Confluence
INVESTMENT MANAGEMENT

FIRST QUARTER
2020

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 strategy is suitable for clients seeking total return from dividend income and capital appreciation.

Strategy Commentary

Equity markets experienced extreme selling pressure in the first quarter of the year with the S&P 500 and Russell 3000 Value Indexes falling 19.6% and 27.3%, respectively. By comparison, Equity Income fell 22.1% (gross of fees) over the same period. (*The strategy was down 22.7% (net of fees). Net of fees calculated using the highest applicable annual bundled fee of 3.00%. See disclosures on p.3 for fee description; actual investment advisory fees may vary.*)

The decline in asset prices was steep, rapid, and largely indiscriminate as investors reacted to the COVID-19 global pandemic, an ill-timed pricing war in the energy markets, and the return of zero-bound interest rates, which elevated stress within credit markets. It's a common axiom that investors hate uncertainty. With global economies at various stages of self-imposed lockdown of indeterminate length, uncertainty is palpable. Within a surprisingly short period of time, the U.S. (and global) economy moved from a period of steady growth and low unemployment to a position of great vulnerability.

Importantly, steps are being taken to help address this period of vulnerability. The Federal Reserve Bank has taken swift and broad actions to provide liquidity and support to stressed areas of the financial and credit markets. This was a necessary step to help ensure the proper functioning of our financial markets. Congress was also relatively quick to act in providing relief to displaced workers and businesses. These and similar actions will help preserve the foundations of economic growth during this period of government-directed stasis, foundations that were relatively solid only a few weeks ago.

When the economy resumes, we would not expect the same environment that preceded it. Supply chains will be revisited. Businesses will carry more debt initially but are likely to prioritize reducing it and may even look to build reserves. Consumers, too, are likely to remain reticent for a period, both in their spending and social behaviors. This would be typical behavior following an economic downturn. That being said, this hasn't been a typical contraction or a typical response. We've never seen such quick and decisive actions by the Federal Reserve and Congress to an economic downturn. The effectiveness of these actions to keep productive capacity (households and businesses) intact could meaningfully influence the pace of recovery. Although there are many unknowns, the current period of heightened uncertainty is finite. Additional data, testing, experience, and therapies related to COVID-19 will continue to amass and bring with them better visibility as to when and how the public will be able to return to more normalized patterns of work and social activity.

A look at a few indexes provides additional insight into the market's undercurrents in the first quarter. The Russell 3000 Growth (down 14.9%) and Russell 3000 Value (down 27.3%) show that value stocks, which have underperformed growth stocks for the past several years, have been punished even more in this selloff (energy and banks, in particular). While growth stocks outperformed in the first quarter, they have primarily been supported by the FAANG+ stocks which include the five largest market caps in the S&P 500 (Microsoft, Apple, Amazon, Google, Facebook). These "top five" account for 19.5% of the index and had a Q1 weighted average return of around -6%. This overweight appears to be the primary reason the headline S&P 500 Index has held up better than the general experience of individual stocks, which is more accurately represented by the S&P 500 equal-weighted index return of -26.7% (the combined weight of these five names is roughly 1% of this index). While those five stocks are uniquely positioned (both in their business models and balance sheets) for the unforeseen impact of social distancing, we believe a diversified portfolio should not have such high concentration in a narrow subgroup.

Changes to the Equity Income portfolio during the quarter include the addition of Snap-On Tools, the sale of NXP Semiconductors, the purchase and sale of Carnival Cruise Lines, and modest trimming and adding to existing portfolio holdings. We anticipate making additional moves during the quarter currently underway, believing environments like this provide opportunities to upgrade the portfolio.

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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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Strategy Commentary continued...

Carnival Corporation was an uncharacteristically short holding for us, having been bought and sold in the same quarter. We had been looking at Carnival since 2012 and, more recently, since Q4 2019, before the coronavirus outbreak. The company had dealt with structural headwinds for the last 12-18 months as supply issues had affected some of its better markets. Increased industry capacity was well understood, and the shares were trading at valuation multiples not seen since the 2008-2009 time frame. Of note, the industry was more highly levered in 2008-2009 and had since gone through a positive transformation, led by technology, that allowed operators to better maximize revenue in ticket pricing and onboard spending. As the industry's largest operator, Carnival benefits from scale when it comes to purchasing power in its supply chain and port access. We felt the entry point (late February) offered compelling total return potential over the next several years as the industry returned to a more normalized operating environment.

Shortly after purchasing shares in Carnival, we sold the position. Why so soon? In short, the economic environment deteriorated rapidly which prompted us to reassess our initial assumptions. The severity of the pandemic and potential for recession went beyond what we had anticipated at the time of purchase. Specifically, actions by Saudi Arabia and Russia to initiate a price war in the oil market were not part of our original thinking. This situation, in our opinion, dramatically increased recession probabilities, which meant a recovery in Carnival's business was likely to extend beyond the public health crisis. In light of these developments, we were no longer comfortable with the risk profile or range of potential outcomes and decided it was best to exit the position despite the very brief holding period.

A new position in Snap-on Inc. was established during the quarter. Snap-on is a global manufacturer and marketer of tools, equipment, diagnostic instruments, and repair information systems targeting professional users. Although the brand is best known for its franchised mobile distribution business of stocked vans that visit automotive repair shops, the company also sells into a diverse array of industrial end-markets including aerospace, agriculture, construction, government, energy, and mining. We've owned the company in the past but felt compelled to sell in the years following the financial crisis due to what we believed at the time was an excessive valuation relative to its growth prospects. The stock price spent the last five years in a tight trading range despite the company having grown operating income, reduced share count, and diversified its business while maintaining a flexible balance sheet. Thus, we found the valuation more attractive and worthy of reinvestment.

The Snap-on brand is generally considered among the best by mechanics. The products are priced at a premium and have an aspirational quality, and it's common for mechanics to own their own tools rather than be supplied by an employer. The company has been a good steward of its brand and continues to innovate, allowing it to maintain premium pricing power and strong profit margins. It has consistently generated high returns on capital and cash well in excess of what's needed to support a healthy business. This has allowed management to pay a meaningful, well-covered dividend, invest in new product development, and pursue strategic acquisitions.

NXP Semiconductors was sold during the quarter. We originally added NXPI as management was set to return capital to shareholders following years of optimizing the product portfolio and balance sheet. It was also on the heels of its terminated sale to Qualcomm which resulted in the receipt of a $2 billion breakup fee. Management ultimately decided to skew the capital return toward share repurchases, given the valuation, and initiated a smaller dividend than anticipated. We sold the position to seek higher yielding investment opportunities.

The investment team at Confluence has always taken a pragmatic approach toward investing which strives to temper emotions by focusing on the underlying businesses and what they're worth. The objective is to own competitively advantaged businesses that are responsibly financed and guided by good stewards. While the shares of these types of businesses are not immune to near-term sentiment, as we are currently witnessing, their underlying attributes should provide the ballast to not just survive but also take advantage of any dislocations. Our task is to construct a portfolio of businesses that have the wherewithal to survive the downside, while providing ample opportunity to participate when the recovery occurs. This too shall pass, and rest assured we have a seasoned team of analysts working diligently to ensure the portfolios are aligned accordingly.

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

Security	Avg Weight	Contribution
Top 5		
Digital Realty Trust, Inc.	3.15	0.44
Microsoft Corporation	4.55	0.34
Gilead Sciences, Inc.	2.49	0.31
The Progressive Corporation	4.02	0.11
Tiffany & Co.	3.95	(0.08)
Bottom 5		
U.S. Bancorp	2.53	(1.08)
Fidelity National Financial, Inc.	2.81	(1.37)
Polaris Inc.	2.50	(1.56)
Carnival Corporation	0.48	(1.61)
SL Green Realty Corp.	2.99	(1.77)

(Contribution data shown from a sample account)

10 Largest Holdings (as of 3/31/20)

Company	Market Capitalization	Portfolio Weight
	($ billions)	
Digital Realty Trust, Inc.	36.0	4.1%
Nestlé S.A.	305.9	4.0%
The Progressive Corporation	43.2	4.0%
Tiffany & Co.	15.7	3.9%
Linde plc	92.2	3.6%
Microsoft Corporation	1,199.5	3.6%
Gilead Sciences, Inc.	94.1	3.6%
Lockheed Martin Corporation	95.5	3.5%
The Southern Company	57.1	3.4%
PepsiCo, Inc.	166.8	3.4%

The listing of "10 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. 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 3/31/20

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	S&P 500	R3000 Value
Since Inception**	9.2%	6.1%	5.1%	5.4%
15-Year*	7.6%	4.4%	7.6%	5.3%
10-Year*	9.5%	6.3%	10.5%	7.5%
5-Year*	4.7%	1.6%	6.7%	1.6%
3-Year*	1.4%	(1.7%)	5.1%	(2.7%)
1-Year	(9.9%)	(12.6%)	(7.0%)	(18.0%)
YTD	(22.1%)	(22.7%)	(19.6%)	(27.3%)
QTD	(22.1%)	(22.7%)	(19.6%)	(27.3%)

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

Calendar Year	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
2000**	13.5%	12.8%	(7.8%)	3.9%	21.4%	2	$125		N/A	N/A	N/A	N/A
2001	11.6%	8.6%	(11.9%)	(4.3%)	23.5%	32	$6,341		N/A	N/A	N/A	0.2%
2002	0.6%	(2.1%)	(22.1%)	(15.2%)	22.7%	342	$36,726		N/A	N/A	N/A	0.8%
2003	32.1%	28.5%	28.7%	31.1%	3.4%	1,204	$168,181		11.0%	18.1%	16.0%	0.9%
2004	12.1%	9.1%	10.9%	16.9%	1.3%	2,811	$425,234		10.2%	14.9%	14.8%	1.1%
2005	0.4%	(2.3%)	4.9%	6.9%	(4.5%)	3,775	$536,505		8.4%	9.0%	9.7%	0.6%
2006	15.3%	12.1%	15.8%	22.3%	(0.5%)	3,122	$489,578		5.7%	6.8%	7.0%	0.8%
2007	1.5%	(1.3%)	5.5%	(1.0%)	(4.0%)	2,490	$381,383		6.2%	7.7%	8.3%	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
2009	18.8%	15.3%	26.5%	19.8%	(7.7%)	459	$85,079	$533,832	18.1%	19.6%	21.3%	0.8%
2010	16.1%	12.7%	15.1%	16.3%	1.1%	555	$128,855	$751,909	20.2%	21.9%	23.5%	0.8%
2011	5.1%	2.0%	2.1%	(0.1%)	3.0%	918	$225,088	$937,487	18.6%	18.7%	21.0%	1.0%
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%
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%
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%
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%
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%
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%
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%
2019	31.0%	27.1%	31.5%	26.2%	(0.5%)	8,249	$2,725,466	$7,044,708	10.8%	11.9%	12.0%	0.8%

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.

(Source: Bloomberg)

Confluence claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Confluence has been independently verified for the periods of 8/1/2008 through 12/31/2018. A copy of the verification report is available upon request. Verification assesses whether: 1. the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis, and 2. the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. 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. 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.

[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 is available upon request. Additional information regarding policies for valuing portfolios, calculating performance, and preparing compliant presentations 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.

**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.

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. Holdings identified do not represent all of the securities purchased, sold or recommended. Information is presented as supplemental information to the disclosures required by GIPS ® standards. Opinions and estimates are as of a certain date and subject to change without notice. Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable. Past performance is no guarantee of future results. Investing in securities 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.* ***Indices:*** *The S&P 500 Index and Russell 3000 Value Index are shown as additional information. These indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only & do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.*