

Specialty Finance BDC • Alternative Investment Strategies

The Specialty Finance BDC strategy 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 the portfolio holdings are in BDCs, typically involving 20-30 positions with a moderate level of turnover. This strategy is appropriate 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.

Market & Strategy Commentary

The Confluence Specialty Finance BDC strategy had a total return of -13.4% (gross of fees) in the second quarter of 2022, which was slightly higher than the benchmark total return of -13.8%. Year-to-date, the portfolio gross return was -11.0%, which was slightly below the benchmark total return of -10.5%. Across multi-year time frames, gross portfolio returns are higher than the benchmark. [*The net-of-fees return for the same periods were -14.1% QTD and -12.3% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Although BDCs began the year with positive returns, in the second quarter BDC returns turned negative, following the trend of the broader equity market, albeit with less volatility. Market sentiment remained negative as the Fed continued to aggressively tighten, responding to ongoing high levels of inflation. At the same time, investors had to deal with the continuing war in Ukraine, supply interruptions, and the growing possibility of a recession.

Strong operating fundamentals have helped stabilize BDC stock prices and allowed them to outperform other equities with less downside and lower return volatility, as illustrated by comparing the MVIS U.S. BDC Index to the major domestic equity indexes. One of the most visible manifestations of these fundamentals is apparent in BDC income and dividends. During the second quarter, the portfolio had six increases in quarterly dividend rates, nine special dividend distributions, and no reductions. Combining the first and second quarter trends for 2022, the portfolio has had 15 increases in quarterly dividend rates, 15 special dividend distributions, and no reductions thus far this year. It is important to remember that BDC dividends can and will go down, given certain market and economic conditions. However, at this point, BDCs appear well-positioned to handle what's in front of them.

Are higher interest rates one of the conditions that pose a challenge for BDCs? Our view is that rising interest rates alone don't usually pose a serious operational risk. Most BDC loans tend to get repaid in three to five years, so managers typically have a large proportion of their assets to reinvest if rates rise. At the same time, most of the industry has substantial exposure to floating rate coupons on their assets and significant fixed rate liabilities, paving the way for profitability to rise as short-term rates increase. So, in this regard, rising rates can actually be helpful to BDC earnings. It's also important to note that these positive factors can become negative if rates were to decline.

Looking forward, we're keeping an eye on BDC credit metrics, which remain in good shape. Tighter Fed policy has often predated recessions, which usually cause loan default rates to rise. We position the portfolio with an emphasis on BDC managers who have historically delivered good results, even during difficult parts of the credit cycle. This approach may not always create the highest returns when times are good, but we feel it can be particularly important in addressing risk when times aren't good. It also positions the portfolio to deliver a high level of income, derived from the alternative markets, throughout market and economic cycles. At the end of the second quarter, the portfolio yield was 9.8%.

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5 Largest Holdings¹ (as of 6/30/22)

Company	Market Capitalization <i>(\$ millions)</i>	Portfolio Weight
Barings BDC Inc.	1,034.1	7.7%
Golub Capital BDC Inc.	1,214.8	7.0%
SLR Investment Corp.	801.3	6.7%
Main Street Capital Corp.	2,811.9	6.3%
Sixth Street Specialty Lending Inc.	1,411.7	6.1%

Performance Composite Returns² (For Periods Ending June 30, 2022)

	Since Inception**	5-Year*	3-Year*	1-Year	YTD	QTD
Specialty Finance BDC						
<i>Pure Gross-of-Fees³</i>	8.2%	5.0%	5.6%	(3.7%)	(11.0%)	(13.4%)
<i>Net-of-Fees⁴</i>	4.9%	1.9%	2.5%	(6.5%)	(12.3%)	(14.1%)
MVIS U.S. BDC Index (MVBIZDTG)	7.8%	4.4%	5.2%	(4.2%)	(10.5%)	(13.8%)

Calendar Year	Pure Gross-of-Fees ³	Net-of-Fees ⁴	Benchmark (MVBIZDTG)	Difference (Gross-Benchmark)	# of Portfolios	Composite Assets (000s)	Total Strategy Assets (000s) ^{***}	Total Firm Assets (000s)	Composite 3yr Std Dev	Benchmark 3yr Std Dev	Composite Dispersion
2011**	1.1%	0.9%	(0.7%)	1.8%	1	\$104	\$6,645	\$937,487	N/A	N/A	N/A
2012	27.9%	24.1%	34.5%	(6.6%)	1	\$133	\$34,748	\$1,272,265	N/A	N/A	N/A
2013	15.8%	12.4%	16.3%	(0.5%)	2	\$1,459	\$42,929	\$1,955,915	N/A	N/A	N/A
2014	(4.4%)	(7.2%)	(7.8%)	3.4%	18	\$3,644	\$51,015	\$2,589,024	9.7%	11.4%	0.0%
2015	(3.3%)	(6.2%)	(4.1%)	0.8%	25	\$4,621	\$51,912	\$3,175,419	12.0%	12.7%	0.3%
2016	22.1%	18.4%	24.4%	(2.4%)	21	\$3,857	\$64,970	\$4,413,659	13.1%	13.7%	0.8%
2017	0.9%	(2.1%)	0.1%	0.8%	19	\$2,905	\$55,878	\$5,944,479	12.4%	13.6%	0.3%
2018	(1.7%)	(4.6%)	(6.6%)	4.8%	24	\$3,702	\$54,037	\$5,486,737	11.1%	12.9%	0.2%
2019	25.0%	21.3%	27.3%	(2.3%)	35	\$7,179	\$57,964	\$7,044,708	10.9%	13.1%	0.5%
2020	(6.8%)	(9.6%)	(11.2%)	4.4%	33	\$6,782	\$27,280	\$6,889,798	31.6%	30.8%	1.0%
2021	32.0%	28.1%	36.4%	(4.5%)	38	\$9,856	\$20,805	\$7,761,687	31.4%	30.5%	0.7%

*Average annualized returns

**Inception is 12/1/2011

See performance disclosures on last page.

Portfolio Benchmark

MVIS U.S. Business Development Companies Index (MVBIZDTG) – A total return index that measures the performance of the largest and most liquid companies which are classified as BDCs in the U.S. The index is reviewed on a quarterly basis, is modified float market cap-weighted, and the maximum component weight is 20%.

(Source: Bloomberg)

The benchmark was changed prospectively starting 7/1/2021 as the prior benchmark, the Wells Fargo BDC Index (WFBDC), was discontinued in July 2021.

Disclosures

Market & Strategy Commentary—Information is presented as supplemental information to the disclosures required by GIPS® standards. Individual holding performance and contribution methodology as well as a list of every holding's contribution to the strategy can be obtained by contacting Confluence. Material is published solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or investment product. Opinions and estimates are as of a certain date and subject to change without notice. Past performance is no guarantee of future results.

Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable. It is important to review your investment objectives, risk tolerance, and liquidity needs before choosing an investment style or manager. All investments carry a certain degree of risk, including possible loss of principal, that investors should be prepared to bear. Equity securities are subject to market risk and may decline in value due to adverse company, industry, or general economic conditions. There can be no assurance that any investment objective will be achieved or that any investment will be profitable or avoid incurring losses.

Indices: The MVIS U.S. Business Development Companies Index is shown as additional information. This index is unmanaged. An investor cannot invest directly in an index. It is shown for illustrative purposes only & does not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

1 Largest Holdings—The listing of “5 Largest Holdings” is not a complete list of all stocks in the portfolio or which Confluence may be currently recommending. Application of the investment strategy as of a later date will likely result in changes to the listing. Individual client portfolios in the program may differ, sometimes significantly, from these listings. Contact Confluence for a complete list of holdings.

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, 2021. 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.

GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. The Specialty Finance BDC strategy was inceptioned on December 1, 2011, and the current Specialty Finance BDC Composite was created on February 1, 2013. 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. This fee includes brokerage commissions, portfolio management, consulting services and custodial services. The Confluence fee schedule for this composite is as follows: 1.00% on the first \$500,000; 0.90% on the next \$500,000; and 0.75% 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. Subsequent to February 1, 2013, bundled fee accounts make up 100% of the composite. 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.

Performance prior to February 1, 2013, is based on the Specialty Finance BDC—Direct Composite which was created on December 1, 2011. The Specialty Finance BDC—Direct Composite includes accounts that pursue the Specialty Finance BDC strategy, but do not have bundled fees. Gross returns from the Specialty Finance BDC—Direct Composite include transaction costs and net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly.

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 Specialty Finance BDC Composite contains fully discretionary Specialty Finance BDC wrap accounts. The Specialty Finance BDC portfolio invests primarily in Business Development Companies (BDCs) to earn current income with potential long-term capital appreciation. **Results shown for the year 2011 represent partial period performance from December 1, 2011, through December 31, 2011. ***Total Strategy Assets are shown as supplemental information. 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.

A BDC's portfolio typically will include a substantial amount of securities purchased in private placements, and its portfolio may carry risks similar to those of a private equity or private debt fund. Securities that are not publicly registered may be difficult to value and may be difficult to sell at a price representative of their intrinsic value. To the extent a BDC focuses its investments in a specific sector, the BDC will be susceptible to adverse conditions and economic or regulatory occurrences affecting the specific sector or industry group, which tends to increase volatility and result in higher risk. BDCs may employ the use of leverage in their portfolios through borrowings or the issuance of preferred stock. While leverage often serves to increase the yield of a BDC, this leverage also subjects the BDC to increased risks, including the likelihood of increased volatility and the possibility that the BDC's common share income may fall if the interest rate on any borrowings rises.

About Confluence Investment Management LLC

Confluence Investment Management is an independent Registered Investment Advisor located in St. Louis, Missouri, that provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates evaluation of market cycles, macroeconomics and geopolitical analysis with the firm's value-driven, company-specific approach. The portfolio management philosophy begins by assessing risk and follows through by positioning clients to achieve their income and growth objectives.

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