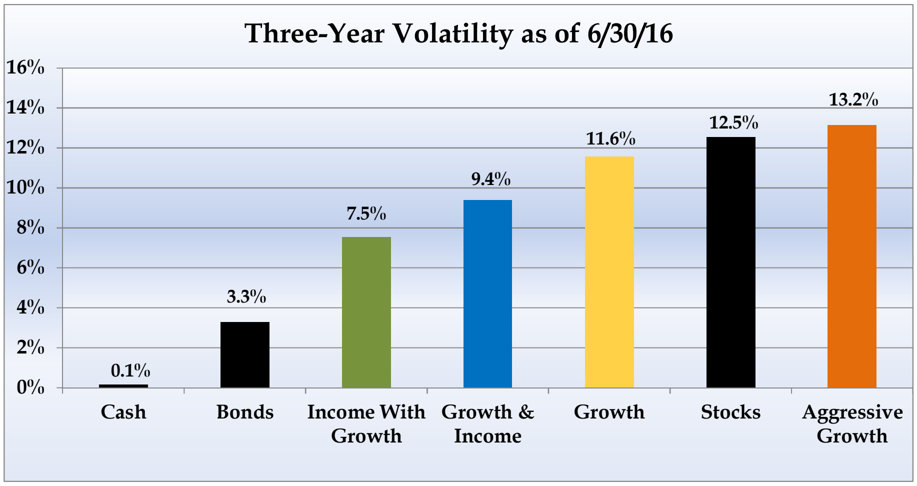
ASSET ALLOCATION QUARTERLY
Third Quarter 2016

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.

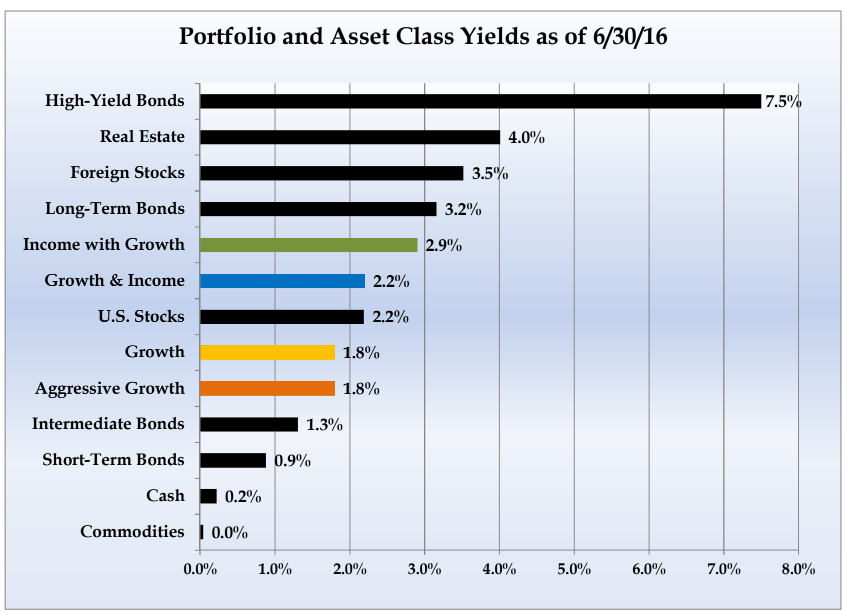


Source: Bloomberg, CIM. Cash is the ML 0-3 Month T-Bill Index; Bonds are the ML Domestic Master Index; Stocks are the S&P 500 Index. See disclosures on page 6* for important details.

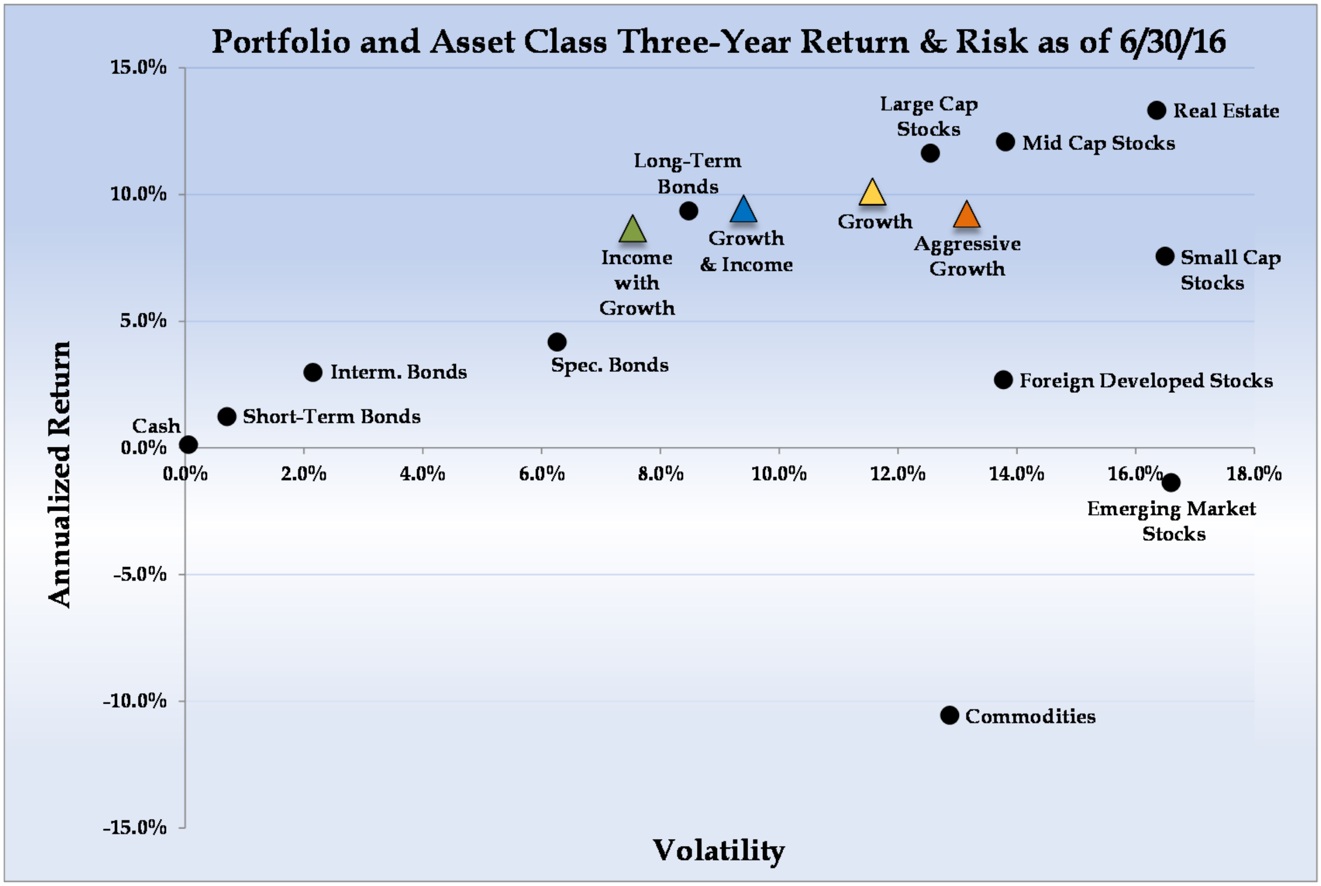
The Confluence asset allocation process is centered upon risk management. Our portfolios offer a broad spectrum of risk profiles, ranging from a fairly conservative posture in Income with Growth (green) to a more risk tolerant profile in Aggressive Growth (orange). The primary asset classes of cash, 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, one can't see how the circles and triangles have moved across time. However, one can see a wider range of return outcomes at the higher volatility levels. For example, commodities and large cap stocks have similar levels 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. Where income is an objective, we have adjusted exposures between areas of credit risk (speculative grade bonds) and areas of interest rate risk (long-term bonds), while also utilizing real estate. Our dynamic approach has helped position the income-oriented portfolios to participate in income and capital appreciation, while maintaining a fairly consistent risk profile.

Looking at the more volatile areas where growth allocations reside, our portfolios have benefited from exposure to large and mid-caps, real estate and even a measure of long-term bonds. Furthermore, the focus on domestic equities helped avoid some of the lower return profiles associated with foreign investments. Still, the volatile areas of the market have been challenging for aggressive investors and our small cap allocations have increased risk and lowered returns. On the upside, recent small cap performance is improving, and risk-tolerant portfolios are positioned to participate in ongoing progress. We also just added commodity allocations to all portfolios this quarter through the use of gold. Although commodities have underperformed for quite a while, we believe the diversification and return potential today can benefit portfolios going forward.

THIRD QUARTER 2016 ASSET ALLOCATION OUTLOOK

- **The U.S. economy is likely to remain in its low-growth trend and we don't foresee a recession, given that the Fed has become less inclined to raise rates.**
- **Brexit should be largely transitory for Britain, but may reveal a variety of weaknesses within the European Union.**
- **The U.S. presidential elections reveal a myriad of changing views within the population. Changing policies in Washington will be important to monitor.**
- **Domestic equities, diversified across capitalization sizes, maintain the lion's share of stock allocations. Our view toward equities remains generally positive, although we expect moderate returns, absent easy policy from the Fed. Our style bias remains in favor of growth at 60/40.**
- **We believe slow economic growth and low inflation, along with low global interest rates and high geopolitical risk, will keep U.S. interest rates near current levels.**
- **We introduce a commodity allocation this quarter, utilizing gold. We believe gold can help address risks related to global central bank policies.**

ECONOMIC VIEWPOINTS

Although U.S economic growth remains far below its long-term average, the economy continues to move forward in one of the longest expansions in modern history. The stability of the economy, more so than inflation or the strength of the labor markets, compelled the Fed to begin raising rates last December. However, with domestic economic data indicating potential pockets of instability, along with Britain's decision to exit the European Union (Brexit), the Fed has recognized there is enough uncertainty to put further rate hikes on hold. We believe this decision is a good one, and absent future Fed policy errors we do not foresee a recession at this point in time.

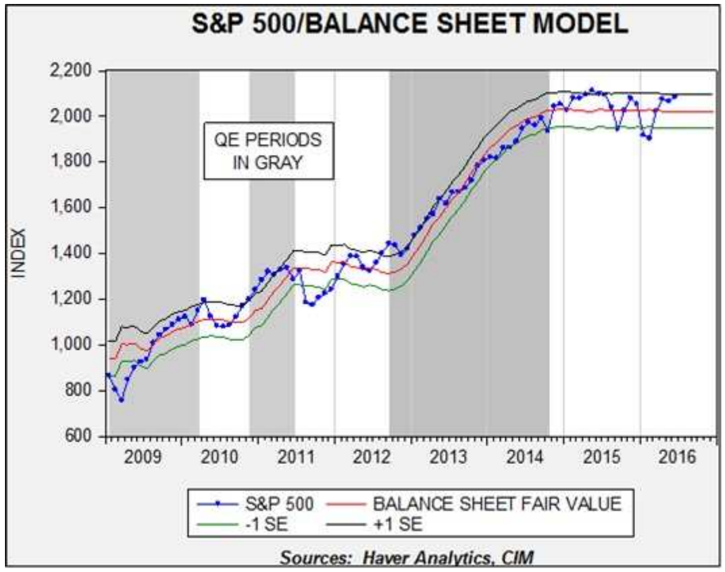
Equity and bond markets around the world were shocked with the British vote to leave the EU. Equities became volatile, while bond yields in developed countries continued to decline. In our view, Brexit may create some near-term uncertainty for the British economy, but we expect the problems to be mostly transitory. The British economy will benefit from rising exports as a result of the weak British pound. Furthermore, the Bank of England has telegraphed its intention to help address uncertainty in the country's financial system. For these reasons, we believe Britain will work its way through its departure from the EU.

However, for the rest of the EU, Brexit opens a Pandora's Box of potential problems. On the immediate horizon, the uncertainty is likely to slow already low levels of economic growth. Germany is particularly dependent upon exports, including those to Britain. Perhaps more important is the weakness of the Italian banking system. Like many other peripheral EU countries, Italy has yet to address the billions of euros of bad loans dating back to the 2008 financial crisis. Policies thus far have generally been Band-Aids that only defer problems rather than fix them. Brexit may bring these problems to the forefront, along with the EU's limited political cohesion and inability to address conditions in a consistent manner. Accordingly, one of the longer term risks we see from Brexit is the potential for the EU to begin unravelling.

We have long held a significant domestic bias in our portfolios, recognizing weak foreign growth and elevated levels of geopolitical risk. This posture has helped insulate portfolios from risks like Brexit; however, we recognize that global markets and economies have become increasingly interconnected. If Britain or the EU were to dip into recession, this could cause the U.S. economy to grow even slower. Still, we believe the U.S. economy is likely to prove itself as the strongest one standing among developed countries.

Of course, it is a presidential election year and it's important to acknowledge the changes taking place in Washington. For investors, it's important to remember that Fed Chair Yellen is likely to have a much more immediate impact on portfolios than either Clinton or Trump. Still, the political forces at work reveal changing views within the country. Many of the same issues that elevated Trump also buoyed Sanders. So, whether our next president is Trump or Clinton, the issues themselves will remain. These include policy changes related to trade, taxation, immigration and income inequality, to name a few. Policy changes take time to work through the political process but, as Washington adjusts, we will carefully monitor the trends, which will affect our views toward issues including inflation, productivity, growth and valuations.

STOCK MARKET OUTLOOK



We find it ironic that even as the Fed has embarked on a policy to raise short-term interest rates, the result has actually been lower long-term rates. One could argue that the Fed's recent policies have been an amalgamation of unintended consequences. Nevertheless, one fairly consistent outcome of Fed policy over the past few years has been the relationship between easier monetary policy and rising equity valuations. We saw a pretty clear relationship during the three rounds of Quantitative Easing (2009-2014), and we have seen it again this year in February and June, when the Fed clarified a slowing path for raising rates. For equity investors, this indicates higher potential return when the Fed chooses a path of easy monetary policy, which is a possibility going forward. But absent help from the Fed, we believe equity returns are likely to be moderate. Earnings growth remains low, while valuations are somewhat elevated. This profile isn't necessarily negative, but we believe equity investors should temper their expectations for returns over the next several quarters.

Except for a relatively small allocation in our most aggressive portfolio, our equity allocations remain entirely domestic. Our economic viewpoint toward Europe reflects a much weaker growth environment than that of the U.S. In addition, we believe Japan is likely to struggle, and perhaps enter recession, as the yen strengthens and harms Japanese exports. Within the U.S. equity allocations, we remain diversified across capitalization sizes. For large cap allocations, we are overweight technology, energy and consumer discretionary. We have a particular emphasis in energy that adds exposure to crude oil prices, which have the potential to increase as U.S. production declines and global geopolitical risks remains elevated. We are underweight financials, healthcare, utilities and telecom. Our style bias remains in favor of growth over value (60/40).

BOND MARKET OUTLOOK

Interest rates around the world remain historically low and rates are actually negative across a wide range of maturities in many countries. Low and negative rates reflect a variety of factors, including weak global economies, disinflation, aggressive central bank policies, enormous liquidity and investor risk aversion. So, even as U.S. rates are also historically low, domestic bond yields are actually pretty high relative to many other developed countries.

We continue to include a range of different maturities in our bond allocations. One important benefit that bonds have provided over the past several quarters is diversification. Oftentimes when equity markets have declined, bond prices have surged, particularly for longer maturity Treasuries. The inclusion of longer maturities has benefited portfolios and we continue to include them. Our allocations include corporate bonds as well as U.S. Treasuries.

OTHER MARKETS

We continue to believe real estate can play a constructive role in portfolios, particularly where income is an objective. Although this asset class has become increasingly similar to equities, and its diversification benefits are now more limited, we believe strong fundamentals can continue to benefit investors. Valuations are high for certain industries, but we believe an attractive return/risk tradeoff is available when factoring in low interest rates and strong foreign capital flows.

This quarter we introduce a commodity allocation, which is something we have avoided for many quarters. After several years of poor performance, commodities have provided some of the highest returns this year. We have concerns that low or declining global growth may cause commodity prices to turn lower; however, we believe gold provides ballast to the risks central bankers are creating with negative interest rate policies. Gold can also provide a safe haven during periods of elevated geopolitical and currency risks.

Third 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	5%	5%	-	-	-	-	-	-
Intermediate Term Bonds	-	(14%)	-	-	-	-	-	-
Long Term Bonds	35%	-	21%	-	7%	-	5%	-
Speculative Grade Bonds	-	-	-	-	-	-	-	-
Real Estate	15%	-	10%	-	5%	-	10%	-
U.S. Large Cap Stocks	11%	4%	25%	5%	40%	-	-	-
U.S. Mid Cap Stocks	12%	-	19%	(8%)	18%	(8%)	17%	(3%)
U.S. Small Cap Stocks	15%	-	20%	-	25%	5%	58%	-
Foreign Developed Country Stocks	-	-	-	-	-	-	-	-
Emerging Market Stocks	-	-	-	-	-	-	5%	-
Commodities	5%	5%	3%	3%	3%	3%	3%	3%
Total	*100%*		*100%*		*100%*		*100%*	

INCOME WITH GROWTH

Income with Growth investors have benefited from a significant allocation to long-term bonds. These bonds have not only performed well as rates declined, but they also provide a significant measure of diversification, often rising in value when equity markets declined. We continue to believe bonds can play an important role and this quarter we move to a “barbell” position, combining short- and long-term bonds. We believe this adjustment can help address interest rate risk, while maintaining the diversification benefits of longer maturities.

The bond barbell allows for a modest increase in large cap stocks, which adds to an equity allocation across capitalization sizes that is entirely domestic. Real estate contributes to portfolio income and this quarter we initiate a commodity allocation. Gold contributes diversification and can provide a safe haven from risks related to global central bank policies and currency fluctuations.

GROWTH & INCOME

The long-term bond allocation in the Growth and Income portfolio has provided attractive returns as well as significant diversification. We continue to believe long-term bonds can play an important role in an environment of low growth, low inflation and low global interest rates.

For growth purposes, the portfolio remains diversified across a range of large, mid and small caps and is entirely domestic. We continue to believe U.S. equities should have a better growth environment relative to most foreign economies. This quarter we trim mid-caps in order to increase exposure to energy in the large cap allocation. We believe oil prices may create an improving environment for energy companies. Real estate provides both growth and income opportunities and we also introduce a commodity allocation this quarter. Gold can help address various risks related to global central bank policies and currency fluctuations.

GROWTH

For several quarters, the Growth portfolio’s equity allocation has avoided foreign allocations, instead focusing on domestic equity. This posture has helped limit the portfolio’s exposure to international events that have elevated volatility. Domestic returns have also been generally higher than foreign ones and we continue to favor the return/risk profile of U.S. equities. The equity allocation remains diversified across large, mid and small cap stocks. This quarter we shift the portfolio slightly, from mid-caps to small caps. We also have a more pronounced exposure to energy within the large cap allocation because we believe oil prices in coming quarters may create a more favorable environment for energy companies.

We maintain the allocation to long-term bonds, which provide both return potential and diversification. We also initiate a commodity allocation utilizing gold, which we believe can help address risks associated with global central bank policies and currency fluctuations.

AGGRESSIVE GROWTH

The Aggressive Growth portfolio remains centered on small cap stocks. In a world of low growth, we believe many smaller companies have the potential to grow their businesses faster than the overall economic environment (we include a smaller proportion to mid-caps for similar reasons). This quarter, we adjust the small cap allocation with a greater focus on the energy sector as we believe oil prices are likely to create an improving environment for this industry.

Real estate provides a differentiated return opportunity. This asset class continues to benefit from strong fundamentals, low interest rates and strong foreign capital flows. Smaller allocations to long-term bonds and emerging market equities also create return potential, along with unique risks. This quarter we introduce a commodity allocation, bringing gold into the portfolio. We believe gold prices may help investors address risks associated with central bank policies and currency fluctuations.

Performance & Disclosures

As of 6/30/16

Strategy	Quarter	YTD	1 - Year	3 - Year	5- Year	ITD
Aggressive Growth - Gross of Fees	4.0%	4.9%	0.0%	9.3%	7.1%	6.1%
Aggressive Growth - Net of Fees	3.2%	3.3%	-3.0%	6.0%	3.9%	2.9%
Benchmark - S&P 500	2.5%	3.8%	4.0%	11.6%	12.1%	8.9%
Growth - Gross of Fees	3.0%	5.3%	3.2%	10.1%	8.2%	6.2%
Growth - Net of Fees	2.3%	3.8%	0.1%	6.9%	5.0%	3.1%
Benchmark - S&P 500	2.5%	3.8%	4.0%	11.6%	12.1%	8.8%
Growth and Income Taxable - Gross of Fees	4.1%	7.9%	6.0%	9.4%	8.0%	6.7%
Growth and Income Taxable - Net of Fees	3.3%	6.3%	2.8%	6.2%	4.8%	3.6%
Benchmark - 70% S&P 500 and 30% ML Bond Index	2.4%	4.4%	4.9%	9.5%	9.8%	7.9%
Income Taxable with Growth - Gross of Fees	4.9%	9.4%	9.4%	8.7%	8.0%	11.0%
Income Taxable with Growth - Net of Fees	4.1%	7.8%	6.1%	5.5%	4.8%	7.7%
Benchmark - 40% S&P 500 and 60% ML Bond Index	2.4%	4.9%	5.5%	7.3%	7.3%	8.9%

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 6/30/16. 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 June 2016. Representations: U.S. stocks are the S&P 500; foreign stocks are the average of developed country and emerging markets.

The Asset Allocation Team

Mark Keller Bill O'Grady David Miyazaki Patty Dahl Kaisa Stucke

For more information contact one of our sales team members:

Wayne Knowles – Northeast
(314) 743-5292
wknowles@confluenceim.com

John Pierucki – Southeast
(314) 743-5293
jpierucki@confluenceim.com

Ron Pond – Southwest
(314) 743-5294
rpond@confluenceim.com

Steve Mikez – Northwest
(314) 743-5291
smikez@confluenceim.com

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.