Fixed Income (Tax-Exempt)

Third Quarter 2023

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 million[1]

[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 Portfolio[2]

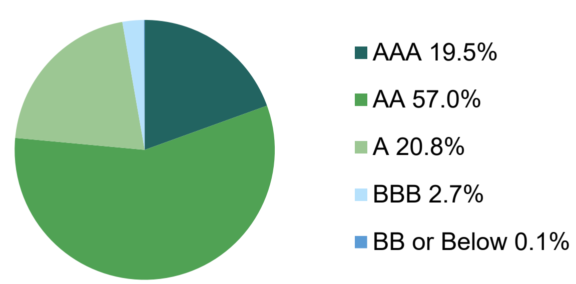
(As of 7/20/2023 rebalance)

Characteristics	Weighted Average
SEC Yield	3.1%
Tax-Equivalent SEC Distribution Yield Estimate* **Assumes Federal Income Tax Rate of 35%*	4.7%
Duration	4.0
Maturity	9.0
ETF Expense Ratio	0.19%

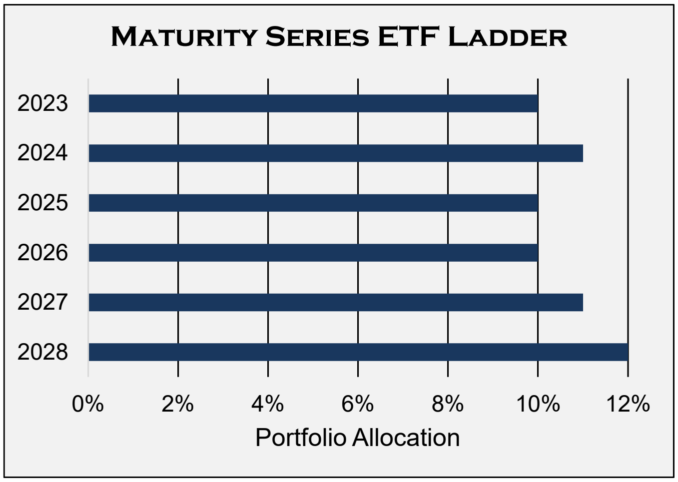
Sector Allocation	Weight
General Obligation	34.1%
Advance Refunded	6.0%
Revenue	59.9%

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 2024 Muni Bond ETF - BSMO	11.0%

Rating Categories



Maturity Series ETF Profile



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.

July 2023 Market Observations & Recent Portfolio Changes[3]

- With both inflation and economic growth declining, the 2- to 10-year portion of the municipal yield curve has inverted for the first time in history.
- We expect inflation to continue its cyclical decline, but the long-term trend will be higher than pre-pandemic levels. We believe this increases the likelihood that long-term rates may rise.
- The portfolio sectors remain underweight state and local general obligation municipals [GOs]. The portfolio duration is 4.0 years, which is almost three years shorter than the benchmark.

For the second quarter of 2023, the Confluence Fixed Income Tax-Exempt strategy slightly lagged the benchmark with a gross return of -0.3% versus 0.0% for the benchmark. The slight underperformance was caused by the absence of long municipal exposure, which produced marginally higher returns over the quarter. Municipal revenue bonds on the longer end produced the healthiest returns. [*The strategy's net-of-fees return for the same period was -1.0% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Inflation continues with a cyclical decline, helped by improving supply chains and more normalized consumer spending. At the same time, the economy is showing signs of slower growth. In addition, banks have been reducing their balance sheet exposures to Variable Rate Demand Notes [VRDNs], which are short-term instruments, resulting in higher yields in the shorter segment of the municipal yield curve. The combination of these forces has resulted in the municipal yield curve to become inverted in the 2- to 10-year segment for the first time in history. The widespread market expectation is that the Fed will stop raising the fed funds rate in the second half of the year and might begin lowering fed funds, perhaps in 2024.

For quite some time, we have expected this cyclical decline in inflation. However, our long-term view is that inflation is unlikely to return to its pre-pandemic level, given the ongoing trend away from globalized trade. So, while lower short-term inflation opens the door to easier Fed policy and lower short-term interest rates, higher secular inflation, perhaps in the 3-4% range, is likely to pressure longer maturity interest rates higher. Given this risk, we believe a shorter maturity profile remains appropriate.

The current 2- to 10-year inversion creates a rather unusual opportunity to increase portfolio yield while simultaneously lowering interest rate risk. Therefore, we find the return/risk profile of shorter maturities particularly attractive. Part of the risk of this posture would manifest if short-term rates fall sooner and more deeply than we expect. The portfolio would then have more exposure to reinvestment in lower yields; however, our assessment for long-term inflation indicates that this scenario is unlikely.

As economic growth declines, we believe state and local municipal budgets may deteriorate. For this reason, we remain underweight GOs, while maintaining the overweight to essential service revenue bonds. The majority of the strategy remains in a municipal bond ladder within five years, which we believe will allow the strategy to benefit from elevated short-term yields, while minimizing interest rate risk. The overall duration of the strategy is 4.0 years, while the benchmark is approximately 6.8 years.

Confluence Fixed Income Strategy Committee

Mark Keller, CFA
Gregory Ellston
Patrick Fearon-Hernandez, CFA
David Miyazaki, CFA
William O'Grady
Kaisa Stucke, CFA

Performance Composite Returns[4] (For Periods Ending June 30, 2023)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Fixed Income Tax-Exempt *Pure Gross-of-Fees*[5]	1.2%	1.3%	0.6%	(2.0%)	1.1%	1.7%	(0.3%)
Max Net-of-Fees[6]	(1.8%)	(1.8%)	(2.4%)	(4.9%)	(1.9%)	0.2%	(1.0%)
Benchmark (BofA/Muni)	3.0%	2.8%	1.8%	(0.6%)	3.1%	2.8%	0.0%

Calendar Year	Pure Gross-of-Fees[5]	Max Net-of-Fees[6]	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 7/20/23 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. 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. Individual client portfolios may differ, sometimes significantly, from these listings. Yield data source: Morningstar; 30-day SEC yield of the model portfolio as of 7/20/23. 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] **Market Observations & Recent Portfolio Changes—**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.

[4] **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 incepted 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.

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

[6] 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.