First Quarter

2019

Equity Strategies • Equity Income

Equity Income is focused on businesses across a broad range of market capitalizations that collectively generate an above-average stream of dividend income, while also providing for capital appreciation potential. The businesses are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that have the ability to either pay a high level of dividend income or grow the dividend stream over time. The portfolio typically comprises 30-35 holdings and is expected to result in low to moderate turnover. The portfolio is suitable for clients seeking total return from dividend income and capital appreciation.

Portfolio Commentary

Equity markets experienced strong returns in the first quarter with the S&P 500 and Russell 3000 Value Indexes rising 13.6% and 11.9%, respectively. Although growth-defined benchmarks continued to outperform value, across all market capitalizations, equity returns during the first quarter were relatively broad-based. The Equity Income strategy rose 13.2% (gross of fees) over the same period and its annualized yield at quarter-end was 3.0%. (*The strategy was up 12.4% (net of fees) over the same time period. Net of fees calculated using the highest applicable annual bundled fee of 3.00%. See performance disclosures on p.3 for fee description; actual investment advisory fees may vary.*)

The portfolio saw elevated levels of activity during the quarter. New additions included shares of U.S. Bancorp, Entergy Corporation and Lockheed Martin. These purchases were financed by the sales of Iron Mountain, Johnson & Johnson and Kraft Heinz.

U.S. Bancorp has always been our type of bank with its conservative management style, disciplined underwriting and strong focus and adherence to core banking fundamentals. The company's relatively high mix of fee revenues due to its strong payments business and historical avoidance of big mistakes has consistently resulted in top tier returns on equity and assets versus its peers. Financial markets have historically recognized the quality of U.S. Bancorp by capitalizing its shares at a premium multiple of book value relative to its peer set. While that premium exists today, it has narrowed to a point where we view the company to be worthy of inclusion in the portfolio.

Entergy is a utility company that is in the latter stages of exiting the merchant market to become a fully regulated utility. The company's regulated assets, operating in the Southeast and Texas, are in areas enjoying above-average growth relative to the country as a whole. Furthermore, these regulatory environments are generally constructive and Entergy's utilities operate with relatively low costs to customers which should allow the company to grow earnings over time. The process of exiting the merchant business has created some noise around the stock to provide what we viewed as an attractive entry point. Cash flows from the regulated utility are far more stable and predictable than those of the merchant market, which could result in the added benefit of multiple expansion post-transition.

Lockheed Martin is a defense contractor with a balanced set of products and service offerings, many of which are strategically positioned. Its business is an attractive mix of substantial, large platform contracts, ongoing maintenance and parts contracts, and services relating to a variety of government agencies, both U.S. and overseas. The company currently enjoys a relatively high degree of visibility into its business given a large and growing backlog, of which the F-35 is a meaningful component. With the F-35 now running closer to full production rates, we expect the company to realize further manufacturing efficiencies as it works to modernize an aged fleet over the coming years. In addition to becoming a more profitable piece of business for Lockheed Martin, we also see the F-35 program as offering some degree of insulation from broader economic challenges should they manifest, given the clear need for these planes. At current levels, the company offers an attractive free cash flow yield which we expect will go toward continued share repurchases and dividend increases.

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Portfolio Commentary continued…

Our decision to sell Johnson & Johnson wasn't an easy one as we've owned the shares for many years and the investment outcome achieved was largely in line with our expectations. We've always appreciated the company's diverse business mix, exceptional balance sheet and disciplined capital allocation. That being said, the combination of ample drug company exposure within the Equity Income portfolio, a more modest discount to our estimate of intrinsic value in the shares of JNJ versus other pharmaceutical holdings and the potential for near-term volatility around legal proceedings led us to the decision to sell.

We also held Iron Mountain in the Equity Income portfolio for a number of years. We originally purchased Iron Mountain because we believed its conversion to a REIT structure would unlock value and support an attractive and growing dividend. For the most part, our expectations were met, although it's fair to say the REIT investor community never fully embraced shares of IRM given its non-traditional assets (primarily document storage facilities). We were comfortable with the company's assets but did set certain performance criteria that we wanted the business to maintain. Specifically, realizing that the company's core document storage business had secular challenges, we established guard rails for the volume levels we would tolerate. In recent months, the company's business began to approach the levels we had set. Although we suspect management will be able to mitigate current volume declines in the document storage business, we nevertheless made the decision to sell shares and reallocate funds.

Regrettably, our investment in Kraft Heinz proved to be a money loser. The company's recent report of year-end 2018 results fell short of expectations as management-anticipated savings failed to materialize and the company faced higher-than-expected cost levels in its procurement, manufacturing and logistical operations. Moreover, the company cut its dividend by more than a third and took a substantial write-down on the carrying value of its Kraft and Oscar Mayer brands. We liked the 2015 merger of Kraft Foods, which was owned in Equity Income, and H.J. Heinz as it brought together not only strong brands but also a partnership through substantial ownership stakes between Berkshire Hathaway (bringing capital and a longer term perspective) and 3G Capital (noted for its cost-cutting and operational efficiency tactics). Indeed, before long, KHC sported food sector-leading operating margins. Even at the somewhat diminished levels in 2018, its operating margin of 23.4% was more than 600 bps better than the median margin of the large-cap food group. However, the results and actions taken in the fourth quarter report called into serious question whether 3G's tactics would have the capability to enhance growth and, ultimately, the equity value of major consumer brands as we originally expected.

The top-performing and worst-performing positions during the quarter were as follows:

Security	Avg Weight	Contribution
Top 5		
Kinder Morgan, Inc.	3.39	0.97
The Progressive Corporation	3.96	0.89
Microsoft Corporation	5.12	0.84
Fastenal Company	3.41	0.81
Paychex, Inc.	3.47	0.79
Bottom 5		
DowDuPont Inc.	2.78	0.02
Pfizer Inc.	3.06	(0.07)
Lockheed Martin Corporation	0.98	(0.10)
U.S. Bancorp	2.17	(0.15)
The Kraft Heinz Company	1.47	(0.53)

(Contribution data shown from a sample account)

Equity Strategies • Equity Income

10 Largest Portfolio Holdings (as of 3/31/19)

Company	Market Capitalization ($ billions)	Portfolio Weight
The Progressive Corporation	42.1	3.7%
Paychex, Inc.	28.8	3.6%
Diageo plc	98.0	3.6%
Microsoft Corporation	904.9	3.5%
Kinder Morgan, Inc.	45.3	3.4%
Linde plc	95.9	3.4%
Nestlé S.A.	291.9	3.4%
Pfizer Inc.	235.8	3.2%
Digital Realty Trust, Inc.	26.0	3.1%
3M Company	119.7	3.1%

The listing of "10 Largest Holdings" is not a complete list of all stocks in the portfolio or which Confluence may be currently recommending. Furthermore, application of the investment strategy as of a later date will likely result in changes to the listing. Sector weightings and holdings of individual client portfolios in the program may differ, sometimes significantly, from these listings. Contact Confluence for a complete list of holdings.

All investments carry a certain degree of risk, including possible loss of principal. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager. Equity securities are subject to market risk and may decline in value due to adverse company, industry or general economic conditions.

Performance Composite Returns For Periods Ending 3/31/19

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	S&P 500	R3000 Value
QTD	13.2%	12.4%	13.6%	11.9%
YTD	13.2%	12.4%	13.6%	11.9%
1-Year	6.9%	3.7%	9.5%	5.3%
3-Year*	9.9%	6.6%	13.5%	10.5%
5-Year*	9.5%	6.3%	10.9%	7.5%
10-Year*	15.1%	11.7%	15.9%	14.5%
15-Year*	9.0%	5.8%	8.6%	7.6%
Since Inception**	10.3%	7.2%	5.8%	6.9%

*Average annualized returns
**Inception is 10/1/2000

Confluence claims compliance with the Global Investment Performance Standards (GIPS®).
The Equity Income Strategy was incepted on October 1, 2000 and the current Equity Income Composite was created on August 1, 2008. Performance presented prior to August 1, 2008 occurred while the Portfolio Management Team was affiliated with a prior firm and the Portfolio Management Team members were the primary individuals responsible for selecting the securities to buy and sell. 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.
[1] Pure gross returns are shown as supplemental information to the disclosures required by the GIPS ® standards.
[2] Net of fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly (2.75% prior to 7/1/08). This fee includes brokerage commissions, portfolio management, consulting services and custodial services. The Confluence fee schedule for this composite is as follows: 0.60% on the first $500,000; 0.55% on the next $500,000; and 0.50% 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.
A complete list of composite descriptions and/or fully compliant GIPS® presentations are available upon request. Additional information regarding policies for calculating and reporting performance are available upon request. The annual composite dispersion is an equal weighted standard deviation calculated for accounts in the composite for the entire year. The Equity Income Composite contains fully discretionary Equity Income wrap accounts. Equity Income is a value-based, bottom-up portfolio that invests in stocks from all market capitalizations based on their ability to generate an above average stream of dividend income, while also providing capital appreciation potential.

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	S&P 500	R3000 Value	Difference (Gross-S&P500)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	S&P 500 3yr Std Dev	R3000V 3yr Std Dev	Composite Dispersion
2018	(8.9%)	(11.6%)	(4.4%)	(8.6%)	(4.5%)	7,772	$1,945,646	$5,486,737	9.7%	10.8%	11.1%	0.5%
2017	17.5%	14.0%	21.8%	13.2%	(4.4%)	7,423	$2,177,984	$5,944,479	8.4%	9.9%	10.3%	1.1%
2016	18.0%	14.5%	12.0%	18.4%	6.0%	5,272	$1,549,506	$4,413,659	9.4%	10.6%	11.0%	0.4%
2015	0.1%	(2.9%)	1.4%	(4.1%)	(1.3%)	3,528	$939,550	$3,175,419	9.4%	10.5%	10.7%	0.4%
2014	11.4%	8.1%	13.7%	12.7%	(2.2%)	2,834	$858,027	$2,589,024	8.4%	9.0%	9.4%	0.4%
2013	26.1%	22.4%	32.4%	32.7%	(6.3%)	1,947	$606,780	$1,955,915	10.5%	11.9%	12.9%	1.3%
2012	17.8%	14.3%	16.0%	17.6%	1.8%	1,200	$337,610	$1,272,265	13.5%	15.1%	15.8%	0.6%
2011	5.1%	2.0%	2.1%	(0.1%)	3.0%	918	$225,088	$937,487	18.6%	18.7%	21.0%	1.0%
2010	16.1%	12.7%	15.1%	16.3%	1.1%	555	$128,855	$751,909	20.2%	21.9%	23.5%	0.8%
2009	18.8%	15.3%	26.5%	19.8%	(7.7%)	459	$85,079	$533,832	18.1%	19.6%	21.3%	0.8%
2008	(18.9%)	(21.2%)	(37.0%)	(36.2%)	18.1%	346	$44,339	$291,644	12.0%	15.1%	15.5%	N/A
2007	1.5%	(1.3%)	5.5%	(1.0%)	(4.0%)	2,490	$381,383		6.2%	7.7%	8.3%	0.8%
2006	15.3%	12.1%	15.8%	22.3%	(0.5%)	3,122	$489,578		5.7%	6.8%	7.0%	0.8%
2005	0.4%	(2.3%)	4.9%	6.9%	(4.5%)	3,775	$536,505		8.4%	9.0%	9.7%	0.6%
2004	12.1%	9.1%	10.9%	16.9%	1.3%	2,811	$425,234		10.2%	14.9%	14.8%	1.1%
2003	32.1%	28.5%	28.7%	31.1%	3.4%	1,204	$168,181		11.0%	18.1%	16.0%	0.9%
2002	0.6%	(2.1%)	(22.1%)	(15.2%)	22.7%	342	$36,726		N/A	N/A	N/A	0.8%
2001	11.6%	8.6%	(11.9%)	(4.3%)	23.5%	32	$6,341		N/A	N/A	N/A	0.2%
2000**	13.5%	12.8%	(7.8%)	3.9%	21.4%	2	$125		N/A	N/A	N/A	N/A

**Results shown for the year 2000 represent partial period performance from October 1, 2000 through December 31, 2000. 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.

Portfolio Benchmarks
S&P 500 Index – A capitalization-weighted index of 500 stocks. The Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Russell 3000® Value Index – A capitalization-weighted index designed to measure performance of those Russell 3000® Index companies with lower price-to-book ratios and lower forecasted growth values.

About Confluence Investment Management LLC

Confluence Investment Management LLC is an independent Registered Investment Advisor located in St. Louis, Missouri that was founded in 2007. Confluence provides professional portfolio management and advisory services to institutional and individual clients. The firm'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, fundamental company-specific approach. Confluence's portfolio management philosophy begins by assessing risk and follows through by positioning clients to achieve their income and growth objectives. The Confluence team has more than 500 years of combined financial experience and 300 years of portfolio management experience.