

## 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

The equity markets experienced a sharp turnaround in the second quarter of 2020 following a tumultuous first quarter. The Russell 3000 Value and S&P 500 indexes were up 14.6% and 20.5%, respectively, for the second quarter. This helped offset the sluggish first quarter in which the Russell 3000 Value and the S&P 500 were down 27.3% and 19.6%, respectively, bringing the year-to-date returns to -16.8% for the Russell 3000 Value and -3.1% for the S&P 500.

The past two quarters produced drastically different results as investor focus shifted from economic prospects, or lack thereof, to policy influence—monetary and fiscal. The year began with optimistic expectations of continued economic expansion which was abruptly halted by COVID-19 and the ensuing lockdowns. Businesses quickly switched from an upbeat tone highlighted by a growing shortage of workers to a sharp spike in unemployment. It wasn't until the Federal Reserve stepped in to provide liquidity in late March and indicated its willingness to provide additional monetary policy programs to support main street businesses that the equity markets began their turnaround. Congress followed with their own fiscal policy programs to support individuals and businesses. Today, many questions still abound regarding the pace and magnitude of the turnaround, but the commitment of the Federal Reserve and Congress gives investors the confidence to look past the near-term impact of the lockdowns and focus on the future.

The current recession was caused by the mandated lockdowns in order to protect the health of U.S. citizens. It was truly unprecedented. The sudden closure of large segments of the economy provided a headwind for many businesses; however, a small segment of the economy benefited from the ensuing shift

to working and schooling remotely, which accelerated a few trends already in place such as enterprise movement to cloud computing and the remote economy. These new economy businesses tend to be asset-light and require less working capital relative to their more mature and asset-intensive brethren.

The lockdowns caused capital and liquidity concerns for many entities that took advantage of lower interest rates to optimize their capital structures, so it comes as no surprise that a bifurcation resulted in the market as evidenced by the year-to-date returns of the Russell 3000 Growth, +9.0%, versus the Russell 3000 Value, -16.7%. Despite the broad-based snapback in the second quarter, the underlying valuation disparities continued. In fact, this bifurcation has been in place over the past few years as the Russell 3000 Growth has outperformed the Russell 3000 Value by a cumulative 79% from the end of 2016 through the second quarter of 2020. This outperformance has been driven by the mega-cap tech names, which now claim the top five spots by market capitalization in the S&P 500 with a cumulative weighting of approximately 22% of the index, compared to 17% at year-end 2019, and posted a weighted average return of 25.4% year-to-date. In this environment, investors appear more focused on lockdown risks than valuation risks.

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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

Equity Income also generated solid returns in the second quarter, up 15.3%, following a tough first quarter where the strategy was down 22.1%, bringing its year-to-date return to -10.2% (all gross of fees). *(Net-of-fees returns for the same periods were +14.4%, -22.7%, and -11.5%. See disclosures on p.3 for fee description; actual investment advisory fees may vary.)*

For Equity Income, the objective is a balance between generating an above-average stream of income and capital appreciation. Our near-term efforts have been focused on ensuring our businesses have the wherewithal to not just survive the lockdowns but also the cash flow to support their businesses. This entails analyzing the balance sheets, specifically the leverage as it relates to their ability to service the debt as well as meet any near-term maturities. To date, there has only been one dividend suspension, Weyerhaeuser, in the Equity Income strategy. While the recent activity in Equity Income has primarily been concentrated on bringing names that were below full position size due to valuations up to full positions, our focus remains on vetting ideas with sustainable dividends in order to meet the cash flow needs of clients. With that said, we did begin to build a new position in the quarter which we will discuss next quarter once complete.

Going forward, we expect monetary policy to remain accommodative through targeted programs and low interest rates. We also expect continued fiscal policy to support the economy. While an extended low rate environment presents obstacles for investors seeking income, our task is to construct a portfolio of businesses that can generate an above-average income stream of dividends, while providing ample opportunity to participate when the recovery occurs. This too shall pass, and rest assured that 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
<b>Top 5</b>		
Polaris Inc.	2.50	1.63
Fastenal Company	3.64	1.24
Microsoft Corporation	4.13	1.13
Broadridge Financial Solutions, Inc.	3.24	0.99
Linde plc	3.76	0.85
<b>Bottom 5</b>		
Corteva, Inc.	0.43	0.06
Entergy Corporation	3.11	0.05
Graco Inc.	3.00	(0.03)
The Southern Company	3.27	(0.09)
Tiffany & Co.	4.11	(0.26)

*(Contribution data shown from a sample account)*

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### 10 Largest Holdings (as of 6/30/20)

Company	Market Capitalization (\$ billions)	Portfolio Weight
Microsoft Corporation	1,543.3	4.0%
Linde plc	111.4	3.9%
The Progressive Corporation	46.9	3.7%
Nestlé S.A.	329.0	3.7%
Fastenal Company	24.5	3.7%
Digital Realty Trust, Inc.	38.1	3.6%
Broadridge Financial Solutions, Inc.	14.5	3.4%
Lockheed Martin Corporation	102.3	3.3%
Paychex, Inc.	27.2	3.3%
PepsiCo, Inc.	183.5	3.2%

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 6/30/20

	Pure Gross-of-Fees <sup>1</sup>	Net-of-Fees <sup>2</sup>	R3000 Value	S&P 500	Calendar Year	Pure Gross-of-Fees <sup>1</sup>	Net-of-Fees <sup>2</sup>	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
Since Inception**	9.9%	6.7%	6.1%	6.0%	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%
15-Year*	8.5%	5.4%	6.2%	8.8%	2002	0.6%	(2.1%)	(15.2%)	(22.1%)	15.8%	342	\$36,726		N/A	N/A	N/A	0.8%
10-Year*	12.0%	8.7%	10.2%	14.0%	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%
5-Year*	8.3%	5.1%	4.4%	10.7%	2005	0.4%	(2.3%)	6.9%	4.9%	(6.4%)	3,775	\$536,505		8.4%	9.7%	9.0%	0.6%
3-Year*	5.3%	2.2%	1.4%	10.7%	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%
1-Year	(1.9%)	(4.8%)	(9.4%)	7.5%	2008	(18.9%)	(21.2%)	(36.2%)	(37.0%)	17.4%	346	\$44,339	\$291,644	12.0%	15.5%	15.1%	N/A
YTD	(10.2%)	(11.5%)	(16.8%)	(3.1%)	2009	18.8%	15.3%	19.8%	26.5%	(1.0%)	459	\$85,079	\$533,832	18.1%	21.3%	19.6%	0.8%
QTD	15.3%	14.4%	14.6%	20.5%	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%

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

#### 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. 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.  
 (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 inceptioned 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.

<sup>1</sup> Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

<sup>2</sup> 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 Russell 3000 Value Index and S&P 500 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.*