



Specialty Finance BDC

Alternative Investment Strategies



Second Quarter 2025

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, and most of the portfolio income will be in the form of non-qualified dividends. 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.

Market & Strategy Commentary

The Confluence Specialty Finance BDC strategy had a total return of -0.2% (gross of fees) in the second quarter of 2025, which was higher than the benchmark return of -1.0%. Year-to-date, our Specialty Finance BDC strategy was up 1.2% (gross of fees), which was also higher than the benchmark return of 0.2%. Over multi-year periods, the strategy's returns have generally been near or in line with the benchmark. *[The strategy's net-of-fees returns for the same periods were -0.9% QTD and -0.3% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.]*

In the second quarter, markets continued to adjust to an environment characterized by rapid policy changes coming out of Washington. The direction and magnitude of the policies have been unpredictable, often creating difficult conditions for investors. The initial response across asset classes was an increase in volatility and rapid shifts toward "risk-off" assets. However, some safe havens, including long-term Treasuries and the US dollar, were avoided. This condition exacerbated investor concerns as the market response departed from normal pathways.

Ultimately, investors did adjust to the policies emanating from Washington, recognizing that initial declarations could subsequently be altered, and final decisions might end up being very different. Investors returned to a "risk-on" posture throughout the second quarter, which elevated returns across asset classes, even as volatility declined. Both large and small caps delivered positive returns, offsetting all or most of the previous declines, with financials generally outperforming the broad market.

Total Return	Q2 2025	YTD 2025
S&P 500	10.9%	6.2%
S&P 500 Financials	5.5%	9.2%
Russell 2000	8.5%	(1.8%)
S&P Small Cap Financials	5.5%	1.2%
MVIS US BDC Index	(1.0%)	0.2%

(Sources: Bloomberg, Confluence)

Although BDCs also experienced an increase in volatility, the overall pathway has been milder relative to other equities, particularly in comparison to other small caps. BDCs are often (though not always) able to deliver lower volatility relative to other stocks because their dividends are much higher. This characteristic allows BDC investors to capture significant income, even when stock prices are pressured downward, thereby helping to balance total return during periods of elevated market volatility. To that end, all BDCs in the portfolio continued to pay meaningful dividends during the second quarter.

The portfolio architecture involves position sizes that are not uniform; thus, typically the larger positions tend to have a greater impact on return. In the second quarter, this condition continued to be the case, with the largest return contributions coming from Sixth Street, Main Street, Ares, Capital Southwest, and MSC Income. The first four on this list are larger positions and their steady operating results and dividend distributions were additive to the second quarter portfolio return. MSC Income is a smaller position, but the stock performed particularly well after being added to the portfolio during the quarter. This BDC entered the public arena in the first quarter and was added to the portfolio during a period of elevated volatility, which created an attractive opportunity to establish the position.

The lowest contributors included Barings, Hercules, Blackstone, Oaktree, and Crescent. These BDCs reported generally good operating results, though their valuations were pressured lower during the quarter. Still, Oaktree and Crescent reported some credit challenges in their portfolios, which contributed to some of the downside.

Outlook

Equity markets are adjusting to various sudden policy changes related to tariffs, regulation, and administrative oversight coming out of Washington. Broadly speaking, there's a realization that initial declarations are likely to be quite different than the final outcomes, and market volatility has declined as investors have tempered their responses to breaking news. Still, uncertainty remains as a condition in the market. Not only are final policies unknown, but so too is the impact. For example, higher tariffs are generally expected to foster some amount of inflation; however, the magnitude, tenor, and timing are difficult to predict.

Although most businesses are forced to deal with this uncertainty, BDCs face it on an additional level. Private market activity with regard to mergers and acquisitions has been muted in recent years as private equity sponsors (the BDC industry's primary borrowers) grappled with rising short-term rates. Then late in 2024, with the Fed in easing mode and the elections settled, optimism emerged that 2025 might form a "supercycle year" as the M&A volume dam finally broke, spilling into a constructive environment with lower rates. However, this cycle failed to emerge as attention turned toward tariffs early in the year.

The upshot is that BDC operating fundamentals remain stable, even in the lower M&A volume environment. Transaction volume is beginning to slowly improve, while businesses and private equity sponsors adjust to changing tariffs. At the same time, large amounts of capital continue to flow into the private credit markets, which has driven lending spreads and loan yields lower to the point where the lending environment is similar to the conditions we saw prior to the tariff negotiation era. This dynamic creates a good news/bad news field for BDC managers, who can benefit from rising M&A volume but will face lower yields and possibly lower returns. From our perspective, these challenges underscore the importance of focusing the portfolio on high-quality BDCs that are led by managers with deep experience across a wide range of conditions. We aim to invest in "all-weather tire" BDCs, ones that can deliver attractive returns across a variety of circumstances.

The portfolio is well-positioned to continue delivering a high level of current income, derived from the alternative asset class of private credit. We're pleased that the portfolio's BDC investments have navigated recent challenges and delivered good results. We remain optimistic that they can continue to do so, even as the broad environment has a higher level of uncertainty.

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Contribution¹

(QTD as of 6/30/2025)

The portfolio's top contributors and detractors for Q2 2025 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Sixth Street Specialty Lending Inc.	7.92	0.96
Main Street Capital Corp.	6.48	0.41
Ares Capital Corp.	5.58	0.18
Capital Southwest Corp.	3.92	0.16
MSC Income Fund	0.97	0.10
Bottom 5		
Barings BDC Inc.	7.05	(0.14)
Hercules Capital Inc.	5.70	(0.16)
Blackstone Secured Lending Fund	4.88	(0.22)
Oaktree Specialty Lending Corp.	4.25	(0.31)
Crescent Capital BDC Inc.	2.84	(0.53)

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

Performance Composite Returns² (For Periods Ending June 30, 2025)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Specialty Finance BDC							
Pure Gross-of-Fees ³	9.3%	8.5%	16.9%	13.3%	3.4%	1.2%	(0.2%)
Max Net-of-Fees ⁴	6.0%	5.3%	13.4%	9.9%	0.3%	(0.3%)	(0.9%)
MVIS US BDC Index (MVBIZDTG)	9.1%	8.4%	17.4%	14.0%	3.8%	0.2%	(1.0%)

Calendar Year	Pure Gross-of-Fees ³	Max 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%
2022	(10.2%)	(12.9%)	(8.6%)	(1.7%)	42	\$9,231	\$18,086	\$6,931,635	33.2%	32.7%	0.3%
2023	25.8%	22.1%	27.3%	(1.5%)	42	\$10,797	\$13,104	\$7,200,019	16.1%	17.6%	0.5%
2024	13.2%	9.8%	13.7%	(0.6%)	45	\$11,907	\$16,214	\$7,280,773	14.9%	16.5%	0.3%

*Average annualized returns

**Inception is 12/1/2011

See performance disclosures on last page.

Portfolio Benchmark

MVIS US 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)

Confluence Specialty Finance BDC Committee

Mark Keller, CFA

David Miyazaki, CFA

For more information contact a member of our sales team: (314) 530-6729 or sales@confluenceim.com

See [Territory Map](#) on the Confluence website for sales coverage.

Disclosures

Market & Strategy Commentary—Individual holding performance and contribution methodology 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.

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Index: The MVIS US BDC 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 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, 2024. 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 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 US 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: 0.80% on the first \$500,000; 0.70% on the next \$500,000; and 0.60% 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.

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

****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.