Equity Income • Value Equity Strategies

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 appropriate for clients seeking total return from dividend income and capital appreciation.

Market Commentary

In the first quarter of 2024, the equity markets saw a continuation of the Santa Claus rally that ended 2023, with the S&P 500 Index posting a rare back-to-back quarterly gain in the double-digits. The rally was sparked in late October 2023 when the Federal Reserve signaled the end of policy tightening as the downward trend in inflation (aka disinflation) was expected to continue toward the Fed's target of 2.0%. In short order, market participants were pricing in six interest rate cuts for 2024 (see *Figure 1*), which increased the probability of a soft landing. And although recent datapoints indicate that elevated levels of inflation may be sticky (see *Figure 2*), hence the reduction during the quarter in the number of expected rate cuts to three, the equity markets continued to rally.

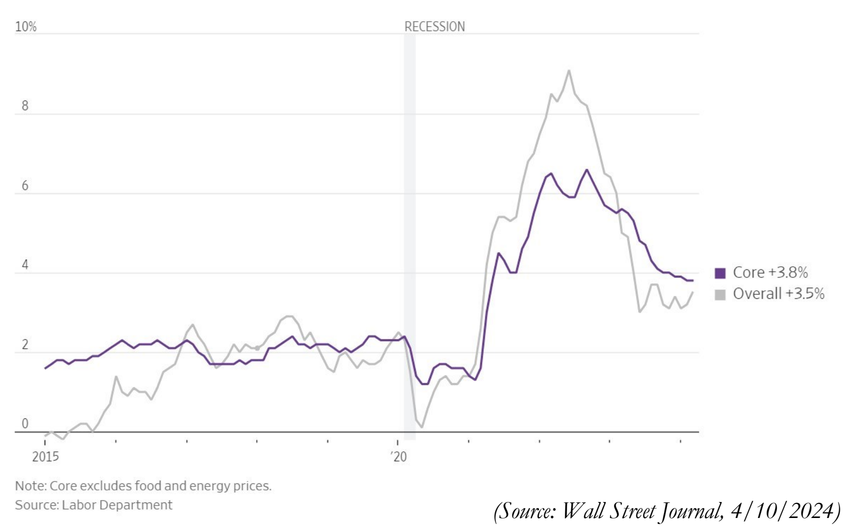
Why would stocks remain strong when elevated inflation data is pointing to the possibility that the Fed will keep rates higher for a longer period? There are a handful of possible reasons, but we suspect it is the belief that the Fed is bluffing on its inflation target. More specifically, investors doubt the validity of the Fed maintaining its stated 2.0% inflation target, believing the Fed will instead settle for a higher inflation target and move forward with rate cuts despite inflation stalling at levels well above 2.0%. This would clearly benefit the economy near-term and support revenue and earnings growth. As a result, we are seeing a continued tailwind for stocks, with the S&P 500 up 10.6% in the first quarter and 28% from the low in late October 2023.

Figure 1 **U.S. Interest Rate (%)**

(Source: Financial Times, 3/19/2024)

Unlike much of the past several years, recent returns have been broader-based. Both large caps and small caps, as measured by the Russell 1000 and 2000 indexes, respectively, are up approximately 30% off the October low. Although growth has outperformed value, the gap was much narrower than the recent past as Apple (AAPL) was up only 2% and Tesla (TSLA) posted a loss of 15.2%, which helped narrow the gap to "only" 5.3%, with the Russell 1000 Growth up 31.4% versus the Russell 1000 Value up 26.1%.

Figure 2 **Consumer Price Index, Change From a Year Earlier**



(Source: Wall Street Journal, 4/10/2024)

See GIPS Report on pages 5-6.

Market Commentary continued...

There are still pockets of excess speculation specifically around artificial intelligence (AI) and cryptocurrency, perhaps best evidenced by two "small cap" names, Super Micro Computer (SMCI) and MicroStrategy (MSTR), which are up +320% from the October low and now sport market capitalizations of $60 billion and $30 billion, respectively. And yet these two companies are still included in the Russell 2000 Index, a small cap index with a median market cap of approximately $956 million, and are impacting the index's returns. Both companies also have checkered histories as SMCI was delisted from the NASDAQ in 2019 for accounting irregularities, while MSTR leader Michael Saylor has used the company's balance sheet to acquire bitcoin (and, more recently, issued stock and convertible bonds to acquire even more bitcoin), all while actively selling his own shares. This revival of bitcoin and the recent Reddit IPO lends further credence to the sense that speculation still abounds.

On the other hand, fixed income markets were more sanguine in light of the recent inflation datapoints, giving back some of their recent gains. Recall that the 10-year Treasury yield fell from 4.98% in late October 2023 to 3.88% by year-end, providing a boost to financial assets and the Santa Claus rally. However, during the first quarter of 2024, the 10-year Treasury yield rose to 4.20% (see *Figure 3*). With inflation remaining at elevated levels, the backup in yields was rather muted and has some pundits pointing to the limited supply of longer-term notes as the Treasury Department shifted refunding to favor short-term bills. This shift helped suppress long-term yields which aided longer-duration bonds as well as stocks. At current levels, the 10-year Treasury is trading more in line with levels preceding the Great Financial Crisis in 2008-09 and provides a real rate of return that has been absent for much of the past 15 years and has benefited financial engineering over operating acumen.

Figure 3 **Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity**

(Source: Federal Reserve Economic Data, 3/31/2024)

Outlook

Thus far, the economy has avoided a recession in the face of a sharp rise in interest rates, while employment has remained strong and inflation levels have been trending downward. This environment has benefited the equity markets; however, the disinflation of the past year and a half appears to be stalling. Thus, the primary focus remains on inflation and how future datapoints will impact the timing and magnitude of Fed actions. While the broadening of the equity markets over the past few months is a positive sign, the strength has outpaced earnings growth which has pushed up valuations and leaves equities susceptible to a pullback. Given the spotlight on inflation, the geopolitical backdrop, with conflicts in Russia/Ukraine, the Middle East, and China/Taiwan, and elections occurring in 2024 for half of the world's population, we anticipate some added volatility which also means opportunities for long-term investors. Of course, we will continue to stay focused on our investment philosophy which has always been centered on business and valuation analysis.

Strategy Commentary

The Confluence Equity Income strategy's objective is to provide an above-average stream of income balanced with capital appreciation, while delivering reasonable dividend growth to protect purchasing power. As the table below shows, the strategy continues to generate a high level of growing income.

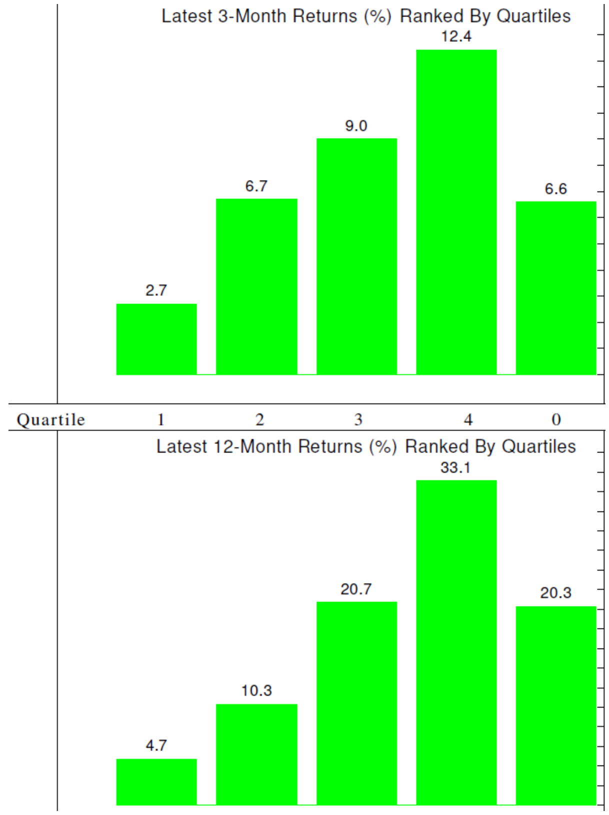
As mentioned in the Market Commentary, the equity markets continued their strength during the quarter while interest rates migrated upward. Equity returns were also relatively broad-based as all sectors, except Real Estate, posted positive results, with the Russell 3000 up 10.0% and the Russell 3000 Growth and Russell 3000 Value indexes up 11.2% and 8.6%, respectively. The rise in the 10-year Treasury from 3.88% in October 2023 to 4.20% in the first quarter did put a little pressure on yield-oriented securities as depicted by Ned Davis Research in their breakdown of the S&P 500 returns ranked by quartiles of dividend yields (*Figure 4*), where Quartile 1 shows the highest yielding, Quartile 4 shows the lowest yielding, and Quartile 0 represents non-payers. In the first chart, we see that the higher-yielding stocks produced lower returns, but all were in positive territory during the first quarter.

This backup in rates has occurred over the past year as the 10-year Treasury yield has been moving up from 3.48% on March 31, 2023. This movement has pressured higher-yielding securities as reflected in the dispersion of the Ned Davis quartiles over the past 12 months, which mimics that of the first quarter.

As discussed, equity returns were broadly positive and Equity Income was no exception, up 6.4% (gross of fees) in the first quarter. [*The strategy's net-of-fees return for the same period was 5.6% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Figure 4

S&P 500 Stock Constituents* Ranked by Quartiles (Dividend Yield)



*Actual Historical Constituents. *Returns through 3/31/2024*
(Source: Ned Davis Research, Copyright 2024)

Despite the change in interest rates, the companies held in the Equity Income portfolio continued to pay and grow their dividends. As stated in the table (*Figure 5*), 14 of the 34 companies in the current[1] Equity Income portfolio have increased their dividends year-to-date, with an average announced growth rate of 5.3%. As of March 31, 2024, the equal-weighted average dividend yield of the current[1] holdings in the Equity Income portfolio is 3.2% *(source: FactSet)*.

Figure 5 **Annual Dividend Statistics for Equity Income Portfolio at 12/31** ***(Dividend Growth Using Announcement Date)*** [1]

			Dividend Change from Prior Year**			
			# of companies with			
Year	**Holdings**	**Avg. Yield+**	Increase	Flat	Decrease	Avg. Growth***
2014	33	3.4%	29	4	0	13.0%
2015	34	3.9%	27	7	0	8.4%
2016	33	3.4%	25	6	2	2.2%
2017	33	3.1%	25	6	1	10.1%
2018	34	3.5%	30	4	0	13.8%
2019	34	3.0%	32	2	0	9.4%
2020*	36	3.4%	26	10	0	4.4%
2021	36	2.8%	30	6	0	5.4%
2022	34	3.3%	31	2	1	6.5%
2023	34	3.4%	28	6	0	5.2%
Average-10 yrs (2014-2023)		3.3%	28	5	0	7.8%
YTD (3/31/24)	34	3.2%	14		0	5.3%

** 2020 excludes impact of temporary dividend suspensions during the pandemic of 2020. ** Dividend Change from Prior Year excludes impact of special dividends and spin-offs.*
**** For YTD statistics, the average growth rate is calculated using only those holdings for which an increase or decrease in the indicated annual dividend amount has been announced. Full-year statistics are calculated as the average of all holdings, including those which did not announce a change to their indicated annual dividend during the year.*
+ Avg. Yield column is the equal-weighted average dividend yield of portfolio holdings at 12/31, calculated based on annualized current dividend plus any special dividend paid during the year. Avg. Yield as of 3/31/2024 calculated using Indicated Annual Dividend (IAD) from FactSet.

(Table shows past 10 years of dividend history; the Equity Income strategy was incepted 10/1/2000.)

Strategy Commentary continued...

As we have discussed in the past, with real rates returning to positive territory, the headwinds facing yield-oriented investments will likely subside. The FRED chart included in the Market Commentary (*Figure 3*) shows how the 10-year Treasury is trading more in line with levels preceding the 2008 financial crisis, which resulted in the unprecedented length of monetary easing that included Zero Interest Rate Policy and Quantitative Easing.

For the quarter, the Equity Income portfolio benefited from the underlying strength in Progressive (PGR) and Fastenal (FAST), which both continue to execute solid growth, while the laggards, Nestlé (NSRGY) and Gilead Sciences (GILD), operate in the defensive arenas of Consumer Staples and Health Care. [*See contribution table on page 5*.]

There was one portfolio change during the quarter as we swapped Digital Realty Trust (DLR) for WEC Energy Group (WEC), formerly known as Wisconsin Electric. WEC is mainly a regulated electric and gas utility with operations in Wisconsin, Minnesota, Michigan, and Illinois. The company operates in historically constructive regulatory environments, especially Wisconsin (63% of business), and has a history of executing on financial targets and exceeding investor expectations by adding incremental investments to its long-term capital plan to increase earnings. On the expense side, WEC has shown to be an excellent operator by cutting costs.

By working constructively with state jurisdictions and focusing on cost reductions, WEC has an EPS compounded annual growth rate of 6.5% from 2018 through 2023, which has translated to a compounded annual dividend growth rate of +7% over the same time period. With a solid balance sheet and minimal equity needs to execute its five-year capital plan, we believe WEC has the opportunity to continue to grow its EPS and dividend in a similar manner into the future.

With the recent pullback in WEC shares, and Utilities in general, Confluence sees the potential for an attractive investment. With a current yield of more than 4%, we believe the investor is being paid to wait for the market to reward a company that can compound earnings in a regulated, low-risk environment at 6.5-7.0% growth per annum.

Outlook

As always, there is no shortage of events to prognosticate about. What will happen with interest rates, the economy, elections, and geopolitics? Will the market be driven by a handful of enormous companies, or will performance become more broad-based? We are humble students of history and current events; however, we believe the highest return on our efforts is time spent studying businesses and searching for those with attributes that enable multi-year compounding. This is especially important in a more normalized era of positive real interest rates. We are steadfast in our philosophy that owning competitively advantaged businesses, ones that are run by experienced managers and trading at attractive valuations, is a wise long-term orientation.

Contribution[2]

(YTD as of 3/31/2024)

The top contributors and detractors for the portfolio in 2024 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Progressive Corp.	4.39	1.21
Fastenal Co.	4.60	0.86
Linde plc	3.93	0.52
Microsoft Corp.	4.32	0.50
Chubb Ltd.	3.28	0.47
Bottom 5		
Cisco Systems Inc.	2.40	(0.01)
Broadridge Financial Solutions Inc.	3.61	(0.01)
United Parcel Service Inc.	2.59	(0.15)
Gilead Sciences Inc.	2.06	(0.19)
Nestle S.A.	2.77	(0.24)

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

Performance Composite Returns[3] (For Periods Ending March 31, 2024)

	Since Inception**	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Equity Income *Pure Gross-of-Fees[4]*	10.4%	9.4%	13.7%	10.2%	10.8%	8.4%	15.3%	6.4%	6.4%
Max Net-of-Fees[5]	7.3%	6.2%	10.3%	6.9%	7.5%	5.2%	11.8%	5.6%	5.6%
Russell 3000 Value	7.6%	8.2%	13.0%	8.8%	10.1%	7.7%	20.2%	8.6%	8.6%
S&P 500	7.7%	10.1%	15.6%	12.9%	15.0%	11.5%	29.9%	10.6%	10.6%

Calendar Year	Pure Gross-of-Fees[4]	Max Net-of-Fees[5]	R3000 Value	S&P 500	Difference (Gross-R3000V)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	R3000V 3yr Std Dev	S&P 500 3yr Std Dev	Composite Dispersion
2000**	13.5%	12.8%	3.9%	(7.8%)	9.7%	2	$125		N/A	N/A	N/A	N/A
2001	11.6%	8.6%	(4.3%)	(11.9%)	16.0%	32	$6,341		N/A	N/A	N/A	0.2%
2002	0.6%	(2.1%)	(15.2%)	(22.1%)	15.8%	342	$36,726		N/A	N/A	N/A	0.8%
2003	32.1%	28.5%	31.1%	28.7%	0.9%	1,204	$168,181		11.0%	16.0%	18.1%	0.9%
2004	12.1%	9.1%	16.9%	10.9%	(4.8%)	2,811	$425,234		10.2%	14.8%	14.9%	1.1%
2005	0.4%	(2.3%)	6.9%	4.9%	(6.4%)	3,775	$536,505		8.4%	9.7%	9.0%	0.6%
2006	15.3%	12.1%	22.3%	15.8%	(7.1%)	3,122	$489,578		5.7%	7.0%	6.8%	0.8%
2007	1.5%	(1.3%)	(1.0%)	5.5%	2.5%	2,490	$381,383		6.2%	8.3%	7.7%	0.8%
2008	(18.9%)	(21.2%)	(36.2%)	(37.0%)	17.4%	346	$44,339	$291,644	12.0%	15.5%	15.1%	N/A
2009	18.8%	15.3%	19.8%	26.5%	(1.0%)	459	$85,079	$533,832	18.1%	21.3%	19.6%	0.8%
2010	16.1%	12.7%	16.3%	15.1%	(0.1%)	555	$128,855	$751,909	20.2%	23.5%	21.9%	0.8%
2011	5.1%	2.0%	(0.1%)	2.1%	5.2%	918	$225,088	$937,487	18.6%	21.0%	18.7%	1.0%
2012	17.8%	14.3%	17.6%	16.0%	0.2%	1,200	$337,610	$1,272,265	13.5%	15.8%	15.1%	0.6%
2013	26.1%	22.4%	32.7%	32.4%	(6.6%)	1,947	$606,780	$1,955,915	10.5%	12.9%	11.9%	1.3%
2014	11.4%	8.1%	12.7%	13.7%	(1.3%)	2,834	$858,027	$2,589,024	8.4%	9.4%	9.0%	0.4%
2015	0.1%	(2.9%)	(4.1%)	1.4%	4.3%	3,528	$939,550	$3,175,419	9.4%	10.7%	10.5%	0.4%
2016	18.0%	14.5%	18.4%	12.0%	(0.4%)	5,272	$1,549,506	$4,413,659	9.4%	11.0%	10.6%	0.4%
2017	17.5%	14.0%	13.2%	21.8%	4.3%	7,423	$2,177,984	$5,944,479	8.4%	10.3%	9.9%	1.1%
2018	(8.9%)	(11.6%)	(8.6%)	(4.4%)	(0.3%)	7,772	$1,945,646	$5,486,737	9.7%	11.1%	10.8%	0.5%
2019	31.0%	27.1%	26.2%	31.5%	4.7%	8,249	$2,725,466	$7,044,708	10.8%	12.0%	11.9%	0.8%
2020	4.6%	1.5%	2.9%	18.4%	1.8%	7,557	$2,440,128	$6,889,798	17.1%	20.0%	18.5%	0.8%
2021	27.2%	23.5%	25.3%	28.7%	1.9%	7,508	$3,048,035	$7,761,687	16.6%	19.3%	17.2%	0.5%
2022	(7.9%)	(10.6%)	(8.0%)	(18.1%)	0.2%	7,457	$2,609,193	$6,931,635	19.1%	21.5%	20.9%	0.4%
2023	10.8%	7.5%	11.6%	26.3%	(0.8%)	7,462	$2,743,018	$7,200,019	15.6%	16.7%	17.3%	0.7%

*Average annualized returns   **Inception is 10/1/2000   *See performance disclosures on last page.*

Portfolio Benchmarks

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.

S&P 500® Index – A capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. *(Source: Bloomberg)*

Confluence Value Equities Investment Committee

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

All investments carry a certain degree of risk, including possible loss of principal. It is important to review your investment objectives, risk tolerance & liquidity needs before choosing an investment style or manager. Equity securities are subject to market risk & may decline in value due to adverse company, industry or general economic conditions. There can be no assurance that any investment objective will be achieved.

Indexes: The S&P 500 and Russell 3000 Value 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.

[1] **Annual Dividend Statistics—***Figure 5:* Annual dividend income history is available upon request. Current portfolio statistics exclude companies that have been sold and include companies that have been purchased year-to-date.

[2] **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. Holdings identified do not represent all of the securities purchased, sold or recommended. Individual client portfolios in the strategy may differ, sometimes significantly, from these listings.

[3] **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.

GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

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.

[4] Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

[5] 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. 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 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.