

**OBJECTIVE**

Invests in fixed income Exchange Traded Funds (ETFs), diversified across maturities and corporate, Treasury, and MBS sectors. Strives to deliver the income and lower volatility traditionally available from a diversified bond portfolio.

**INVESTMENT PHILOSOPHY & PROCESS**

Fixed Income Taxable invests in fixed income ETFs with domestically oriented, investment-grade benchmarks. It is constructed to have characteristics similar to a traditional, laddered bond portfolio and its benchmark is the ICE BofA U.S. Corporate, Government & Mortgage 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 may also adjust the exposure to corporate, Treasury and MBS sectors according to its viewpoints regarding Fed policy, the shape of the yield curve, relative yields, credit spreads, default rates and other market factors.

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 amount of credit or interest rate risk in a portfolio.

Fixed Income Taxable 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
- ◆ 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.
- ◆ Diversified across maturities and sectors
- ◆ Available as a standalone portfolio or in Confluence Balanced account combined with value equity strategy
- ◆ Strategy assets: \$20.4 million<sup>1</sup>

<sup>1</sup> Total strategy assets include assets under management (AUM) and assets under advisement (AUA). As of 12/31/23, AUM = \$9.2 million and AUA = \$11.2 million.

**CURRENT PORTFOLIO<sup>2</sup>**

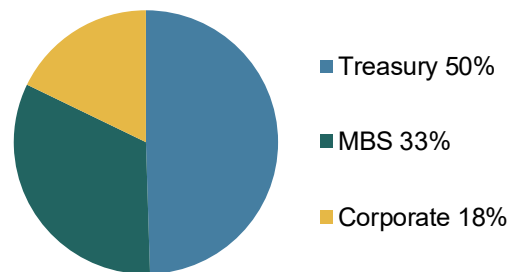
(As of 2/1/2024 rebalance)

CHARACTERISTICS	WEIGHTED AVERAGE
SEC Yield	4.4%
Duration	4.9
Maturity	5.6
ETF Expense Ratio	0.07%

RATING CATEGORIES	WEIGHT
AAA	27.7%
AA	58.4%
A	6.4%
BBB	7.6%
BB or Below	0.0%

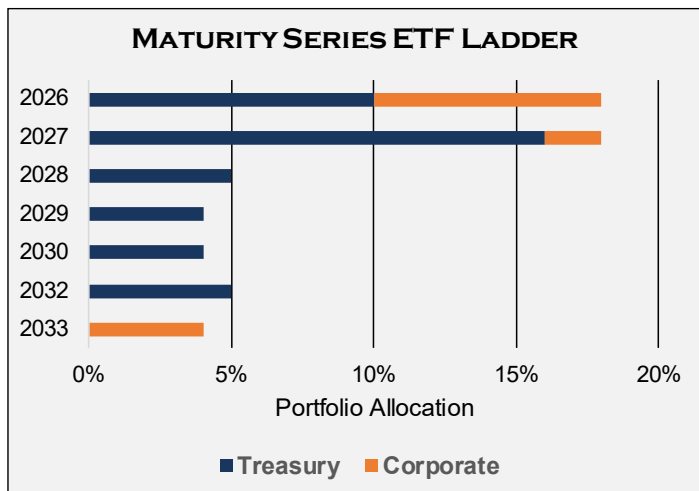
5 LARGEST HOLDINGS	WEIGHT
SPDR® Portfolio Mortgage Backed Bond ETF - SPMB	24.0%
iShares iBonds Dec 2027 Term Treasury ETF - IBTH	16.0%
iShares iBonds Dec 2026 Term Treasury ETF - IBTG	10.0%
iShares MBS ETF - MBB	9.0%
iShares iBonds Dec 2026 Term Corporate ETF - IBDR	8.0%

**SECTOR ALLOCATION**



See GIPS Report on pages 2-3.

## MATURITY SERIES ETF PROFILE



Fixed Income Taxable 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 2026 and 2033, with more emphasis in the middle of the range. 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 2024 MARKET OBSERVATIONS & RECENT PORTFOLIO CHANGES<sup>3</sup>

- ◆ The bond market enjoyed a rally in the fourth quarter following nearly two years of pricing pressure. The cyclical decline in inflation and the Fed’s indications that it is at the end of its tightening cycle provided support, particularly in longer durations.
- ◆ Although we don’t expect a full pivot by the Fed to commence rapidly lowering fed fund rates in the near-term, we believe the aggressive battle against inflation is over.
- ◆ We continue to favor a shorter duration than the benchmark, with the core of the portfolio laddered in intermediate maturities. Sector weights favor MBS and Treasuries, while corporates are underweight. Portfolio duration of 4.9 years remains shorter than the benchmark.

The Confluence Fixed Income Taxable strategy’s gross return in the fourth quarter was 5.1%, which was lower than the benchmark’s return of 6.7%. The principal difference in returns was derived from the portfolio’s shorter duration, which earlier in the year helped to protect it from rising interest rates yet later hindered the portfolio as long-term bonds rallied in the fourth quarter. Over the course of the full year, the strategy’s gross return was 5.2%, in line with the benchmark at 5.4%. [The strategy’s net-of-fees returns for the same periods were 4.3% QTD and 2.1% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.]

The portfolio was neutral in its mortgage-backed securities (MBS) allocation, but slightly underweight corporates and overweight Treasuries. MBS and corporates outperformed Treasuries in the fourth quarter and for the entire year. The MBS sector faced challenges throughout the year, driven by a dramatic slowdown in refinancing, which caused average durations to extend. At the same time, technical factors related to low levels of new origination, Fed balance sheet runoff, and portfolio selling pressure from regional banks also created uncertainty. However, in the fourth quarter, conditions stabilized and MBS spreads narrowed. On the corporate side, spreads also continued to narrow in the fourth quarter as credit quality remained generally good.

Following a difficult bond market that prevailed from January 2022 through October 2023, the rally of the last two months of the year was a welcome relief to bond investors. The Fed’s pronouncement in early December that it was likely to suspend its monetary tightening program called into question the notion of “higher for longer.” The positive price response to the Fed’s guidance was most pronounced for longer maturities.

Our outlook is for the continuation of a cyclical decline in inflation, though we expect it to ultimately settle higher than the Fed’s preferred level of 2%. Moreover, the volatility of inflation should remain elevated, especially as fiscal spending remains high. As a result, the risk of incremental increases in long-term rates, combined with the attraction of intermediate rates, encourages a shorter posture.

With a shorter duration, the focus is on the middle of the yield curve, which captures higher attractive yields, while avoiding longer maturity interest rate risk. In January we moved out of the shortest rungs of our bond ladder (2024 and 2025), where yields are likely to decline. Proceeds were deployed into a new position in 2033 corporates and an additional position in MBS. We believe conditions in the MBS market are favorable, given the widespread expectation for mortgage refinancing to remain low. Relative to the new benchmark, the portfolio is modestly overweight MBS, underweight corporates and overweight Treasuries. With a duration of 4.9 years, it remains shorter than the benchmark duration of 6.3 years.

### Confluence Fixed Income Strategy Committee

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See [Territory Map](#) on the Confluence website for sales coverage.

**PERFORMANCE COMPOSITE RETURNS<sup>4</sup>** (FOR PERIODS ENDING DECEMBER 31, 2023)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
<b>Fixed Income Taxable</b>							
<i>Pure Gross-of-Fees<sup>5</sup></i>	2.2%	1.5%	0.9%	(3.8%)	5.2%	5.2%	5.1%
<i>Max Net-of-Fees<sup>6</sup></i>	(0.9%)	(1.5%)	(2.1%)	(6.6%)	2.1%	2.1%	4.3%
<b>Benchmark (BofA/U.S. Master)</b>	2.2%	1.8%	1.1%	(3.5%)	5.4%	5.4%	6.7%

Calendar Year	Pure Gross-of-Fees <sup>5</sup>	Max Net-of-Fees <sup>6</sup>	Benchmark (BofA/US-Master)	Difference (Gross-Benchmark)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	Benchmark 3yr Std Dev	Composite Dispersion
2010**	1.8%	0.3%	1.1%	0.7%	1	\$1,334	\$751,909	N/A	N/A	N/A
2011	6.3%	3.2%	7.9%	(1.5%)	2	\$1,376	\$937,487	N/A	N/A	0.1%
2012	7.7%	4.5%	4.4%	3.3%	3	\$1,459	\$1,272,265	N/A	N/A	0.1%
2013	(1.0%)	(3.9%)	(2.3%)	1.3%	2	\$3,668	\$1,955,915	3.5%	2.8%	N/A
2014	5.5%	2.4%	6.4%	(0.9%)	3	\$7,995	\$2,589,024	3.1%	2.8%	0.0%
2015	0.3%	(2.7%)	0.6%	(0.3%)	5	\$8,990	\$3,175,419	3.2%	3.1%	0.1%
2016	1.4%	(1.6%)	2.6%	(1.2%)	7	\$9,259	\$4,413,659	3.4%	3.1%	0.0%
2017	3.2%	0.1%	3.6%	(0.5%)	8	\$9,676	\$5,944,479	3.2%	2.9%	0.0%
2018	(0.3%)	(3.2%)	0.0%	(0.3%)	9	\$9,684	\$5,486,737	3.1%	2.9%	0.0%
2019	9.7%	6.4%	9.0%	0.7%	13	\$13,158	\$7,044,708	3.1%	3.0%	0.1%
2020	7.1%	3.9%	7.6%	(0.5%)	13	\$17,013	\$6,889,798	3.7%	3.5%	0.1%
2021	(2.3%)	(5.2%)	(1.6%)	(0.7%)	7	\$9,945	\$7,761,687	3.8%	3.5%	0.2%
2022	(13.3%)	(15.9%)	(13.3%)	(0.0%)	3	\$8,273	\$6,931,635	5.7%	5.8%	0.0%
2023	5.2%	2.1%	5.4%	(0.2%)	4	\$6,866	\$7,200,019	6.3%	7.1%	0.1%

\*Average annualized returns

\*\*Inception is 7/1/2010

**Portfolio Benchmark:**

**BofA/U.S. Master** – ICE BofA U.S. Corporate, Government & Mortgage Index (Domestic Master) (Source: Bloomberg)

**DISCLOSURES**

<sup>2</sup> **Current Portfolio**—Sector allocations shown represent the model portfolio as of 2/1/24 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. 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 2/1/24. 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.

<sup>3</sup> **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.

<sup>4</sup> **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, 2022. 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 Taxable strategy was inceptioned on July 1, 2010, and the current Fixed Income Taxable Composite was created on July 1, 2013. 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>5</sup> Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

<sup>6</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 July 1, 2013, 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 July 1, 2013, is based on the Fixed Income Taxable—Direct Composite which was created on July 1, 2010. The Fixed Income Taxable—Direct Composite includes accounts that pursue the Fixed Income Taxable strategy, but do not have bundled fees. Gross returns from the Fixed Income Taxable—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 Taxable Composite contains fully discretionary Fixed Income Taxable wrap accounts. The Fixed Income Taxable portfolio utilizes bond ETFs to earn taxable income.

\*\*Results shown for the year 2010 represent partial period performance from July 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.