

Objective: Balanced Large Cap Value combines equity and fixed income allocations in a single account. The equity portion invests in large cap companies, with an investment objective of capital appreciation and a secondary objective of dividend income. The fixed income portion is invested in fixed income Exchange Traded Funds (ETFs), diversified across maturities and sectors.

Overview

Balanced accounts are an efficient way for long-term investors to combine equity and fixed income exposure in a single account, while providing diversification and a more tailored level of volatility. Five different portfolio allocations are available, ranging from 30% fixed income/70% equity to 70% fixed income/30% equity, in increments of 10%. Balanced Large Cap Value is appropriate for clients whose primary objective is capital appreciation and whose secondary objective is dividend income from equities, along with income and stability from bonds.

Background

Due to the different risk and return characteristics of fixed income, the inclusion of bonds within an investment portfolio has historically been an effective way to address risk and lower volatility. The challenge, however, is that bonds are denominated differently than stocks and trade in unique ways. Because of these differences, bond investments are often managed in a separate account from stocks.

With the development of the fixed income ETF market, Confluence is able to efficiently bring together common stocks and securities that have the characteristics of bonds into a single account. Fixed income ETFs trade in similar fashion to stocks (in fact, often on the same exchanges), while still providing the volatility and income stream characteristics of bonds. In addition, many ETFs trade with greater liquidity for a broad range of position sizes, accommodating the needs of small and large accounts. These characteristics enable Confluence to efficiently handle deposits, withdrawals, systematic withdrawals and periodic rebalancing, while avoiding the higher transaction costs often associated with smaller trades in traditional fixed income securities.

It is important to note that fixed income ETFs are not bonds. An ETF can be viewed as a portfolio of investments, created with unique, transparent specifications, with each share representing a pro rata interest in that portfolio. In this manner, the ETF structure is similar to open-ended mutual funds. So, while a fixed income ETF isn't a bond, its attributes tend to mimic that of a bond portfolio. Fixed income ETFs are available in a wide range of maturities across corporate, agency and treasury sectors. The overall fixed income allocation average maturity can be adjusted by increasing or decreasing the focus on ETFs with longer or shorter maturities.

Investors should be aware there are limitations in utilizing fixed income ETFs. There may be times when the performance of an ETF may vary relative to its targeted benchmark. While ETFs generally trade very close to their net asset values, during times of market disruption, they can trade at discounts or premiums, which can directly affect an investor's performance. Liquidity is also generally good but can vary depending upon market conditions. A fixed income ETF also does not mature like an individual bond. These and various other differences highlight the fact that fixed income ETFs may vary in performance relative to direct investments in bonds.

Experience

The professionals at Confluence have utilized fixed income and equity ETFs in separately managed accounts for over a decade. Through the management of the fixed income allocations, Confluence professionals developed a solid background in understanding the mechanics of ETFs, as well as how to blend the various sectors and maturities to pursue specific objectives. This collective experience is applied in forming the fixed income allocations in Confluence Balanced accounts.

Equity Characteristics¹

	Portfolio
Equity Wtd. Avg. Market Cap.(\$B)	164.7
Equity Median Market Cap. (\$B)	92.0
Large Cap Value Dividend Yield	1.3%
Number of Securities	23-25
Annual Turnover (5-yr rolling)	10%

Fixed Income Characteristics¹

	Portfolio
Benchmark Profile	Investment Grade
Fixed Income Yield	4.1%
Number of Securities	8-12

10 Largest Equity Holdings²

TJX Cos. Inc.
 Berkshire Hathaway Inc. (Class B)
 Lowe's Cos. Inc.
 Raytheon Technologies Corp.
 PepsiCo Inc.
 Oracle Corp.
 Thermo Fisher Scientific Inc.
 Mastercard Inc.
 Stryker Corp.
 Market Corp.

5 Largest Fixed Income ETF Holdings²

SPDR® Portfolio Mortgage Backed Bond ETF - SPMB
 iShares iBonds Dec 2027 Term Treasury ETF - IBTH
 iShares iBonds Dec 2026 Term Treasury ETF - IBTG
 iShares iBonds Dec 2030 Term Treasury ETF - IBTK
 iShares iBonds Dec 2026 Term Corp ETF - IBDR

¹ Investing involves the risk of loss of the amount invested that investors should be prepared to bear. There can be no assurance that any investment objective will be achieved or that any investment will be profitable or avoid incurring losses. Yield calculations: Equity: composite level weighted average yield, calculated based on annualized current dividends as of 12/31/22 (Source: FactSet); Fixed Income: 30-day SEC yield for the model portfolio as of 1/19/23 (Source: Morningstar). Equity annual turnover (5-yr rolling) calculated from sample accounts for periods ending 12/31/2021.

² The listings of "10 Largest Equity Holdings" (as of 12/31/22) and "5 Largest Fixed Income ETF Holdings" (as of 1/19/23) are not complete lists of all stocks and/or ETFs 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 may differ, sometimes significantly, from these listings. Contact Confluence for a complete list of holdings.

Equity Investment Process

Large Cap Value invests in businesses that generally have market capitalizations above \$10 billion. Stocks are selected through Confluence's independent research, evaluating the fundamentals of individual companies. The equity portion of the portfolio includes companies with sustainable competitive advantages, often derived from unique products and services in niche industries. Stocks are purchased when trading at discounts to our estimate of intrinsic value. Large Cap Value typically comprises 23-25 holdings and is expected to result in low to moderate turnover.

Confluence's equity investment philosophy seeks to identify companies that have the ability to generate high levels of cash flow through a business model that maintains a competitive advantage over time. These advantages may include strong brand names, highly differentiated services or products, dominant market share, flexible pricing power, protected technology or specialized industrial skills sets. Confluence looks for management teams with proven track records of value-enhancing capital allocation decisions.

Confluence defines risk as the probability of a permanent loss of capital. To protect against this risk, we invest in quality businesses at attractive valuations diversified across a variety of market sectors. This discipline helps to protect against losses, while enhancing upside potential. Over time, Confluence believes this approach positions the portfolio to deliver superior risk-adjusted returns.

Security Selections – “Great Companies”

- Suitable companies possess substantial competitive advantages which are reflected in their ability to maintain pricing power and generate high returns on capital.
- These companies generate more cash than needed to sustain their market-dominant position.
- The businesses are led by management teams that have proven ability to allocate capital and whose interests are aligned with shareholders via inside ownership.
- These businesses are purchased only when trading at significant discounts to Confluence's estimate of fair value. This buy discipline may at times result in higher than usual cash balances at the inception of a new account.

Sell Discipline

To help preserve capital, positions are continually reviewed. A company's stock may be sold if:

- The share price reaches or exceeds Confluence's estimate of full valuation.
- More attractive opportunities are identified.
- The company's fundamentals deteriorate.

Fixed Income Investment Philosophy & Process

Within the fixed income allocation, Confluence strives to deliver the income and lower volatility traditionally available from a diversified bond portfolio. It is constructed to have characteristics similar to a traditional, laddered bond portfolio and its benchmark is the ICE BofAML U.S. Corporate, Government & Mortgage Index. The Confluence Fixed Income Strategy Committee may adjust the portfolio duration and maturity to be longer, shorter or in line with this benchmark. The investment committee may also adjust the exposure to corporate, Treasury and MBS sectors according to its viewpoints regarding Fed policy, the shape of the yield curve, relative yields, credit spreads, default rates and other market factors.

The strategy focuses on fixed income ETFs following investment grade benchmarks with a domestic orientation. The investment committee continuously monitors fixed income allocations, rebalancing at least annually, but may elect to rebalance over shorter time frames.

Allocation Adjustments

Clients are encouraged to establish long-term strategic allocations. However, allocations may be easily adjusted to address changing objectives and risk tolerances.

Firm Overview

Value Equities Investment Committee

Mark Keller, CFA	Joe Hanzlik
Daniel Winter, CFA	Dustin Hausladen
Tom Dugan, CFA	Kaisa Stucke, CFA
Tore Stole	Blair Brumley, CFA
John Wobbe	Brett Mawhiney, CFA

Fixed Income Strategy Committee

Mark Keller, CFA	Kaisa Stucke, CFA
William O'Grady	Patrick Fearon-
Gregory Ellston	Hernandez, CFA
David Miyazaki	

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 investment team's portfolio management philosophy begins by addressing risk and follows through by positioning clients to achieve income and growth objectives.

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