

OBJECTIVE

Invests in municipal bond Exchange Traded Funds (ETFs), diversified across maturities and a wide variety of municipalities. These ETFs produce income generally exempt from federal income taxes. Strives to deliver the income and lower volatility traditionally available from a diversified municipal bond portfolio.

INVESTMENT PHILOSOPHY & PROCESS

Fixed Income Tax-Exempt invests in municipal bond ETFs with domestically oriented, investment-grade benchmarks. These ETFs produce income that is generally exempt from federal income taxes. The investment approach incorporates ETFs with a national, not state-specific, posture. It is constructed to have characteristics similar to a traditional, laddered bond portfolio and its benchmark is the ICE BofA U.S. Municipal Securities Index. The Confluence Fixed Income Strategy Committee may adjust the portfolio duration and maturity to be longer, shorter or in line with this benchmark. The investment committee incorporates its viewpoints regarding Fed policy, the shape of the yield curve, relative yields, credit spreads, default rates and other market factors into the portfolio construction process.

The strategy invests in a range of maturity-date ETFs to construct a portfolio similar to a diversified bond ladder, and complements these positions with traditional fixed income ETFs with more “static” maturity profiles, allowing for more precise exposures to maturities and sectors of the bond market. The Fixed Income Strategy Committee continuously monitors the portfolio, rebalancing at least annually, but may elect to rebalance over shorter time frames at its discretion. The investment committee may direct larger allocations to certain ETFs to alter the nature of maturity exposures in a portfolio.

Fixed Income Tax-Exempt is available as a standalone portfolio and may also be available as part of a Balanced account, which allows investors to combine this fixed income strategy with one of the firm's equity strategies in one portfolio.

OVERVIEW

- ◆ Uses high-quality ETFs following investment-grade benchmarks with domestic orientation that provide income exempt from federal income tax
- ◆ Similar characteristics to traditional bond ladder or diversified bond index by combining use of maturity-date ETFs with traditional fixed income ETFs
- ◆ Allocations incorporate viewpoints on Fed policy, yield curve shape, relative yields, credit spreads, default rates, etc.
- ◆ Nationally diversified across maturities and municipalities; not managed on a state-specific basis
- ◆ Available as a standalone portfolio or in Confluence Balanced account combined with value equity strategy
- ◆ Strategy assets: \$3.3 million¹

¹ Total strategy assets include assets under management (AUM) and assets under advisement (AUA). As of 12/31/22, AUM = \$0.6 million and AUA = \$2.7 million.

CURRENT PORTFOLIO²

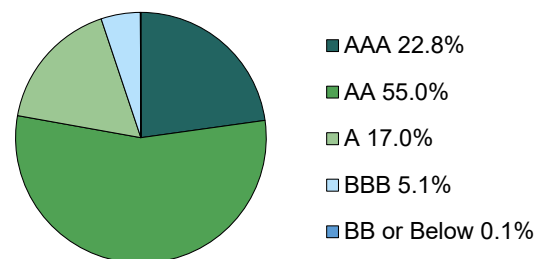
(As of 1/19/2023 rebalance)

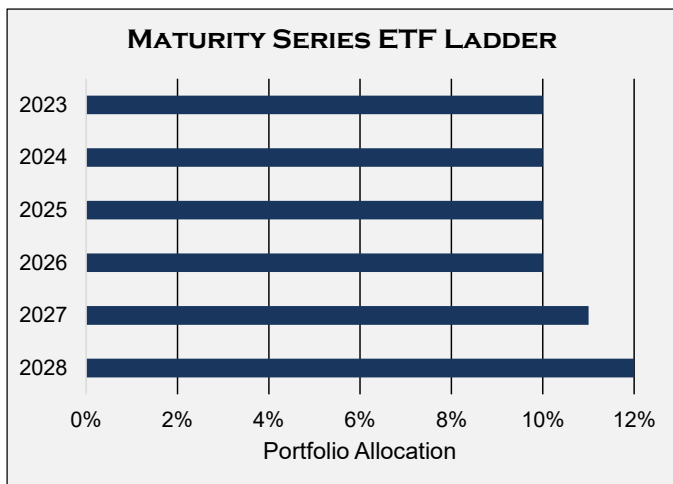
CHARACTERISTICS	WEIGHTED AVERAGE
SEC Yield	2.8%
Tax-Equivalent SEC Distribution Yield Estimate*	4.3%
*Assumes Federal Income Tax Rate of 35%	
Duration	4.8
Maturity	6.3
ETF Expense Ratio	0.19%

SECTOR ALLOCATION	WEIGHT
General Obligation	34.8%
Advance Refunded	6.9%
Revenue	58.3%

5 LARGEST HOLDINGS	WEIGHT
Dimensional National Municipal Bond ETF - DFNM	20.0%
Invesco National AMT-Free Muni Bond ETF - PZA	15.0%
Invesco BulletShares 2028 Muni Bond ETF - BSMS	12.0%
Invesco BulletShares 2027 Muni Bond ETF - BSMR	11.0%
Invesco BulletShares 2026 Muni Bond ETF - BSMQ	10.0%

RATING CATEGORIES





Fixed Income Tax-Exempt utilizes a portfolio structure similar to that of a “bond ladder,” a tactic often used when purchasing individual bonds. With our approach, we instead create a ladder of maturity-series ETFs. These ETFs hold large pools of bonds that mature near to, but always before, a specified end date. Accordingly, with the passage of time, the average maturity of this kind of ETF naturally shortens, thereby replicating some characteristics of an individual bond. It’s not exactly the same, particularly because it doesn’t mature at a par value. However, the maturity-series ETF has more credit risk diversification, while oftentimes also providing liquidity improvement, relative to an individual bond.

The strategy has ladder “rungs” from end dates ranging between 2023 and 2028. We believe this laddered approach positions investors to participate in a wider range of yields, while also providing a mechanism to help address the risk of rising interest rates. If rates were to rise, the shortest “rung” could be sold, or allowed to reach its end date. The proceeds could then be redeployed into a longer “rung,” one with a higher yield.

JANUARY 2023 MARKET OBSERVATIONS & RECENT PORTFOLIO CHANGES⁴

- ◆ With inflationary pressures easing, we believe the Fed is approaching the end of its tightening cycle.
- ◆ We anticipate a relatively mild recession and expect the yield curve to normalize as economic growth recovers. We are cautious regarding exposure to longer maturity bonds.
- ◆ The portfolio sectors are slightly overweight municipal revenue bonds and underweight general obligation bonds. The portfolio duration is 4.8 years, which remains shorter than the benchmark duration of 6.9 years.

For the fourth quarter of 2022, the Confluence Fixed Income Tax-Exempt strategy return was 2.9% (gross of fees), which was below the benchmark return of 4.0%. The underperformance came from the portfolio’s shorter duration posture, which held back returns as longer-term rates declined. For the full year, the strategy’s gross return of -10.6% also lagged that of the benchmark at -9.0%. [Strategy net-of-fees returns for the same periods were 2.2% QTD and -13.2% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.]

As we open the new year, we enter the realm of the one-year anniversary of the Fed’s current tightening cycle. Initially, expectations were that the Fed would follow the protocol used in recent decades wherein rate hikes would be highly telegraphed, easily predicted, and modest in magnitude. The Fed came to understand, however, that not only was the high inflation not “transitory,” but the central bank was behind the curve in fighting it. Ultimately, the Fed raised short-term rates seven times in 2022, increasing from 0% to 4.5%, on a pathway that was erratic and surprising, and most certainly not modest in magnitude.

At this juncture, with inflation on a downward trend, it appears we are much closer to the end of the tightening cycle than the beginning. Fed officials are openly contemplating incremental increases of 0.25%, which would represent a much milder tap on the brakes relative to the four instances last year when the Fed raised rates by 0.75%. It appears the Fed’s peak in policy is likely to be in the neighborhood of 5%, and that destination may be reached in the first half of 2023.

Looking at the yield curve, the inversion reflects the expectation of lower rates in coming years, ostensibly a function of recession, lower economic growth, declining inflation, and easier Fed policy. While we also expect a recession, economic conditions, particularly those in the labor markets, indicate a relatively mild one. Accordingly, we’re looking through this widely anticipated recession and expect growth to resume relatively soon, along with inflationary pressures. In such an environment, there may be much less need for the Fed to stimulate the economy with lower rates; in fact, inflation may make that policy quite difficult to enact.

These viewpoints form our expectation that the yield curve will normalize in coming quarters and much of the change could come from rising longer-term rates as opposed to declining short-term rates. For this reason, we continue to view longer maturity bonds with a high degree of caution. At the same time, we find yield opportunities in short to intermediate maturities relatively attractive. We believe our laddered allocations capture higher short-term yields, while also creating reinvestment opportunities over an intermediate time frame.

Our sector exposure remains unchanged from the adjustments made in the latter half of 2022, with the portfolio slightly overweight municipal revenue bonds and underweight general obligation bonds. shorter in weighted average duration not only by removing much of the long-term municipal exposure, but also by eliminating the laddered maturity rungs beyond 2028. In addition, we have increased the exposures to advance refunded and general obligation municipal bonds.

Confluence Fixed Income Strategy Committee

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PERFORMANCE COMPOSITE RETURNS⁵ (FOR PERIODS ENDING DECEMBER 31, 2022)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Fixed Income Tax-Exempt <i>Pure Gross-of-Fees⁶</i>	1.1%	0.9%	0.2%	(1.7%)	(10.6%)	(10.6%)	2.9%
<i>Max Net-of-Fees⁷</i>	(1.9%)	(2.1%)	(2.7%)	(4.6%)	(13.2%)	(13.2%)	2.2%
Benchmark (BofA/Muni)	2.9%	2.2%	1.2%	(0.8%)	(9.0%)	(9.0%)	4.0%

Calendar Year	Pure Gross-of-Fees ⁶	Max Net-of-Fees ⁷	Benchmark (BofA/Muni)	Difference (Gross-Benchmark)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	Benchmark 3yr Std Dev	Composite Dispersion
2010**	(3.4%)	(4.1%)	(4.5%)	1.1%	1	\$48	\$751,909	N/A	N/A	N/A
2011	6.5%	3.3%	11.2%	(4.7%)	1	\$51	\$937,487	N/A	N/A	N/A
2012	2.0%	(1.0%)	7.3%	(5.3%)	1	\$52	\$1,272,265	N/A	N/A	N/A
2013	(1.1%)	(4.1%)	(2.9%)	1.7%	1	\$52	\$1,955,915	2.4%	4.4%	N/A
2014	4.0%	0.9%	9.8%	(5.8%)	3	\$600	\$2,589,024	2.2%	4.1%	N/A
2015	1.9%	(1.2%)	3.6%	(1.7%)	4	\$2,678	\$3,175,419	2.1%	3.7%	0.0%
2016	(0.8%)	(3.8%)	0.4%	(1.3%)	5	\$2,983	\$4,413,659	3.3%	3.4%	0.1%
2017	4.1%	1.0%	5.4%	(1.3%)	5	\$3,073	\$5,944,479	3.4%	3.2%	0.0%
2018	0.8%	(2.2%)	1.0%	(0.2%)	4	\$2,961	\$5,486,737	3.5%	3.3%	0.0%
2019	5.5%	2.4%	7.7%	(2.2%)	3	\$2,931	\$7,044,708	2.2%	2.4%	0.0%
2020	5.4%	2.3%	5.3%	0.2%	3	\$3,210	\$6,889,798	3.9%	4.1%	0.0%
2021	0.8%	(2.2%)	1.8%	(1.0%)	3	\$3,274	\$7,761,687	4.0%	4.0%	0.0%
2022	(10.6%)	(13.2%)	(9.0%)	(1.5%)	2	\$513	\$6,931,635	6.3%	6.6%	0.0%

*Average annualized returns

**Inception is 10/1/2010

Portfolio Benchmark:

BofA/Muni – ICE BofA U.S. Municipal Securities Index (Domestic Master) (Source: Bloomberg)

DISCLOSURES

² **Current Portfolio**—Sector allocations shown represent the model portfolio as of 1/19/23 and do not represent the precise allocation in an actual client account. Allocations in client accounts may vary based on individual client considerations and market fluctuations. The allocation of assets in the model portfolio may change from time to time due to market conditions and economic factors. Investments are not guaranteed and do carry a risk of loss of principal. Each asset class has specific risks associated with it and no specific asset class can prevent a loss of capital in market downturns. The listing of “5 Largest Holdings” is not a complete list of all ETFs 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. Individual client portfolios may differ, sometimes significantly, from these listings. Contact Confluence for a complete list of holdings. Yield data source: Morningstar; 30-day SEC yield of the model portfolio as of 1/19/23. Duration and maturity figures shown are based on all holdings in the model portfolio as of the rebalance date. ETF expense ratio is in addition to Confluence management fees. Rating categories reflect S&P ratings; source: Morningstar.

³ **Maturity Series ETF Profile**—Holdings in client accounts may vary based on individual client considerations and market fluctuations. The model portfolio may change from time to time due to market conditions and economic factors. Investments are not guaranteed and do carry a risk of loss of principal. Although fixed income ETFs, including maturity-series ETFs, invest in bonds, they have many differences relative to an individual bond and may trade significantly above or below the stated net asset value. ETFs trade like a stock but charge internal management fees; there will be brokerage commissions associated with buying and selling ETFs.

⁴ **Market Observations & Recent Portfolio Changes**—Information provided in this report is for educational and illustrative purposes only and should not be construed as individualized investment advice or a recommendation. The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Opinions expressed are current as of the date shown and are subject to change.

⁵ **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 Fixed Income Tax-Exempt strategy was inceptioned on October 1, 2010, and the current Fixed Income Tax-Exempt Composite was created on May 1, 2014. 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.

⁶ Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

⁷ Net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly. This fee includes brokerage commissions, portfolio management, consulting services and custodial services. The Confluence fee schedule for this composite is as follows: 0.40% on the first \$500,000; 0.35% on the next \$500,000; and 0.30% 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. Subsequent to May 1, 2014, 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.

Performance prior to May 1, 2014, is based on the Fixed Income Tax-Exempt–Direct Composite which was created on October 1, 2010. The Fixed Income Tax-Exempt–Direct Composite includes accounts that pursue the Fixed Income Tax-Exempt strategy, but do not have bundled fees. Gross returns from the Fixed Income Tax-Exempt–Direct Composite include transaction costs and net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly. 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 Fixed Income Tax-Exempt Composite contains fully discretionary Fixed Income Tax-Exempt wrap accounts. The Fixed Income Tax-Exempt portfolio utilizes bond ETFs to earn tax-exempt income. **Results shown for the year 2010 represent partial period performance from October 1, 2010, through December 31, 2010. 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.