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.

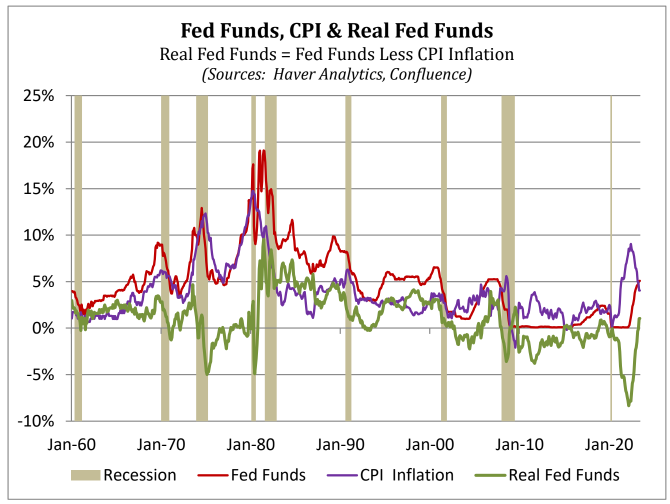
Market Commentary

"The majority of advanced technologies follow a predictable life cycle of hype, disillusionment, realism, and, eventually, productivity."

– Gartner analyst Jackie Fenn, 1995

Risk markets continued their upward trend during the quarter as many of the concerns that pressured the markets in 2022 are gradually receding, while the economy continues to advance. Inflation, and the Federal Reserve's aggressive response, was the primary worry but now that we are past the peak and inflation is trending downward, the Fed has recently decided to pause its rate hikes (*Figure 1*). The domestic debt ceiling also loomed over the financial markets but was resolved in the waning hours in typical Washington, D.C. fashion. The war in Ukraine is progressing more favorably than originally feared and commodity markets have adjusted. Meanwhile, employment remains plentiful and wage growth robust, which have aided the economic advance despite the sharp rise in short-term interest rates and the banking sector stumbles in March. This is likely due to the fact that the last stage of the cycle was not driven by credit expansion but rather liquidity injections, both fiscal and monetary. This would explain why banks were so flush with deposits but have yet to experience credit issues despite the spike in rates. Suffice it to say, the wall of worry has been fading which has boosted investor sentiment as exhibited by the risk markets, per the quilt chart shown below (*Figure 2*).

Figure 1



Risk market returns were broadly positive but widely dispersed with more speculative and longer-duration assets leading the pack. For equity markets, the reduced uncertainty and economic resilience combined with the excess liquidity provided support for equities, but the hype surrounding artificial intelligence (AI) with the release of ChatGPT sparked a frenzy in technology-oriented names, mainly mega caps. These mega cap names have been labeled the "Magnificent Seven" (M7) by none other than CNBC's Jim Cramer and they are Apple (AAPL), Microsoft (MSFT), Amazon (AMZN), Alphabet (GOOG), Nvidia (NVDA), Tesla (TSLA), and Meta (META). In fact, the M7 has added $4.0 trillion (yes, trillion) in market cap year-to-date!

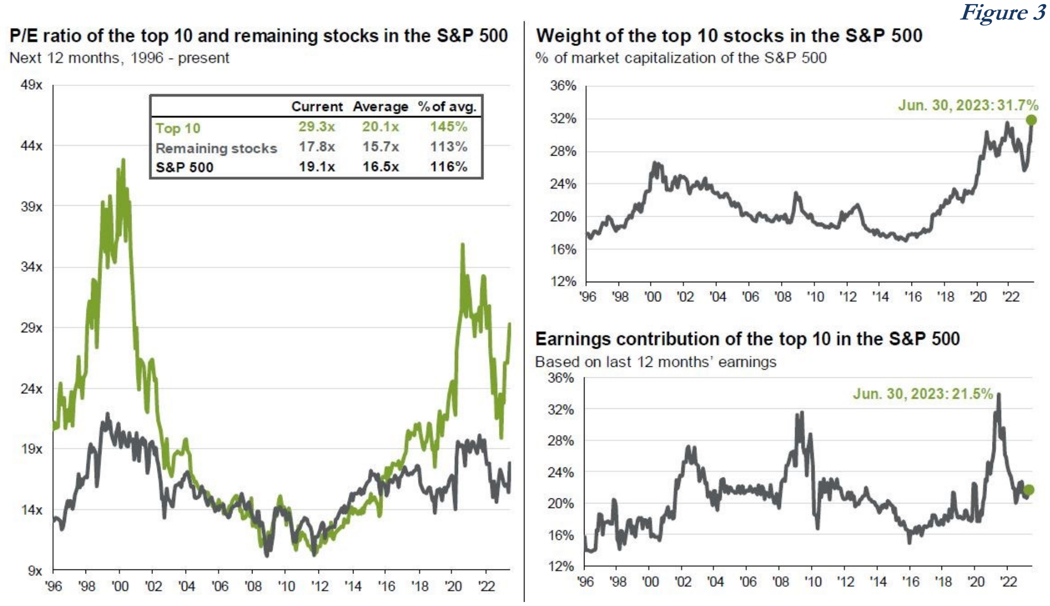
Figure 2 **Quarterly Asset Class Returns as of 6/30/2023**

	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Cash	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.5%	0.8%	1.1%	1.2%
U.S. Short-Term Bonds	0.3%	0.2%	0.0%	0.1%	0.1%	-0.5%	-2.6%	-0.6%	-1.5%	0.9%	1.5%	-0.3%
U.S. Intermediate-Term Bonds	1.1%	0.7%	-4.1%	2.4%	-0.1%	-0.2%	-6.5%	-4.4%	-5.0%	2.2%	3.3%	-1.2%
U.S. Long-Term Bonds	1.2%	1.0%	-10.8%	6.7%	-0.1%	2.3%	-10.9%	-11.5%	-9.4%	2.3%	5.7%	-1.4%
Speculative Grade Bonds	4.7%	6.5%	0.9%	2.8%	0.9%	0.7%	-4.5%	-10.0%	-0.7%	4.0%	3.7%	1.6%
REITs	1.4%	11.6%	8.9%	12.0%	1.0%	16.3%	-3.9%	-17.0%	-9.9%	5.2%	2.7%	2.6%
U.S. Large Cap Stocks	8.9%	12.1%	6.2%	8.5%	0.6%	11.0%	-4.6%	-16.1%	-4.9%	7.6%	7.5%	8.7%
U.S. Mid-Cap Stocks	4.8%	24.4%	13.5%	3.6%	-1.8%	8.0%	-4.9%	-15.4%	-2.5%	10.8%	3.8%	4.9%
U.S. Small Cap Stocks	3.2%	31.3%	18.2%	4.5%	-2.8%	5.6%	-5.6%	-14.1%	-5.2%	9.2%	2.6%	3.4%
Int'l Developed Market Stocks	4.8%	16.0%	3.5%	5.2%	-0.4%	2.7%	-5.9%	-14.5%	-9.4%	17.3%	8.5%	3.0%
Emerging Market Stocks	9.6%	19.7%	2.3%	5.0%	-8.1%	-1.3%	-7.0%	-11.4%	-11.6%	9.7%	4.0%	0.9%
Commodities	4.6%	14.5%	13.5%	15.7%	5.2%	1.5%	33.1%	2.0%	-10.3%	3.4%	-4.9%	-2.7%

(Source: (Confluence Asset Allocation Committee. See disclosures on last page for asset class composition.)

Market Commentary continued...

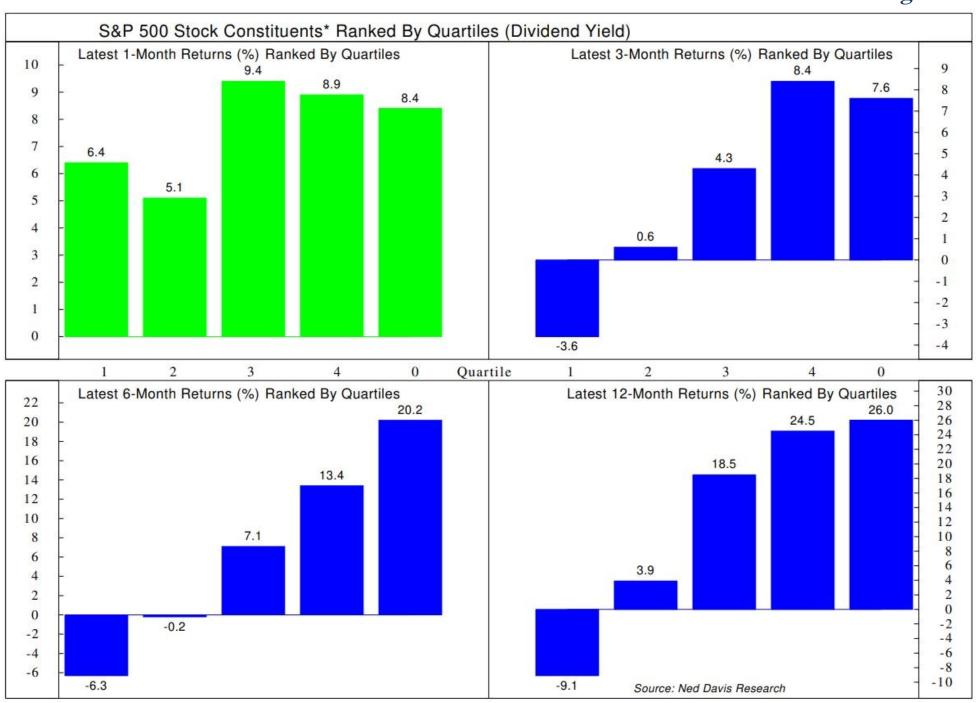
Figure 3



(Source: J.P. Morgan Asset Management; Guide to the Markets®, U.S. 3Q 2023, as of June 30, 2023)

The M7 impact on market cap-weighted indexes like the S&P 500 was meaningful and accounted for approximately 65% quarter-to-date and 73% year-to-date of the overall index return, while the impact on growth indexes was even more significant. The influence and valuations are reflected in the narrow concentration of the top 10 companies in the S&P 500, which now constitute a record 31.7%. J.P. Morgan Asset Management compiled a history of the valuations and weightings of the top 10 stocks, all of which are at the upper end of historical levels, aside from earnings contribution (*Figure 3*). The influence of the M7 is also apparent in the second quarter dispersion between the Russell 1000 Growth Index, up 12.8%, compared to the Russell 1000 Value Index, up 4.1%. More concisely, the difference is also evident in the S&P 500 Equal Weight Index, up 4.0%, versus the S&P 500, up 8.7%.

Figure 4



*Actual Historical Constituents. *Returns through 6/30/2023 (Source: Ned Davis Research) Returns of dividend payers in the S&P 500, ranked by quartile from highest dividend yield (bar 1) to lowest (4), compared to all S&P 500 stocks with zero dividends, reflected in the fifth bar (0).*

The variance in long-duration versus short-duration (i.e., businesses generating earnings/cash flow in the near-term versus later years) is also reflected in the S&P 500 yield quartiles, with the higher yielding equities lagging the low yield and non-dividend payers (*Figure 4*).

The hype of AI will likely disappoint investors in a similar fashion to prior "revolutions" of the past few hundred years. For example, railroad investors of the late 19th century saw more track laid than what is in existence today. More recently, the advent of the internet in the 1990s immensely benefited the businesses of semiconductors and networking yet the industry leaders in semis and networking, Intel and Cisco, trade at lower levels today than their peak almost 25 years ago. AI, much like the technological advances before it, will likely take the path stated in the quote at the beginning of this report: hype, disillusionment, realism, and, eventually, productivity. For an economy grappling with inflationary pressures driven by low unemployment and a splintering global economy, advances in productivity would be a welcome relief.

The U.S. economy's avoidance of a recession so far despite the headwinds of monetary policy restraint speaks to its underlying strength. Consumers are benefitting from the tight job market which is leading to strong wage growth while also being supported by the excess savings built up during the pandemic. While inflation has rolled over from its peak, it remains well above the Fed's target of 2%. Future data will impact whether additional rate hikes are needed. For the equity markets, the near-term focus on long-duration, high-growth companies appears at odds with the rise in rates and inflation. The current earnings environment has met or exceeded expectations, but there are a handful of crosscurrents, including rising rates, wage pressures, and the normalization of the supply chain. As always, we remain focused on finding competitively advantaged businesses with pricing power to protect against inflation that are trading at attractive valuations.

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. While the M7 stocks have ruled the market year-to-date, as we discussed in the Market Commentary section, most of those companies do not pay a dividend. Meanwhile, the companies held in the Equity Income portfolio continued to pay and grow their dividends. As stated in the table (*Figure 5*), 18 of the 33 companies in the current portfolio have raised their dividends year-to-date, with an average announced growth rate of 6.1%.

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
2013	34	3.4%	25	9	0	9.3%
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%
As of 6/30/2023	33	3.3%	18		0	6.1%
Average-10 yrs (2013-2022)		3.3%	28	6	0	8.2%

** 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.*
+ 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 6/30/2023 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.)

Equity Income was born from the needs of investors who desired a high stream of income to augment their current income or replace their income in retirement. The portfolio is constructed by focusing on individual companies exhibiting these dividend characteristics. They tend to be more mature businesses that generate ample cash flow but possess limited reinvestment options, which allows them to pay higher dividends. Our focus on quality businesses with favorable current dividends has shown to provide a measure of ballast in difficult markets as cash flow is returned to shareholders in the near term (dividends) as opposed to later years for immature or faster growing businesses, which typically need that capital to maintain their growth. The shorter-duration, higher-yielding businesses also tend to trade at lower valuations, which can provide downside protection when sentiment shifts. The result is a portfolio composition that is quite different from the broad-based market, which is most apparent at times of extreme sentiment. In such cases, extreme market optimism and pessimism often coincide with either short-term underperformance or outperformance, respectively, for our strategies. Lastly, it is worth mentioning that the value indexes tend to skew toward asset-intensive businesses that are highly regulated or commodity-oriented and often operate with high leverage, also resulting in differences to our strategies.

We strive to outperform on average and over long periods but will vary over shorter periods. The last few years of sentiment swings are prime examples of how the strategy is expected to perform. When tech/growth stocks are hot, Equity Income will tend to underperform the broader benchmarks, but when "old economy" stocks are strong or in down markets, we expect Equity Income to outperform. For a more in-depth discussion on benchmarking, see our *Value Equity Insights* report, "Shining a Light on Indexes."

As detailed in the Market Commentary, shorter-duration (i.e., higher-yielding) equities lagged the broad market but still posted positive results for the quarter. Equity Income also delivered capital appreciation as well as dividend payments and dividend growth for a quarterly return of 2.3% and a year-to-date return of 4.6% (both gross of fees) versus the Russell 3000 Value Index which was up 4.0% for the quarter and 5.0% year-to-date. [*The strategy's net-of-fees returns for the same periods were 1.5% QTD and 3.0% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Year-to-date, the Equity Income portfolio benefited from the underlying strength in Microsoft (MSFT) and Snap-On (SNA), while laggards U.S. Bank (USB) and SL Green (SLG) were negatively impacted by interest rates and concerns on NYC office vacancy, respectively. There were no changes to the portfolio during the quarter. *[See contribution table on next page.]*

Outlook

Going forward, the markets still need to contend with inflation that persists above the Fed's target as the economy remains resilient in the face of the Fed's restraint. And while many uncertainties have receded, risk markets have responded accordingly. The markets await further data on evidence of whether the Fed's recent pause will be temporary or the first step before easing. At Confluence, we are not prognosticators but rather business analysts that remain committed to our philosophy of investing in quality businesses trading at attractive valuations.

Contribution[2]

(YTD as of 6/30/2023)

The top contributors and detractors for the portfolio thus far in 2023 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Microsoft Corp.	3.32	1.23
Snap-on Inc.	4.19	1.08
Fastenal Co.	3.67	0.88
Broadridge Financial Solutions Inc.	2.98	0.70
Analog Devices Inc.	3.60	0.65
Bottom 5		
Entergy Corp.	2.44	(0.31)
Northern Trust Corp.	2.18	(0.34)
Chubb Ltd.	2.89	(0.39)
U.S. Bancorp	1.88	(0.49)
SL Green Realty Corp.	*Sold*	(0.78)

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

Performance Composite Returns[3] (For Periods Ending June 30, 2023)

	Since Inception**	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Equity Income *Pure Gross-of-Fees[4]*	10.2%	9.7%	10.5%	10.3%	9.0%	12.6%	9.2%	4.6%	2.3%
Max Net-of-Fees[5]	7.1%	6.5%	7.3%	7.0%	5.8%	9.3%	6.0%	3.0%	1.5%
Russell 3000 Value	7.2%	8.5%	8.3%	9.1%	7.8%	14.3%	11.2%	5.0%	4.0%
S&P 500	7.1%	10.0%	10.9%	12.8%	12.3%	14.6%	19.6%	16.9%	8.7%

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%

**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)*

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Disclosures

Market & Strategy Commentary—*Figure 2*: Asset class representation: Cash (ICE BofA 3M T-Bill); Short-Term Bonds (ICE BofA 1-3 Year US Corp&Govt); Intermediate-Term Bonds (ICE BofA 5-10 Year US Corp&Govt); Long-Term Bonds (ICE BofA 10+Yr US Corp&Govt); Speculative Grade/High-Yield Bonds (ICE BofA US High Yield Master); REITs (FTSE NAREIT Equity); Large Cap (S&P 500); Mid-Cap (S&P MidCap 400); Small Cap (S&P Small Cap 600); Foreign Developed Country (MSCI EAFE); Emerging Markets (MSCI Emerging Markets); Commodities (S&P GSCI). Data source: Morningstar Direct.

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Indices: 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.

[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, 2021. 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.
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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.