

**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 BofAML 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.

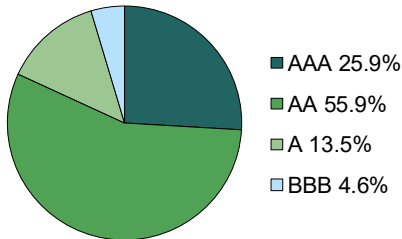
The strategy invests in a range of maturity-date ETFs to construct a portfolio similar to a diversified bond ladder, and complements these positions with traditional fixed income ETFs with more “static” maturity profiles, allowing for more precise exposures to maturities and sectors of the bond market. 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**

- ◆ Strives to deliver income and lower volatility traditionally available from a diversified municipal bond portfolio
- ◆ 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 Balanced accounts combined with equity strategy

**RATING CATEGORIES<sup>1</sup>**



**SECTOR ALLOCATION<sup>1</sup>**

General Obligation	38.3%
Advance Refunded	2.2%
Revenue	59.5%

<sup>1</sup>This information is presented as supplemental information to the disclosures required by the GIPS® standards. Sector allocations shown represent the model portfolio as of 8/12/19 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. Furthermore, application of the investment strategy as of a later date will likely result in changes to the listing. Contact Confluence for a complete list of holdings. Yield data source: Morningstar; 30-day SEC yield for the model portfolio as of 8/12/19. 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.

**CHARACTERISTICS<sup>1</sup>**

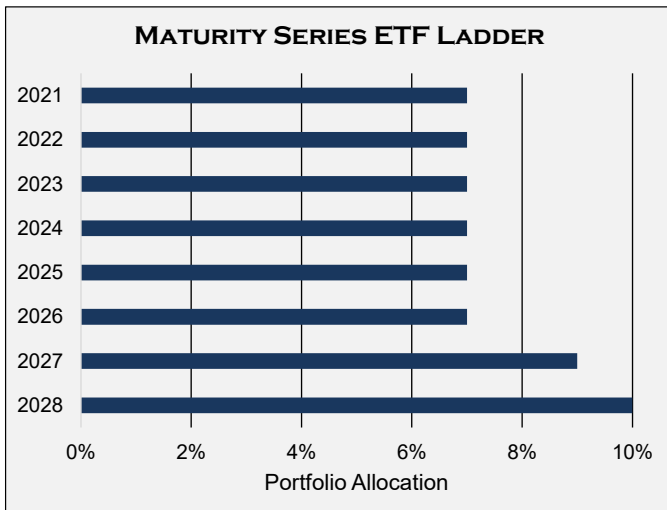
(WEIGHTED AVERAGE)

SEC Yield	1.6%
Tax-Equivalent SEC Distribution Yield Estimate*	2.5%
*Assumes Federal Income Tax Rate of 35%	
Duration	6.0
Maturity	10.5
ETF Expense Ratio	0.19%

**5 LARGEST HOLDINGS<sup>1</sup>**

VanEck Vectors AMT-Free Long Muni ETF - MLN	27.0%
iShares iBonds Dec 2028 Term Muni ETF - IBMQ	10.0%
iShares iBonds Dec 2027 Term Muni ETF - IBMP	9.0%
iShares iBonds Dec 2026 Term Muni ETF - IBMO	7.0%
iShares iBonds Dec 2025 Term Muni ETF - IBMN	7.0%

**MATURITY SERIES ETF PROFILE<sup>2</sup>**



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 2021 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.

<sup>2</sup> 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. This information is presented as supplemental information to the disclosures required by the GIPS® standards.

## THIRD QUARTER 2019 FIXED INCOME TAX-EXEMPT MARKET OBSERVATIONS

- ◆ Global growth and interest rates remain low around the world.
- ◆ The Fed lowered its fed funds rate and we expect easy monetary policy to continue.
- ◆ The strategy remains even with benchmark maturity, applying a laddered profile with an overweight exposure to corporate bonds.

Interest rates continued to move lower through the first half of the year, a move punctuated by a sharp decline in the early part of the third quarter. The 10-year Treasury yield neared 1.6%, a level not seen since mid-2016. With the general level of interest rates already at a low level, the decline in yields surprised many bond investors and seemingly several monetary policymakers as well.

What is behind this decline in interest rates? As is usually the case, the answer is multi-faceted. Changes in Federal Reserve policy, trade disputes and political uncertainty tied to various events have all added to general uncertainty and rising investor caution. But the largest single factor appears to be slowing global growth. China is particularly noteworthy as economic indicators reveal the lowest growth for the country in over a decade. This slowdown has a multiplicity of implications given that China's growth affects most emerging economies, and many developed ones, too. Taking these trends together, we see that Japan and many countries in Western Europe are nearing recessionary conditions, although recession has not been declared in any of the countries yet.

Around the world, bond investors have responded by driving interest rates lower. In part, the response has been driven by expectations of declining inflation, or even deflation in some areas. But the response also reflects the expectation that global central banks will implement and extend low interest rate policies. The Fed lowered rates in the third quarter and we expect it to continue forward with easy policy for many quarters.

The Fixed Income Tax-Exempt strategy has generally held up well in this environment, benefiting in the first half of 2019 from the decline in interest rates and the healthy investor appetite for municipal bonds. Looking forward, we expect low global growth to limit inflation and we don't expect a spike upward in interest rates. Accordingly, we maintain a laddered, intermediate maturity focus with an average maturity and duration similar to the benchmark. We retain a sizable exposure to general obligation municipal bonds (GOs) given the improving fiscal health of state and local governments. The maturity series ETFs that we employ in the laddered portion of the Fixed Income Tax-Exempt strategy hold roughly half of their holdings in GOs as compared to broader municipal bond ETFs that hold two-thirds or greater in revenue bonds.

*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.*

### PERFORMANCE COMPOSITE RETURNS (FOR PERIODS ENDING JUNE 30, 2019)

	Pure Gross-of-Fees <sup>1</sup>	Net-of-Fees <sup>2</sup>	Benchmark (BofAML/Muni)		Pure Gross-of-Fees <sup>1</sup>	Net-of-Fees <sup>2</sup>	Benchmark (BofAML/Muni)	Difference (Gross-Benchmark)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	Benchmark 3yr Std Dev	Composite Dispersion
Since Inception**	2.0%	(1.0%)	4.1%	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
5-Year*	2.2%	(0.8%)	3.7%	2012	2.0%	(1.0%)	7.3%	(5.3%)	1	\$52	\$1,272,265	N/A	N/A	N/A
3-Year*	1.4%	(1.6%)	2.6%	2013	(1.1%)	(4.1%)	(2.9%)	1.7%	1	\$52	\$1,955,915	2.4%	4.4%	N/A
1-Year	5.1%	2.0%	6.7%	2014	4.0%	0.9%	9.8%	(5.8%)	3	\$600	\$2,589,024	2.2%	4.1%	N/A
YTD	4.0%	2.4%	5.4%	2015	1.9%	(1.2%)	3.6%	(1.7%)	4	\$2,678	\$3,175,419	2.1%	3.7%	0.0%
QTD	1.7%	0.9%	2.3%	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%

\*\*Inception is 10/1/2010

\*Average annualized returns

#### Portfolio Benchmark

The benchmark is the ICE BofAML U.S. Municipal Securities Index.

#### Confluence claims compliance with the Global Investment Performance Standards (GIPS®).

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.

<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. 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 and/or fully compliant GIPS® presentations are available upon request. Additional information regarding policies for calculating and reporting performance 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 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.

#### Confluence Fixed Income Committee

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William O'Grady  
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#### The Confluence Mission

Our mission is to provide our clients with superior investment solutions and exceptional client service with the highest standards of ethics and integrity. Our team of investment professionals is committed to delivering innovative products and sound, practical advice to enable investors to achieve their investment objectives.

#### ABOUT CONFLUENCE INVESTMENT MANAGEMENT LLC

Confluence Investment Management LLC is an independent Registered Investment Advisor located in St. Louis, Missouri that was founded in 2007. Confluence provides professional portfolio management and advisory services to institutional and individual clients. The firm'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, fundamental company-specific approach. Confluence's portfolio management philosophy begins by assessing risk and follows through by positioning clients to achieve their income and growth objectives.

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