Fourth Quarter

2023

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 4.6% (gross of fees) in the fourth quarter of 2023, which was below the benchmark return of 5.8%. For the entire year, the strategy's total return was 25.8% (gross of fees), which was also below the benchmark at 27.3%. Over multi-year periods, strategy returns have generally been near or in line with the benchmark. [*The strategy's net-of-fees returns for the same periods were 3.8% QTD and 22.1% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

BDCs had a solid fourth quarter to wrap up a very strong year. This performance stands in contrast to most small cap value stocks, particularly those in the Financials sector. Of course, the failure of SVB in the first quarter cast a broad shadow across many small to mid-sized lenders, but after a brief bout of volatility, BDCs distanced themselves from the struggles facing the banking industry and shaped their own distinct pathway.

Total Return	Q4 2023	Full Year 2023*
S&P 500	11.7%	26.3%
S&P 500 Financials	14.0%	12.1%
Russell 2000	14.0%	16.9%
S&P Small Cap Financials	20.2%	5.1%
MVIS U.S. BDC Index	5.8%	27.3%

(Sources: Bloomberg, Confluence) *as of 12/31/2023

The Confluence Specialty Finance BDC strategy captured the positive trends, which manifested in over two dozen positive dividend changes over the course of the year — including increases in quarterly dividends or the payment of special dividends — with no reductions.

How were BDCs able to deliver these returns? We believe several factors were at play: tighter Fed policy drove BDC income higher due to the large proportion of floating rate loans; credit quality remained intact, defying expectations of rising loan problems; and BDC balance sheets incuded fixed-rate borrowing, which helped to keep interest expenses low. In addition, low valuations at the beginning of the year indicated that most investors had negative expectations for BDC operating fundamentals in 2023. Then, as the year progressed, income rose, NAVs were stable, and dividends increased. The combination of these factors set the stage for investors to benefit simultaneously from rising dividends and rising valuations.

As is usually the case, the largest contributors to portfolio returns in the fourth quarter came from the largest positions, including Sixth Street, Golub, Blue Owl, Main Street, and Ares. These BDCs are focused on larger borrowers in the upper middle market, although Main Street also lends to smaller companies. The management teams have long track records of navigating through difficult economic and credit cycles, while also delivering good results during times of growth and expansion. Sixth Street, Golub, Blue Owl, and Main Street all paid special dividends in the fourth quarter, while Main Street paid a special dividend and also increased its normal quarterly dividend.

At the same time, many of the smallest contributors to fourth quarter returns came from smaller positions, including Bain, TriplePoint, and Portman Ridge. Rounding out the bottom five contributors for the quarter, SLR and Barings were both larger positions, though their contributions were limited. Operationally, these BDCs continued to deliver good results and maintained their dividends even as their returns were lower than the industry.

See GIPS Report on pages 3-4.

Market & Strategy Commentary continued...

Looking at the entire year of 2023, top contributors also came from the larger positions, including Hercules, Sixth Street, Capital Southwest, Golub, and Blackstone. Each of the first four names increased their quarterly dividends and paid special dividends, while Blackstone increased its quarterly dividend twice during the year. Operating fundamentals for these BDCs were strong and their dividends remained well-covered by earnings, despite all of the increases.

The BDCs making the smallest contributions to returns for 2023 included Blackrock TCP, Bain, Stellus, First Eagle, and Portman Ridge. Despite being on the list of small return contributions, the first four actually delivered positive returns for the year. Portman Ridge was the only BDC with negative return contributions. We feel this small BDC continues to make good progress consolidating its acquired assets and should push through some of the negative market valuations in its portfolio. [*See contribution table on next page.*]

Looking forward, we continue with a favorable view toward BDCs. The industry avoided the pitfalls that plagued smaller lenders in 2023. Unlike regional banks, BDCs generally avoid long-maturity, fixed-rate loans, like those that created problems at SVB. BDCs also mark their portfolios to market each quarter and provide good transparency into their loan books. By itself, this dynamic doesn't prevent all credit problems; however, it does allow investors to better understand the nature of what's owned by a BDC and what valuation is appropriate.

By not getting wound up in the banking crises of 2023, BDCs were able to make their distinctions as lenders more apparent. Although this helped the industry recover from the temporary downdraft rather quickly, it also meant BDC balance sheets emerged generally unharmed at a time when other lenders were struggling. Similar to what happened after the 2008 Great Financial Crisis, BDCs were also able to avoid the ire of regulators and legislators, who are likely to increase rules for other small lenders. These conditions collectively opened the door for the industry to resume its growth, and in early 2024, four new BDCs have already entered the public arena. We're pleased to see that these BDCs aren't just making the industry bigger, but their quality profiles are generally good, meaning they may also help the industry become better.

Outlook

The BDC industry navigated the hazards of rising rates in 2022 and 2023, benefitting from higher short-term rates, while avoiding a large increase in nonaccruals. Still, credit metrics will remain at the center of concerns and risks for BDCs as nonaccruals and defaults have a negative duality in harming both NAV and income. Accordingly, we'll be monitoring credit trends, which always have the potential to become problematic when economic growth slows. Another factor to monitor will be the nature of how BDC income is affected as the Fed eases, given that most BDC loans have floating rates. So, as is always the case, there is no shortage of factors to watch. But we believe solid operating fundamentals, a constructive lending environment, and industry growth continue to create attractive opportunities for equity investors seeking a high level of income.

Contribution[1]

(YTD as of 12/31/2023)

The top contributors and detractors for the portfolio in 2023 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Hercules Capital Inc.	5.44	2.30
Sixth Street Specialty Lending Inc.	6.79	2.30
Capital Southwest Corp.	4.14	2.07
Golub Capital BDC Inc.	7.31	2.00
Blackstone Secured Lending Fund	6.12	1.99
Bottom 5		
BlackRock TCP Capital Corp.	5.60	0.26
Bain Capital Specialty Finance Inc.	0.92	0.17
Stellus Capital Investment Corp.	0.10	0.10
First Eagle Alternative Capital BDC Inc.	0.38	0.09
Portman Ridge Finance Corp.	1.76	(0.23)

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

Performance Composite Returns[2] (For Periods Ending December 31, 2023)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Specialty Finance BDC *Pure Gross-of-Fees[3]*	9.2%	6.9%	11.7%	14.2%	25.8%	25.8%	4.6%
Max Net-of-Fees[4]	6.0%	3.7%	8.4%	10.8%	22.1%	22.1%	3.8%
MVIS U.S. BDC Index (MVBIZDTG)	9.1%	6.3%	12.4%	16.7%	27.3%	27.3%	5.8%

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%

**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.

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See Territory Map on the Confluence website for sales coverage.

Disclosures

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Index: The MVIS U.S. 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, 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 Specialty Finance BDC strategy was incepted 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: 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. **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.