Third Quarter

2020

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

Although equity markets ended the period down from recent highs, the third quarter of 2020 was largely one of continued recovery from the pandemic-induced sell-off earlier in the year. The S&P 500 and Russell 3000 Value Indexes gained 8.9% and 5.4%, respectively. On a year-to-date basis, the S&P 500 is now showing a positive return, 5.6%, while the Russell 3000 Value Index remains down 12.2%.

Stocks in the Technology and Consumer Discretionary sectors continue to be the dominant force driving stock market averages this year. Within the S&P 500, these two sectors are up more than 23% year-to-date. Communication Services was the third best-performing sector, up 8.6% year-to-date, while five of 11 S&P 500 sectors remain in negative territory for the year. The worst sectors are Energy and Financials, down roughly 48% and 20%, respectively.

Notably, the Consumer Discretionary sector of the S&P 500 has a heavy concentration in Amazon, greater than 40% of the sector at quarter-end, and the Communication Services sector has high exposure to digital-led businesses, with Facebook, Alphabet, and Netflix accounting for over half that sector. [*Alphabet and Facebook moved from the Technology sector to Communication Services in Q4 2018.*] Investors have been attracted to technology and digital-led businesses this year as they are among the few investments benefiting from the current dislocations in the economy. These areas of the market, however, are not particularly fertile for investors seeking income as part of their equity returns. This has made it difficult for our Equity Income strategy to keep pace with the S&P 500 this year given that the index currently has more than half its assets in Technology, Consumer Discretionary, and Communication Services. The following table illustrates the effects of the index's current concentration in these sectors. The biggest factor in the relative performance of Equity Income versus the S&P 500 has been Equity Income's lower exposer to Technology and Consumer Discretionary stocks, both in the third quarter and on a year-to-date basis.

S&P 500 Index Adjusted

	S&P 500 Index	Equally-Weighted	Dividend Payers	Non-Dividend Payers	Confluence Equity Income
YTD Total Return	5.6%	-10.4%	-12.5%	0.0%	-6.8%

(Source: Ned Davis Research, S09. Returns based on monthly equal-weighted geometric average of total returns of S&P 500 component stocks, components reconstituted monthly. As of 9/30/2020)

Historically, we've had higher Consumer Discretionary exposure in this portfolio, but many of the dividend payers within this sector are dealing with significant disruptions to their traditional business models as a result of COVID-19 and the societal changes it has produced. While Consumer Discretionary was the best-performing sector of the S&P 500 in the third quarter, it also saw the greatest reduction in dividend payments with 51% of the dividend payers within that index cutting or suspending dividends so far this year.

During the fog of this unique and largely unprecedented economic environment, investors may be skeptical as to the staying power of dividends and/or their value against far more robust capital appreciation opportunities in certain corners of the market, such as technology stocks, which, given the situation, appear more defensible than usual. As long-term managers of dividend-focused portfolios, we know that dividends and dividend-paying stocks cycle in and out of favor. It is why we've always believed that we must focus not just on a company's dividend stream and propensity to pay a dividend, but also on the quality of the company, its management team, and competitive positioning. We look for companies with sustainable competitive advantages that can build value irrespective of how they choose to return capital to shareholders. They, too, can temporarily go out of style, but if their competitive positioning is strong, intrinsic value should sustain or rise.

A great deal of uncertainty remains over how the world economies will fully recover from the COVID-19-induced recession, but one signal that has maintained clear fidelity is that very low interest rates are likely to persist for some time.

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Market Commentary continued…

In late August, the Federal Reserve announced an official change to its interest rate policy, specifically around inflation and inflation expectations. Going forward, it will allow for greater levels of inflation and will even allow inflation to run hot in the early days of an economic recovery. The Fed will no longer base policy decisions on where it thinks inflation is going but rather will wait to see clear evidence in the data. As such, in the coming quarters, we think investors will gravitate back to dividend-paying stocks as monetary policy works to support economic activity by keeping interest rates low even as the economy gains steam. This change in policy should support broader economic growth and strengthen the underlying fundamentals of dividend-paying stocks and investors' attitudes toward their durability and appeal. At the same time, a prolonged very low interest rate environment greatly narrows the universe of attractive yield-oriented investments and probably stimulates demand for dividend-paying stocks.

Strategy Commentary

Equity Income gained 3.8% during the third quarter, bringing its year-to-date return to -6.8% (both gross of fees). [*Net-of-fees returns were +3.1% QTD and -8.8% YTD. See disclosures on p.3 for fee description; actual investment advisory fees may vary.*]

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

Security	Avg Weight	Contribution
Top 5		
Graco Inc.	3.39	0.84
The Progressive Corporation	4.69	0.79
Linde plc	4.35	0.51
Weyerhaeuser Company	2.18	0.50
Dow Inc.	2.28	0.36
Bottom 5		
Chubb Limited	2.27	(0.17)
Chevron Corporation	1.55	(0.30)
Cisco Systems, Inc.	2.34	(0.43)
Kinder Morgan, Inc.	2.30	(0.44)
Gilead Sciences, Inc.	2.51	(0.48)

(Contribution data shown from a sample account)

Graco's strength likely relates to its exposure to growing areas of the construction market, pristine balance sheet, and attractive margin profile despite a largely domestic manufacturing footprint. As mentioned last quarter, Weyerhaeuser opted to suspend its dividend during the height of the stay-at-home orders. Since that time, business conditions have improved as demand for wood products has been brisk. In response, shares have recovered to pre-pandemic levels and we anticipate the board will reinstate the dividend in the coming months. Shares of Progressive are responding to the company's persistent market share gains and strong profitability as car usage is down (as are claims).

Regarding the weakest contributors, Chevron and Kinder Morgan have held up better than the broader Energy complex, but Energy has been a tough place to have capital this year given depressed demand, weak balance sheets, and changing attitudes toward investing in the sector. We continue to view Chevron as among the safest dividend payers in the sector with avenues for growth. Kinder Morgan continues to bring down its financial leverage while paying an outsized dividend. We like its distribution assets and believe the market is currently underestimating its longevity. Gilead's performance is harder to explain. Shares appear to trade around news of Remdesivir and its use as a COVID-19 treatment. While strong uptake of the drug to combat the virus would be welcome, we don't believe it to be much of a factor in terms of the company's intrinsic value. We currently view Gilead shares as deeply discounted with an attractive, well-covered, and growing dividend.

Cisco Systems was added during the quarter. Cisco develops, manufactures, and sells networking hardware, software, telecom equipment and other technology-related products and services. Its technology moat is leading edge as it spends more per year in research and development than most of its competitors' total revenue. Its business is highly profitable and cash generative, albeit slower growing in recent years. A new CEO has instilled stronger capital discipline more aligned with the company's maturity, returning 50% of free cash flow to shareholders annually through dividends and buybacks. We're attracted to its leadership position, profit margins, above-average dividend yield, and balance sheet. The market is giving little credit for its strengths, with shares trading at a discount to competitors and its own trading history, which we think is partially due to less resilient sales compared to the more software-focused technology players. In some ways this company looks like a high-margin industrial that will show some pro-cyclicality as the economy normalizes. We view this as a buying opportunity as we expect Cisco to continue moving down the path of more imbedded software and security in its product offerings. We believe great progress has already been made and the company was probably close to an inflection point if not for the dislocations brought on by the pandemic.

Going forward, we expect monetary policy to remain accommodative and for 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 will generate an above-average income stream of dividends, while also providing ample opportunities for capital appreciation as the recovery unfolds. Rest assured that we have a seasoned team of analysts working diligently to ensure the portfolios are aligned accordingly.

10 Largest Holdings (as of 9/30/20)

Company	Market Capitalization	Portfolio Weight
	($ billions)	
The Progressive Corporation	55.4	4.2%
Linde plc	125.1	4.1%
Nestlé S.A.	342.9	3.8%
Graco Inc.	10.2	3.8%
Digital Realty Trust, Inc.	39.5	3.6%
Fastenal Company	25.9	3.5%
Broadridge Financial Solutions, Inc.	15.2	3.5%
Lockheed Martin Corporation	107.1	3.3%
Paychex, Inc.	28.7	3.3%
PepsiCo, Inc.	191.9	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 9/30/20

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	R3000 Value	S&P 500
Since Inception**	10.0%	6.8%	6.3%	6.4%
15-Year*	8.7%	5.5%	6.3%	9.2%
10-Year*	11.1%	7.8%	9.8%	13.7%
5-Year*	10.3%	7.0%	7.4%	14.1%
3-Year*	5.6%	2.5%	2.1%	12.3%
1-Year	(0.6%)	(3.5%)	(5.7%)	15.1%
YTD	(6.8%)	(8.8%)	(12.2%)	5.6%
QTD	3.8%	3.1%	5.4%	8.9%

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

Calendar Year	Pure Gross-of-Fees[1]	Net-of-Fees[2]	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%

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 12/31/2019. 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 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.*