Confluence INVESTMENT MANAGEMENT

Fixed Income (Taxable)

Third Quarter 2023

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: $22.9 million[1]

[1] Total strategy assets include assets under management (AUM) and assets under advisement (AUA). As of 12/31/22, AUM = $11.0 million and AUA = $11.9 million.

Current Portfolio[2]

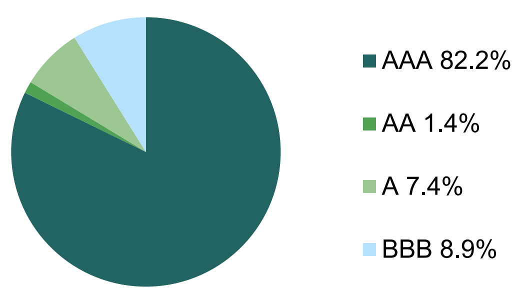
(As of 7/20/2023 rebalance)

Characteristics	Weighted Average
SEC Yield	4.5%
Duration	4.3
Maturity	5.2
ETF Expense Ratio	0.07%

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 iBonds Dec 2030 Term Treasury ETF - IBTK	8.0%
iShares iBonds Dec 2026 Term Corporate ETF - IBDR	8.0%

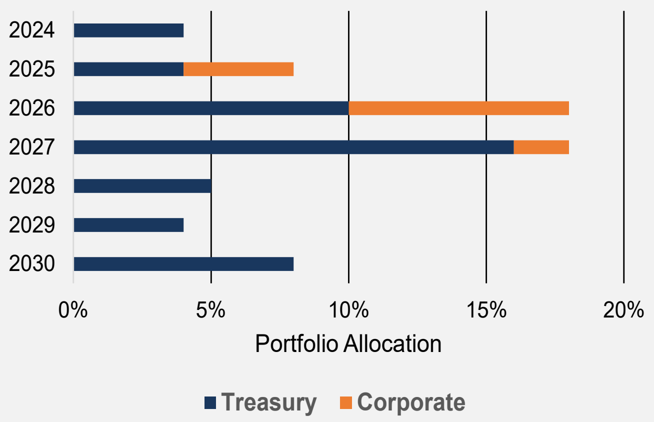
Sector Allocation	Weight
Treasury	58.4%
MBS	23.8%
Corporate	17.8%

Rating Categories



Maturity Series ETF Profile

Maturity Series ETF Ladder



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 2024 and 2030, 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.

July 2023 Market Observations & Recent Portfolio Changes[3]

- With both inflation and economic growth declining, the yield curve remains inverted, reflecting a broad expectation that the Fed will stop tightening in 2023 and perhaps ease in 2024.
- 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 corporates, overweight Treasuries, and evenweight mortgages. The portfolio duration is 4.3 years, which is approximately two years shorter than the benchmark duration.

The Confluence Fixed Income Taxable strategy's gross return in the second quarter was -0.8%, in-line with the benchmark return of -0.8%, while the year-to-date gross return was 1.8%, which was slightly below the benchmark return of 2.1%. [*Strategy net-of-fees returns for the same periods were -1.6% QTD and 0.3% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

The portfolio return in the second quarter was earned with a much shorter duration, but this benefit was offset by the underweight allocation to the corporate sector, which outperformed as spreads narrowed. The portfolio's MBS allocation and performance were roughly in line with that of the benchmark.

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. The combination of these trends bolsters the expectation that the Fed will stop raising rates in the second half of the year. In response, bond investors have maintained an inverted yield curve, where short-term rates are higher than long-term ones. This inversion reflects a widespread expectation that not only will the Fed stop raising rates, but it might begin lowering them, 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 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 default risk may rise. For this reason, we remain underweight corporates, while overweight Treasuries. Mortgages remain generally attractive, and the MBS allocation is evenweight relative to the benchmark. The overall portfolio duration is around 4.3 years, while the benchmark is approximately 6.3 years.

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

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Fixed Income Taxable *Pure Gross-of-Fees[5]*	2.0%	1.3%	0.6%	(4.5%)	(1.7%)	1.8%	(0.8%)
Max Net-of-Fees[6]	(1.0%)	(1.7%)	(2.4%)	(7.3%)	(4.6%)	0.3%	(1.6%)
Benchmark (BofA/U.S. Master)	2.0%	1.5%	0.8%	(4.1%)	(1.1%)	2.1%	(0.8%)

Calendar Year	Pure Gross-of-Fees[5]	Max Net-of-Fees[6]	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%

**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

[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. 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 Taxable strategy was incepted 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.

[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 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.