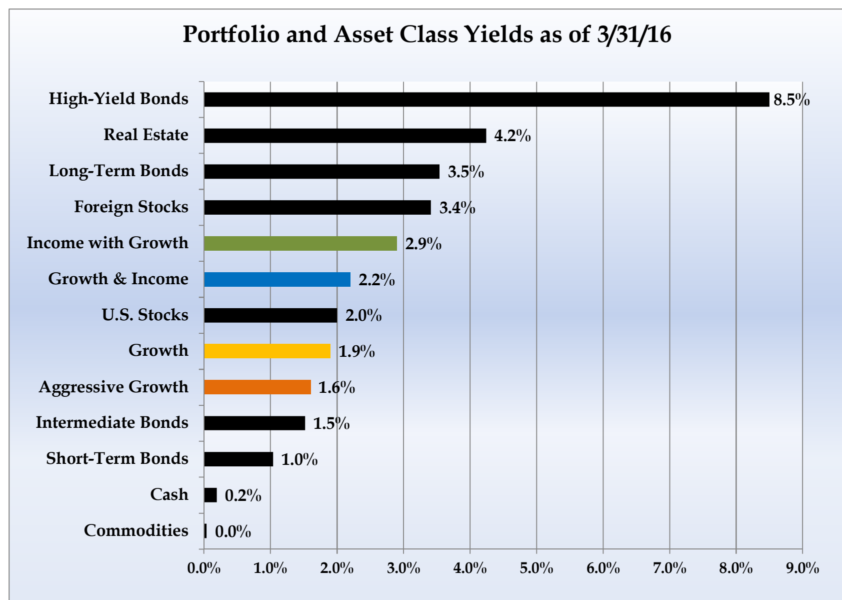
Source: Bloomberg, CIM. Cash is the ML 0-3 Month T-Bill Index; Bonds are the ML Domestic Master Index; Stocks are the S&P 500 Index. See disclosures on page 6* for important details.

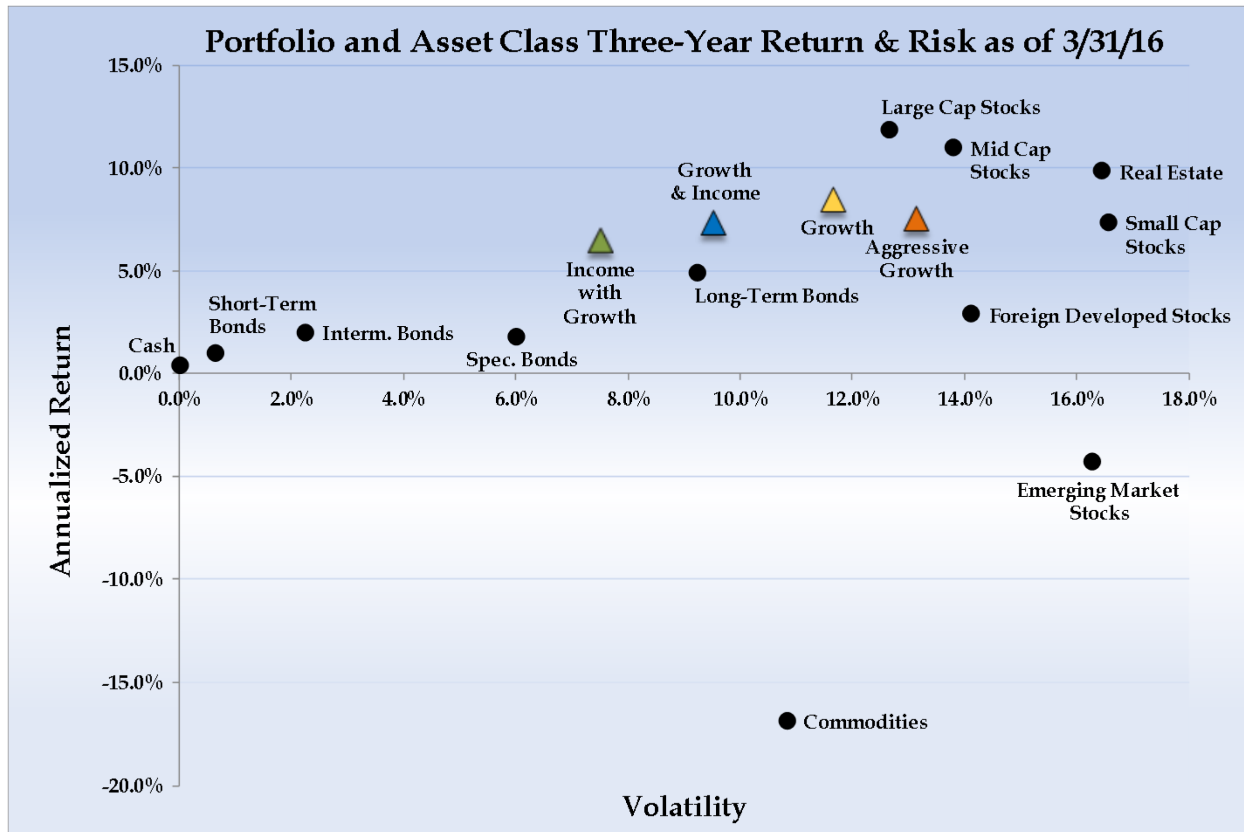
The Confluence asset allocation process is centered upon risk management. Our portfolios offer a broad spectrum of risk profiles, ranging from a fairly conservative posture in Income with Growth (green) to a more risk tolerant profile in Aggressive Growth (orange). The primary asset classes of cash, bonds and stocks are illustrated in the black bars for reference in the above chart.

We recognize that risk levels and return potential rise and fall over market and economic cycles. Therefore, we apply a dynamic process, one that evaluates the economy, interest rates, regulation, valuations and other investment variables in a forward-looking context. Although we seek return opportunities, we do so with a consideration for the amount of risk taken to pursue these returns.

For many investors, income is an important objective and we make it a priority in our income-oriented portfolios. However, we balance the income objective relative to our outlook for various asset classes. Often times, higher yields may not translate into attractive return/risk tradeoffs. This chart shows the recent gross yields of our portfolios, relative to several asset classes.

Source: Bloomberg, CIM. Portfolio yields are before fees. See disclosures on page 6* for asset class composition and other important details.





Source: Bloomberg, CIM, using monthly data and gross returns. See disclosures on page 6* for asset class benchmark details.

PORTFOLIO AND ASSET CLASS COMMENTARY

This chart illustrates the return and volatility for a variety of asset classes, as well as the composite performance for our asset allocation portfolios. It reveals how different kinds of asset classes and portfolios have performed over a three-year period.

Because this chart is a snapshot of a single three-year period, we can't see how much the circles and triangles have moved across time. However, we can see how higher volatility is indicative of a wider range of return outcomes. For example, commodities and large cap stocks often have a similar level of volatility, yet we can clearly see a big difference in returns over the past three years. Of course, when volatility is low, the range of outcomes is much narrower.

For our portfolios, which are illustrated by the colored triangles, the range of return outcomes is also a function of their volatility. Our more conservative, income-oriented portfolios benefited from adjustments we made among shorter and longer maturity bonds, as well as including speculative grade bonds at certain times. Real estate also contributed to return, income and diversification.

In pursuing growth objectives, the portfolios have benefited from large cap allocations along with minimal allocations to foreign and emerging market equities, which have generally underperformed. Contributions from allocations to small caps and mid caps are still unfolding; however, in this three-year time frame they have generally underperformed large caps.

Three of the four portfolios continue to maintain an attractive combination of return and risk relative to the broader asset classes. We're pleased with their profiles as they are consistent with our process, which begins by assessing risk then attempts to create an optimal return profile. The Aggressive Growth portfolio's return/risk profile has been suboptimal. Although we continuously work to maintain an optimal level, we also recognize that the nature of higher volatility investing increases the possibility that there may be periods of underperformance. It's evident from this chart that the more volatile asset classes haven't delivered the highest returns during this time frame. This kind of environment can be challenging for aggressive investing. We can see that while pursuing higher returns usually involves taking more risk, taking more risk doesn't necessarily ensure capturing higher returns.

SECOND QUARTER 2016 ASSET ALLOCATION OUTLOOK

- **Economic growth will likely remain slow, but stable. We expect the Fed to proceed gradually in raising rates.**
- **The labor market continues to strengthen, with more workers entering the labor force, but wage growth remains weak.**
- **We expect domestic growth to be higher and more stable than most foreign economies. Therefore, we maintain a significant domestic bias in our equity allocations.**
- **We remain diversified across capitalization sizes. Our growth/value style bias remains at 60/40, based upon our sector and industry outlook.**
- **Inflation should remain low and we continue to favor longer maturity bonds.**
- **Real estate fundamentals appear strong and we believe this asset class can perform well in a low rate environment.**

ECONOMIC VIEWPOINTS

Although the equity markets generally had a good fourth quarter to end 2015, the first few weeks of 2016 started off pretty rough. Concerns ranged from global central bank policies (negative interest rates) to declining crude oil prices to the possibility of overly aggressive Fed tightening. The bond market also reflected these concerns and low-risk assets like Treasury bonds rallied. But around the middle of February, markets began to turn. Investors evaluated the broad landscape and determined that their concerns were perhaps overblown. Riskier markets – equities, real estate, high yield bonds and commodities – all rallied, while Treasury bonds retreated.

The precise cause for the February turnaround isn't exactly clear. We do know that riskier markets rallied even more late in the quarter when the Fed began telegraphing its plan to slow its pace of raising rates. We believe we've entered an era where global central bank policies (particularly those of the Fed) are having a heightened impact on virtually all asset classes. Accordingly, understanding the objectives of the Fed has become an important issue in managing investment portfolios.

The Fed raised short-term rates last December and economic data have deteriorated since that time. It is for this reason the Fed decided to take a more gradual path in raising rates. Our central bankers continue to monitor the labor market, which remains uneven, and inflation, which remains low. Employment and inflation have long formed the base of how the Fed directs its policy, but a new third variable, international economic growth, is now being considered by the Fed. Here we take a look at the three variables and what they tell us about the economy and Fed policy.

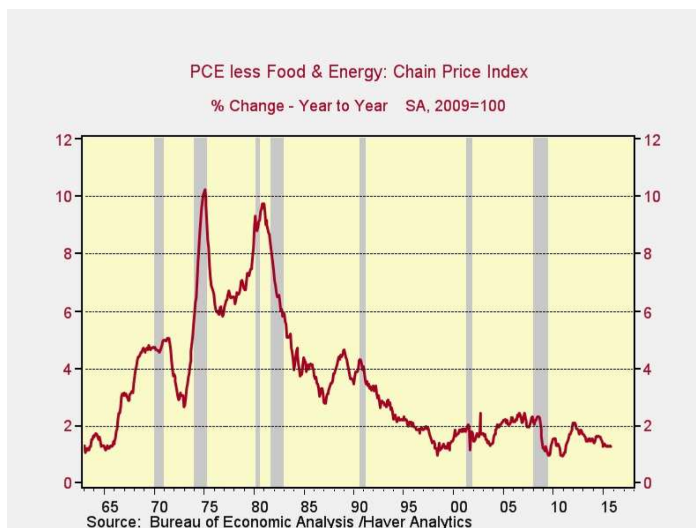
The first issue – the labor market – appears on the surface to be robust. Unemployment has declined to a level that has historically been a precursor to wage inflation. However, looking at the details reveals a measure of weakness in the labor market. Wages are stagnant and the proportion of people in the workforce remains low. So, while conditions are improving, structural weakness in the labor market will probably limit wage pressure, and this metric will likely encourage the Fed to take its time raising rates.

With regard to the second issue – inflation – there simply does not appear to be any current need for concern. Stagnant wages, falling oil prices and widespread global trade are together keeping prices low. Furthermore, expectations of future inflation are declining. In the chart on the next page, we show one of the Fed's favorite measures of inflation. It reflects inflation for consumer goods and services, stripping out the impact of volatile food and energy prices. We can see that inflation has been low for several years and we expect this trend to continue, which should also encourage the Fed to not hurry in raising rates. It's worth noting that in an election year where many anti-trade policies are being showcased, our inflation outlook could change if we perceive protectionist policies are likely.

The third issue – international growth – is somewhat new for the Fed. Historically, the Fed has viewed international growth as an outside factor, one that hadn't ever really threatened U.S. growth. However, it

appears the Fed now believes that high levels of global trade and weak foreign economies can impede U.S. growth. As such, we believe the Fed may pay closer attention to currency exchanges, recognizing that if the U.S. dollar becomes too strong then spending on foreign goods and services may rise and create a drag on the U.S. economy.

We believe these three factors have enabled the Fed to take a more gradual path in raising rates. Accordingly, we believe the likelihood of a policy error that could cause a recession has declined. We anticipate U.S. economic growth, inflation and interest rates are likely to remain low.



STOCK MARKET OUTLOOK

Following the recession of 2008, the stock market has delivered returns higher than the growth of the broad economy and corporate earnings. Part of this trend was due to the very low valuation levels that equities reached during the recession. As valuations recovered, returns were higher than normal. In addition, we believe the Fed's quantitative easing monetary policy helped drive valuations even higher. We believe this combination is why stock returns were above average even as economic growth was below average.

Because we expect below-average economic growth to continue, earnings growth may also be somewhat muted. With valuations already a bit higher than average, we don't expect valuations to rise significantly. Against this backdrop, it's likely that equity returns will be lower going forward. This doesn't imply a negative view toward equities; however, we believe investors should temper their return expectations. Fortunately, it's also likely that volatility will remain lower than normal due to the large amounts of liquidity central banks are providing to global financial systems.

We continue to emphasize small and mid caps, which may have higher return potential than large caps, albeit with higher risk, as many small and mid cap companies have higher growth rates. Still, large caps are additive, particularly for growth investors with a lower risk tolerance. We also continue to avoid foreign allocations in most portfolios as we believe U.S. growth and domestic equities offer more favorable return/risk profiles. Within our large cap allocations, we overweight the technology, consumer discretionary and utilities sectors, while underweighting financials, health care, materials and telecom. Our growth/value bias remains in favor of growth (60/40).

BOND MARKET OUTLOOK

As equity markets declined during the first quarter, our bond allocations provided the diversification we were seeking. Bond prices rose as equities declined, which was helpful in mitigating overall portfolio risk. Additionally, although the Fed hiked rates in December, it has since indicated a more gradual approach to raising rates. Given our expectations for a low growth, low inflation environment, intermediate and long maturity bonds still offer constructive return/risk profiles.

Our intermediate and longer maturity allocations include both corporates and Treasuries. We remain out of speculative grade bonds as energy sector defaults remain a concern.

OTHER MARKETS

Real estate continues to have an attractive profile, offering potential income, capital appreciation and diversification. Additionally, we expect the underlying fundamentals to remain strong, with steady or improving rental and occupancy trends. Valuations are likely to be supported as foreign capital continues to flow into the asset class.

Second Quarter 2016

	Income With Growth		Growth & Income		Growth		Aggressive Growth	
	Current	Change	Current	Change	Current	Change	Current	Change
Cash	2%	-	2%	-	2%	-	2%	-
Short Term Bonds	-	-	-	-	-	-	-	-
Intermediate Term Bonds	14%	(5%)	-	-	-	-	-	-
Long Term Bonds	35%	-	21%	(6%)	7%	-	5%	-
Speculative Grade Bonds	-	-	-	-	-	-	-	-
Real Estate	15%	5%	10%	6%	5%	-	10%	10%
U.S. Large Cap Stocks	7%	-	20%	-	40%	-	-	(15%)
U.S. Mid Cap Stocks	12%	-	27%	-	26%	-	20%	5%
U.S. Small Cap Stocks	15%	-	20%	-	20%	-	58%	-
Foreign Developed Country Stocks	-	-	-	-	-	-	-	(5%)
Emerging Market Stocks	-	-	-	-	-	-	5%	5%
Commodities	-	-	-	-	-	-	-	-
Total	*100%*		*100%*		*100%*		*100%*	

INCOME WITH GROWTH

The Income with Growth portfolio remains primarily allocated to high-quality bonds with intermediate and long-term maturities. With the Fed taking a more moderate path to higher rates, we expect both inflation and growth will likely remain relatively low. In this environment, we believe intermediate and longer maturity bonds can continue to provide both income as well as overall portfolio diversification.

The equity allocations remain entirely domestic and diversified across capitalization sizes. It is our view that the U.S. economy has better growth prospects than many foreign countries, which should foster a better equity environment.

This quarter we increased our allocation to real estate as fundamentals remain strong. We also expect foreign capital to continue flowing into the asset class, which should help maintain or improve valuations.

GROWTH & INCOME

With the Fed pursuing a policy of gradually raising rates, we expect inflation and growth will likely remain low. In this environment, we believe long-term bonds are helpful in providing both income and diversification in the portfolio.

The equity allocation is fairly balanced across large, mid and small cap stocks and remains entirely domestic. The capitalization diversification can provide a variety of growth opportunities, while the domestic focus is based upon our belief that U.S. growth will be higher than that of many foreign countries.

This quarter we increase the allocation to real estate, which can provide both growth and income opportunities. Real estate fundamentals are strong and we expect foreign capital to continue flowing into the asset class.

GROWTH

Growth investors have faced an equity environment characterized by rising uncertainty and declining returns. We believe these conditions are a function of low global economic growth and the growing role of central banks in the financial markets. For these reasons, we remain entirely domestic in our equity allocations as we anticipate that the U.S. economy, markets and policy environment will create more favorable opportunities.

The equity allocation remains anchored in large caps, which typically have lower volatility relative to other equities. However, we also include mid and small caps, which bring higher growth potential, albeit with greater volatility.

We maintain an allocation to long-term bonds as this asset class provides significant diversification. We also include real estate, which continues to benefit from strong fundamentals and foreign capital inflows.

AGGRESSIVE GROWTH

We expect inflation and growth to remain low, but also believe smaller companies may find ways to grow faster than the overall economy. For this reason, we shift the domestic equity allocation out of large caps while continuing to focus on small and mid caps.

We generally prefer domestic equities over foreign ones. However, emerging equities are reaching attractive valuations. So, while the asset class remains risky, it is our view that aggressive investors can participate in the potential recovery of the asset class with a limited allocation. We fund this allocation with the developed country allocation, which appears less attractive.

This quarter we introduce an allocation to real estate, which we believe offers an attractive return. Fundamentals are strong, financing costs are low and foreign capital continues to flow into the asset class. We also maintain the long-term bond allocation, which helps provide both return and diversification benefits.

Performance & Disclosures

As of 3/31/16

Strategy	Quarter	YTD	1 - Year	3 - Year	5- Year	ITD
Aggressive Growth - Gross of Fees	0.9%	0.9%	-4.4%	7.6%	5.9%	5.8%
Aggressive Growth - Net of Fees	0.1%	0.1%	-7.3%	4.4%	2.8%	2.6%
Benchmark - S&P 500	1.3%	1.3%	1.8%	11.8%	11.6%	8.9%
Growth - Gross of Fees	2.2%	2.2%	-1.3%	8.5%	7.2%	6.0%
Growth - Net of Fees	1.5%	1.5%	-4.2%	5.3%	4.1%	2.9%
Benchmark - S&P 500	1.3%	1.3%	1.8%	11.8%	11.6%	8.8%
Growth and Income Taxable - Gross of Fees	3.7%	3.7%	-0.9%	7.3%	7.0%	6.4%
Growth and Income Taxable - Net of Fees	2.9%	2.9%	-3.8%	4.1%	3.8%	3.2%
Benchmark - 70% S&P 500 and 30% ML Bond Index	2.0%	2.0%	2.1%	9.1%	9.4%	7.9%
Income Taxable with Growth - Gross of Fees	4.3%	4.3%	0.2%	6.5%	7.0%	10.7%
Income Taxable with Growth - Net of Fees	3.5%	3.5%	-2.8%	3.4%	3.8%	7.4%
Benchmark - 40% S&P 500 and 60% ML Bond Index	2.5%	2.5%	2.1%	6.3%	7.1%	8.8%

ITD: Inception-to-Date. Inception: Income with Growth (12/1/08), Growth & Income (9/1/08), Growth (9/1/08), Aggressive Growth (8/1/08).

Confluence Investment Management LLC is an independent registered investment adviser. 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.

[1]Net of fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly. This fee includes brokerage commissions, portfolio management, consulting services and custodial services. The Confluence fee schedule for this composite is as follows: 0.40% on the first $500,000; 0.35% on the next $500,000; and 0.30% 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.

Each strategy is implemented using Exchange Traded Funds (ETFs) and the investment objective is the pursuit of nominal returns (yield and growth) in excess of inflation, subject to the limitations of the risk constraint for each strategy. The targeted risk constraint and appropriate investor risk tolerance for each strategy is as follows; Aggressive Growth (High), Growth (Average), Growth and Income Taxable (Moderate), and Income with Growth (Conservative). ML Bond Index consist of Merrill Lynch US Corporate, Government, and Mortgage Bond Index.

Confluence claims compliance with the Global Investment Performance Standards (GIPS®). A complete list of composite descriptions and/or a GIPS compliant presentation is available by contacting Marketing@confluenceim.com or calling (314) 743-5090.

There are investment risks in investing in these strategies. Each asset class has specific risks associated with it and no specific asset class can prevent a loss of capital in market downturns. In a rising interest rate environment, the value of fixed income securities generally declines. Speculative grade bonds are subject to greater risk of loss of principal and interest, including default risk, than higher-rated securities. Investments in international and emerging market securities include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability. The real estate asset class is a portfolio containing Real Estate Investment Trust (REIT) securities.

Confluence utilizes fixed income ETFs for the bond asset classes to deliver the income and lower volatility traditionally available from a diversified bond portfolio. Fixed income ETFs are not bonds, but are pro-rata interests in publicly traded bond funds. Investors should be aware there are limitations in utilizing fixed income ETFs, which are subject to market risk, including the possible loss of principal. There may be times when an ETF's performance may vary relative to its targeted benchmark. And while ETFs generally trade very close to their net asset values, during times of market disruption they can trade at discounts or premiums, directly affecting performance. Liquidity can vary depending upon market conditions. ETFs trade like a stock, and there will be brokerage commissions associated with buying and selling exchange traded funds unless trading occurs in a fee-based account. Investors should consider an ETF's investment objective, risks, charges, and expenses carefully before investing.

Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice or a recommendation. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Opinions expressed are current as of the date shown and are subject to change.

*Benchmark return and volatility calculations utilize monthly data through 3/31/16. Investors cannot invest directly in an index. Past performance does not guarantee future performance. Asset class and benchmark index representation: cash (ML T-Bill); short-term bonds (ML 0-3 Year C/G); intermediate bonds (ML 3-5 Year C/G); long-term bonds (ML 10+ C/G); speculative grade or high yield bonds (ML High Yield Master); real estate (FTSE NAREIT Equity); large cap (S&P 500); mid cap (S&P MidCap 400); small cap (Russell 2000); foreign developed country (MSCI EAFE); emerging markets (MSCI Emerging Market); commodities (Dow Jones UBS Commodity). Yield chart data as of March 2016. Representations: U.S. stocks are the S&P 500; foreign stocks are the average of developed country and emerging markets.

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Confluence Investment Management LLC is an independent, SEC Registered Investment Advisor located in St. Louis, Missouri. We provide professional portfolio management and advisory services to institutional and individual clients. Our investment philosophy is based upon independent, fundamental research that evaluates global markets and economies, and continues all the way down to specific companies. Our portfolio management philosophy begins by addressing risk, and follows through by positioning clients to achieve income and growth objectives.