Increasing Dividend Equity Account (IDEA) • Value Equity Strategies

Increasing Dividend Equity Account (IDEA) is focused on high-quality companies with long track records of distributing earnings to shareholders through dividends. These companies tend to be established companies that generate free cash flow and have management teams committed to growing the dividend. The portfolio is selected from a universe of stocks meeting initial minimum criteria of paying and increasing dividends over the last 10 years. The portfolio typically has approximately 49 holdings and is expected to result in low to moderate turnover. The strategy is appropriate for clients seeking total return from dividend income and capital appreciation.

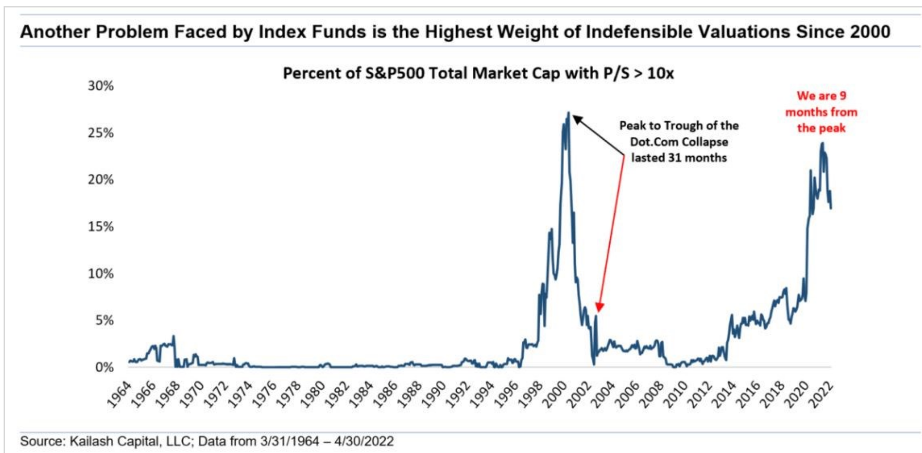
Market Commentary

"Many shall be restored that now are fallen, and many shall fall that now are in honor."

- Horace, "Ars Poetica." The epigraph to Ben Graham's book *Security Analysis*.

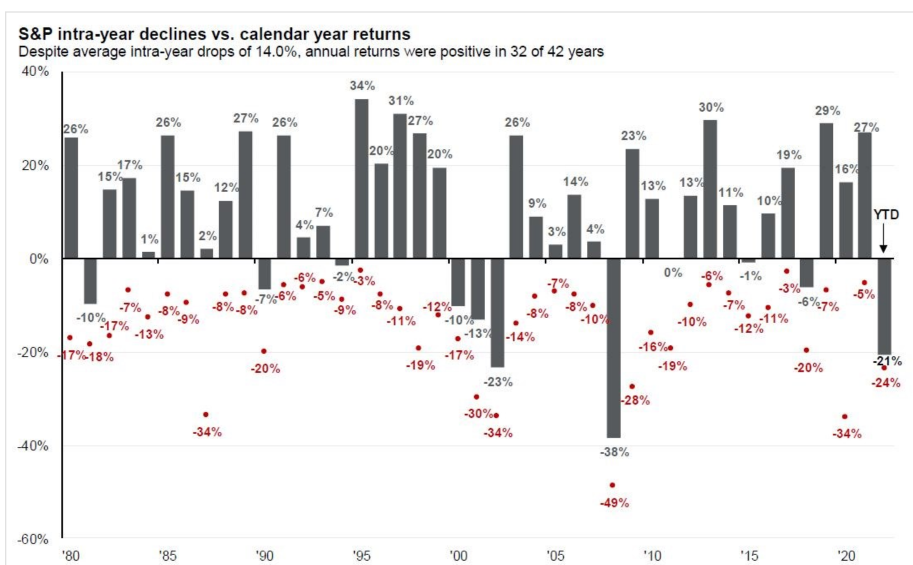
The first half of 2022 witnessed a sharp market pullback, with the S&P 500 Index down 20%. It was also the first consecutive quarterly decline in the S&P 500 since the Great Financial Crisis (GFC) of 2008-2009 and marks a sharp shift in sentiment following exceptional returns that averaged 16% from 2009-2021 following the GFC. Even more remarkable, the most recent five-year period from 2017 to 2021 averaged 19%—over twice the average annual return of 9% for the S&P 500 dating back to 1871 (data from *Kailash Concepts*). Of course, this period was afforded low inflation, which abetted accommodative monetary and fiscal policies that, in turn, favored financial assets. While the recent stimulus prevented a severe recession in 2020, the sheer size relative to the economy fostered pockets of excessive exuberance as many investors shifted their focus to what was *possible* as opposed to what was *probable*. This first chart from *Kailash Concepts* (*Figure 1*) highlights the extreme valuations that developed in a larger percentage of the markets and are now unwinding. Investors are beginning to restore and re-emphasize the fundamentals of valuations.

Figure 1



The recent pullback may be uncomfortable, but it is not uncommon, and provides a healthy cleansing of the prior excesses. It is during these market corrections that selling is generally broad-based, pulling down both the good and the bad. After all, when the bank calls, you sell what you can, not what you want. As time progresses, fundamentals and valuations begin to matter, and the wheat is separated from the chaff. This next chart from J.P. Morgan Asset Management (*Figure 2*) provides a good perspective of the annual intra-year declines dating back to 1980. Given the various pockets of excess, the current pullback is part of a healthy process and provides opportunities for long-term investors.

Figure 2

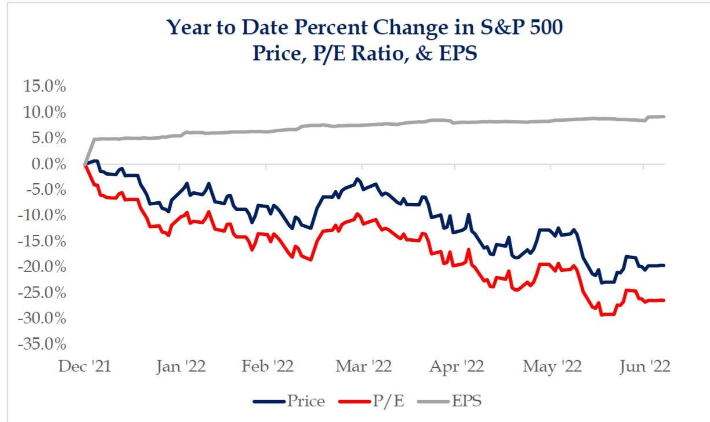


(Chart source: J.P. Morgan Asset Management; Guide to the Markets - U.S., Data as of June 30, 2022)

Market Commentary continued...

The main culprit behind the pullback is inflation! More specifically, its persistence is prodding expectations of higher levels of inflation which would ultimately reduce the present value of future cash-flow streams as well as create added uncertainty for businesses and consumers. This should naturally result in lower equity valuations, *ceteris paribus* (all other things being equal), which is occurring with the pullback. As this chart from Strategas reflects (*Figure 3*), the pullback was driven by a contraction in multiples and not a decrease in earnings as earnings per share rose in the mid-single-digits.

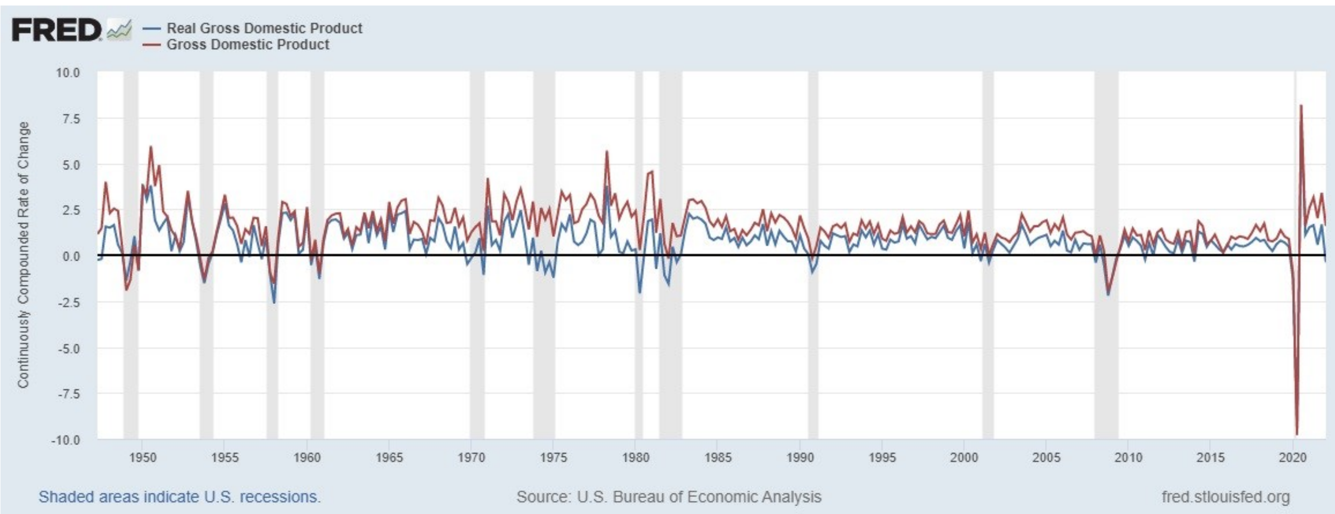
Figure 3



(Source: Strategas; 7/8/2022)

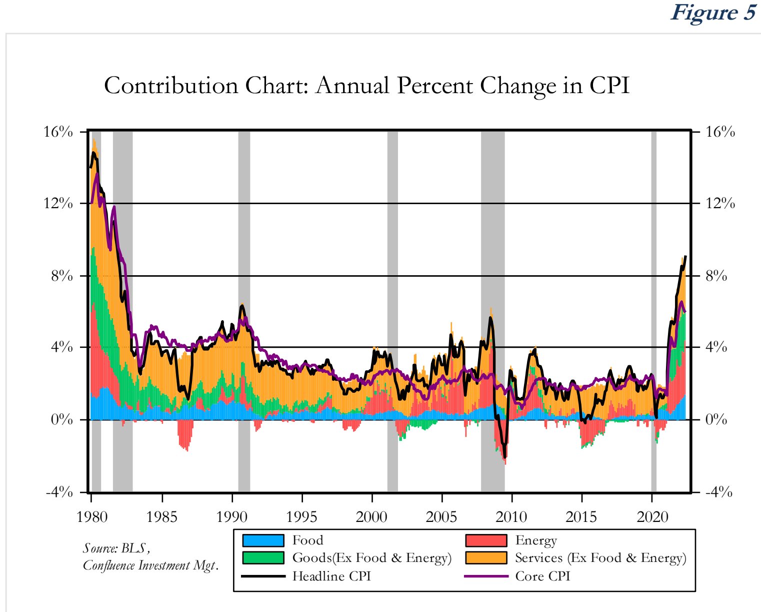
It is worth noting that in an environment of high inflation, a shallow recession can result in nominal GDP growth as mid-to-high single-digit inflation could mask a real GDP decline. This scenario occurred a few times between 1969 and 1982, which was also the last time we had high levels of inflation. [See *Figure 4* below, where Nominal GDP, red line, is above zero, and Real GDP, blue line, is below zero.] During the first quarter of 2022, real gross domestic product (GDP) did decrease at an annual rate of 1.6%, while revenue and earnings grew in nominal terms.

Figure 4



Interestingly, inflation has not been center stage since the 1970s and early 1980s. This chart of the Consumer Price Index from Confluence's macro team (*Figure 5*), shows the history of inflation and its key contributors dating back to 1980. The chart reveals that inflation was relatively benign leading up to the most recent couple of years, which is why the Federal Reserve believed inflation would be transitory. In fact, the Goods component (shown in green) is an atypically large contributor to current inflation as demand for Goods has been elevated by fiscal stimulus, while consumer spending was redirected away from services due to pandemic restrictions. Energy (red) has also contributed to the recent inflationary pressures as geopolitical issues have been impacted by the supply of oil following the Russian invasion of Ukraine and the ensuing sanctions. It is important to note that Energy is excluded from Core CPI as it is often impacted by short-term geopolitical issues that cause extreme volatility, both good and bad; therefore, monetary policy response would offer little to no utility. Going forward, the focus will be on changes that may impact the structure of inflation, such as de-globalization/regionalism and de-regulation/regulation surrounding technology. The Confluence macro team discusses these topics regularly in their various reports, so be sure to follow their publications (*Daily Comment, Bi-Weekly Geopolitical Report, Weekly Energy Update,* etc.) on the **Research & News** section of our website.

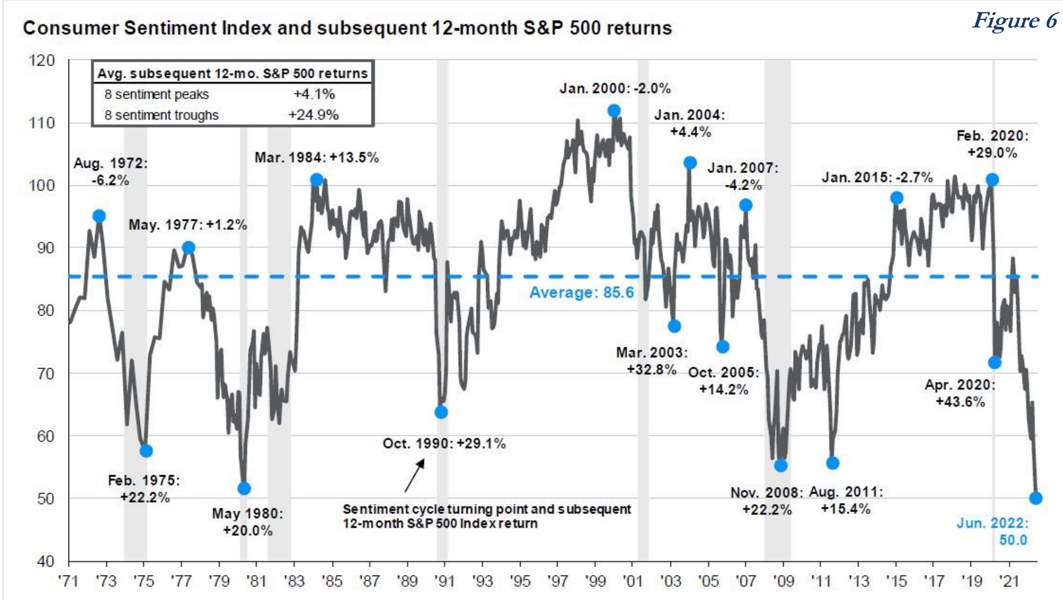
Figure 5



Market Commentary continued…

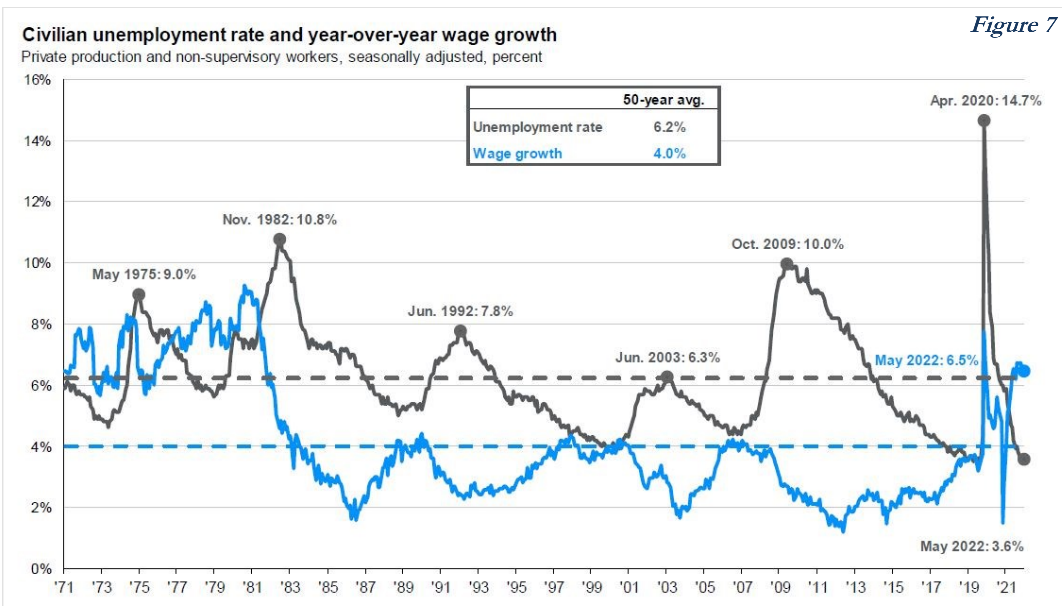
Inflation is also weighing on consumer confidence as reflected in the University of Michigan's Consumer Sentiment Index, which is currently at a multi-decade low. Consumer sentiment is influenced by unexpected rises in inflation since it acts as a stealth tax and disproportionately impacts lower income earners who spend more of their income on basic goods and services. This chart *(Figure 6)* overlays the subsequent 12-month equity returns at peaks and troughs in the survey. The data reveals a contrarian bias, i.e., trough confidence produces better returns over the ensuing 12-months than peaks.

Figure 6



Although the probability of a recession has increased due to inflation remaining stubbornly high, which requires more restrictive monetary policy, it is important to remember that these actions are the result of strong demand which is pushing against constrained supply chains. Unemployment remains near historic lows and wage growth is strong (see *Figure 7*)—there are two job openings for every job seeker—and households are in the best shape in decades (see *Figure 8*). None of the postwar expansions died of natural causes but rather the result of monetary policy intended to stem incipient inflation. However, due to the underlying strength of demand and tight labor markets, the result is likely a shallow recession.

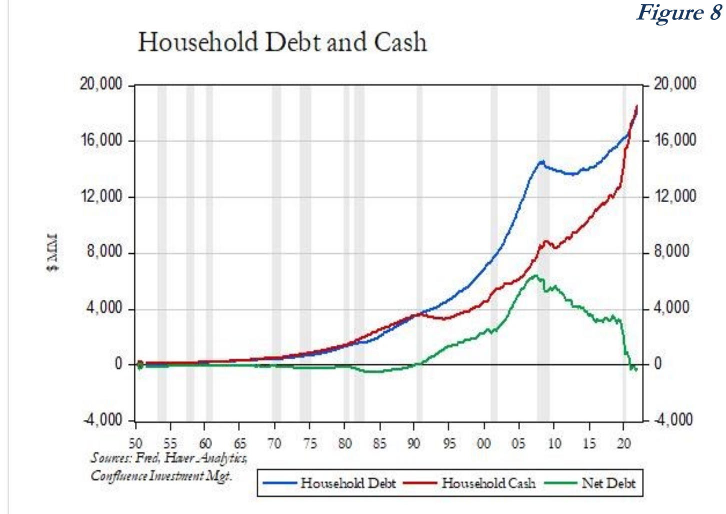
Figure 7



(Figures 6 and 7 chart source: J.P. Morgan Asset Management; Guide to the Markets - U.S., Data as of June 30, 2022)

The past few years have been yet another reminder of the difficulties in forecasting the future and the impact that emotions have on investor sentiment as they shifted from panic in the spring of 2020 to euphoria following the stimulus and reopening of the economy. Investor sentiment was very strong leading into 2022, supported by cash on the sidelines that entered the market and led to areas of excess that are now being purged. We view it as a healthy process, albeit frustrating in the near-term as selling has been indiscriminate. At Confluence, the leadership team has been at the helm since our process began in 1994 and navigated prior cycles with the same consistent application of our investment philosophy. This investment approach implicitly acknowledges the difficulties in forecasting and instead focuses on understanding businesses and what they are worth, with an emphasis on owning companies with substantial competitive advantages that are trading at a discount to intrinsic value. For long-term investors, it is important to maintain a proper perspective of the recent volatility. Rest assured that Confluence remains committed to our disciplined investment process that has served our clients well through uncertain times.

Figure 8



Strategy Commentary

During the second quarter, a bear market (defined as a 20% decline from the market high) set in as the stock market began to take higher interest rates more seriously. With strong consumer balance sheets and insatiable demand, the Fed has pledged to raise interest rates enough to soften demand and bring down inflation, prompting concerns that this will result in a recession. As for the stock market, it appears the speculative fever has broken with valuations moving back toward long-term averages and speculations declining; one example was Bitcoin which fell 73% from its high last November.

Despite the onset of a bear market in the first half of the year, the companies held in the Increasing Dividend Equity Account (IDEA) strategy continued to grow their dividends. As detailed in the table, 25 of the 49 companies in the current portfolio have raised their dividends year-to-date as of 6/30/2022, with an average announced growth rate of 8.8%. Furthermore, the IDEA strategy has produced consistent dividend growth over the past 13 years, resulting in annual dividend income nearly tripling since the strategy's inception.

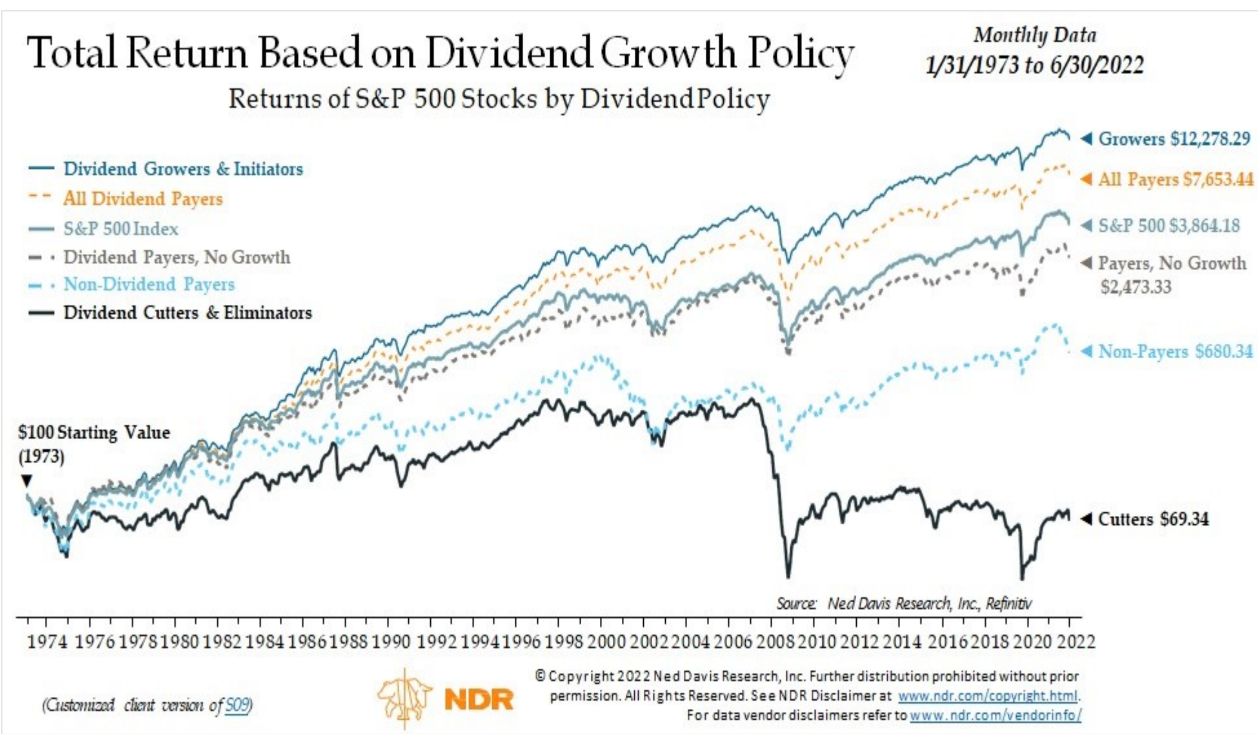
Figure 9 **Annual Dividend Statistics for IDEA Portfolio at 12/31** ***(Dividend Growth Using Announcement Date)*** [1]

			Dividend Change from Prior Year*			
			# of companies with			
Year	**Holdings**	**Avg. Yield**+	Increase	Flat	Decrease	Avg. Growth
2009	49	2.9%	39	10	0	5.6%
2010	49	2.9%	45	4	0	9.3%
2011	49	2.9%	46	3	0	9.6%
2012	48	3.3%	46	2	0	9.3%
2013	49	2.4%	47	2	0	10.6%
2014	49	2.5%	47	2	0	9.3%
2015	49	2.8%	46	3	0	8.9%
2016	50	2.4%	46	4	0	6.9%
2017	48	2.1%	44	4	0	7.4%
2018	49	2.5%	47	2	0	11.3%
2019	49	2.1%	48	1	0	9.5%
2020[1]	49	2.1%	42	7	0	6.2%
2021	49	1.9%	46	3	0	8.3%
Average-13 yrs		2.5%	45	4	0	8.6%
YTD (6/30/22)	49	2.2%	25		0	8.8%

*[1] '2020' excludes impact of temporary dividend suspensions during the pandemic of 2020. * 'Dividend Change from Prior Year' excludes impact of special dividends and spin-offs.*
+ 'Avg. Yield' is the average dividend yield of portfolio holdings at 12/31, calculated based on annualized current dividend plus any special dividend paid during the year.

Over the long term, dividend growers (like many of the companies owned in IDEA) have substantially outperformed companies whose dividends remained flat, companies that have cut their dividends, and companies that do not pay dividends. As seen in this chart from Ned Davis Research (*Figure 10*), $100 invested in dividend growers in 1973 is now worth $12,278 today, while $100 invested in dividend cutters is only worth $69 today.

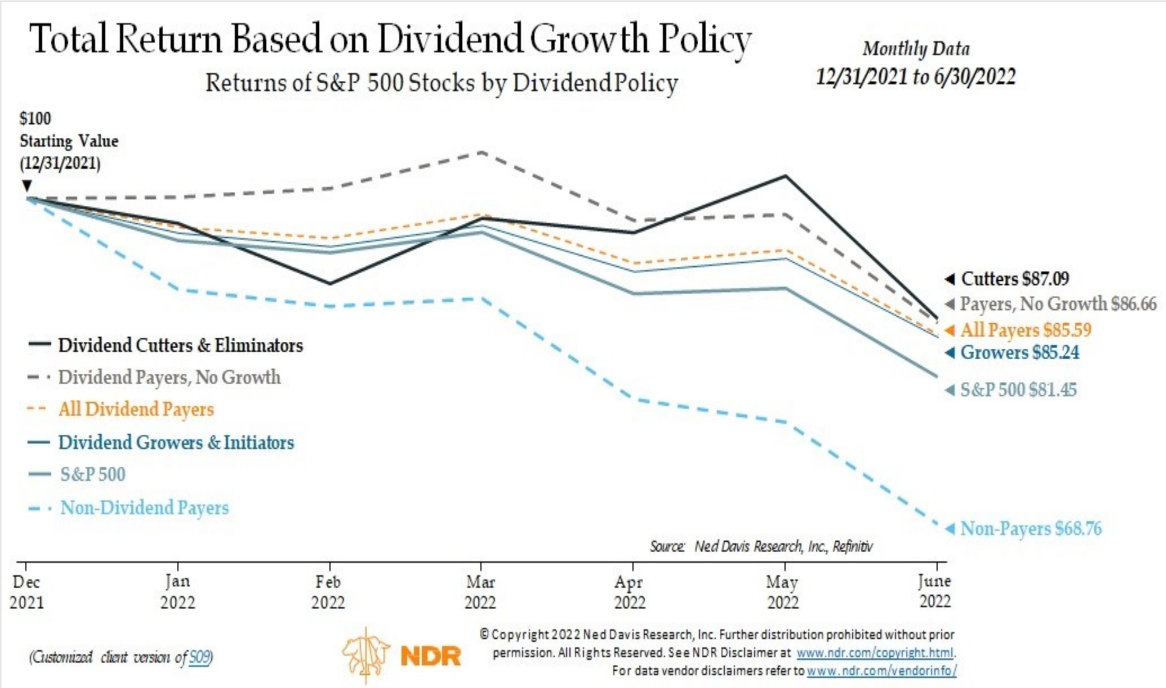
Figure 10



Strategy Commentary continued...

In the first half of 2022, investors moved toward quality companies with attractive valuations, strong cash flow, low leverage, and dividends, and they began to move away from expensive high-growth stocks and speculation. This is reflected in the below chart (*Figure 11*), with non-dividend-paying stocks (which includes most "growth stocks") down 31.2% year-to-date, while dividend-paying stocks were down 14.4%.

Figure 11



As a result, the Confluence IDEA strategy was down 9.8% in the second quarter for a loss of 14.7% thus far in 2022 (both gross of fees). Meanwhile, the S&P 500 Index declined 16.1% in the second quarter and 20.0% year-to-date. *[Net-of-fees returns for the same periods were -10.5% QTD and -16.0% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.]*

The portfolio benefited from owning dividend-paying technology stocks that outperformed many high-growth, non-dividend-paying technology stocks. Additionally, its bank and insurance stocks outperformed along with the top year-to-date contributors, which tended to be defensive, value-focused stocks: Lockheed Martin (LMT), Chevron (CVX), Hershey (HSY), Raytheon Technologies (RTX), and New Jersey Resources (NJR). The weakest contributors were mostly Consumer Discretionary spending-focused stocks: Fortune Brands Home & Security (FBHS), a building supplies company, T. Rowe Price Group (TROW), Starbucks (SBUX), NIKE (NKE), and Expeditors International of Washington (EXPD), a freight forwarding company. *[See contribution data on the next page.]*

During the quarter, 3M Company (MMM) was sold in order to purchase S&P Global Inc. (SPGI). 3M continues to have an attractive dividend yield, but dividend growth has been below our expectations. S&P Global is a diversified information services company and a leading global credit-rating agency. With its recent acquisition of IHS Markit, the company now provides industry data and analytics for financial markets, credit ratings, stock indexes, commodities, automotive markets, and engineering standards. These types of historical datasets are difficult to gather, but once established and imbedded in an industry, additional subscriptions can be sold with little incremental cost, resulting in attractive operating margins for S&P. S&P has a great business with solid competitive advantages, high free cash flow, and a payout ratio that should allow for strong dividend growth well into the future.

Outlook

High prices have begun to weigh on consumer sentiment as it's dropped to an all-time low dating back to 1952. In the second half of 2022, inflation will likely decline from 40-year highs, but the economy will be more widely impacted by rising interest rates. As a result, the next stage of the bear market could come from weak earnings per share on top of the valuation multiple contraction that occurred in the first half of the year. If this occurs, it could provide opportunities to buy great companies at very attractive valuations.

In IDEA, we continue to focus on owning quality companies with growing dividends at reasonable prices. Fortunately, the stock market favored these types of investments in the second quarter and will likely continue to do so as markets unwind years of speculation. Most stocks decline in a bear market, but these losses should be temporary for the high-quality, growing, reasonably valued companies that we look to own. As for the highly valued speculations we look to avoid, bear market declines will likely result in a permanent loss of capital for their investors. Increasing dividends provide growing income for the investor and also indicate business attributes and competitive advantages that have historically driven long-term stock outperformance, including through periods of higher inflation. Even in a bear market, the companies owned in IDEA continue to grow their dividends, thus these high-quality companies owned at reasonable valuations should grow and compound over the long term.

Contribution[2]

(YTD as of 6/30/2022)

The top contributors and detractors for the portfolio thus far in 2022 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Lockheed Martin Corp.	2.53	0.42
Chevron Corp.	2.01	0.32
Hershey Co.	2.22	0.22
Raytheon Technologies Corp.	1.90	0.19
New Jersey Resources Corp.	1.62	0.14
Bottom 5		
Expeditors International of Washington Inc.	2.52	(0.76)
NIKE Inc.	1.66	(0.76)
Starbucks Corp.	1.93	(0.79)
T. Rowe Price Group Inc.	1.58	(0.81)
Fortune Brands Home & Security	1.63	(0.86)

(Contribution data shown from a sample account, based on individual stock performance and portfolio weighting)

Performance Composite Returns[3] (For Periods Ending June 30, 2022)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
IDEA *Pure Gross-of-Fees[4]*	12.6%	12.2%	9.9%	8.0%	(6.9%)	(14.7%)	(9.8%)
Net-of-Fees[5]	9.2%	8.8%	6.6%	4.8%	(9.6%)	(16.0%)	(10.5%)
S&P 500	12.7%	12.9%	11.3%	10.6%	(10.6%)	(20.0%)	(16.1%)
Russell 3000 Value	10.4%	10.4%	7.0%	6.8%	(7.5%)	(13.2%)	(12.4%)

Calendar Year	Pure Gross-of-Fees[4]	Net-of-Fees[5]	S&P 500	R3000 Value	Difference (Gross-S&P500)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	S&P 500 3yr Std Dev	R3000V 3yr Std Dev	Composite Dispersion
2009**	7.5%	6.7%	6.0%	4.2%	1.4%	40	$7,190	$533,832	N/A	N/A	N/A	N/A
2010	16.8%	13.3%	15.1%	16.3%	1.7%	138	$33,407	$751,909	N/A	N/A	N/A	0.4%
2011	8.9%	5.7%	2.1%	(0.1%)	6.8%	325	$68,562	$937,487	N/A	N/A	N/A	0.5%
2012	9.2%	6.0%	16.0%	17.6%	(6.8%)	414	$91,822	$1,272,265	12.7%	15.1%	15.8%	0.2%
2013	31.4%	27.5%	32.4%	32.7%	(1.0%)	536	$153,123	$1,955,915	10.3%	11.9%	12.9%	0.4%
2014	12.0%	8.7%	13.7%	12.7%	(1.7%)	942	$257,782	$2,589,024	8.1%	9.0%	9.4%	0.2%
2015	1.6%	(1.4%)	1.4%	(4.1%)	0.3%	1,265	$311,651	$3,175,419	9.5%	10.5%	10.7%	0.3%
2016	17.0%	13.5%	12.0%	18.4%	5.1%	1,714	$470,340	$4,413,659	9.2%	10.6%	11.0%	0.3%
2017	19.8%	16.2%	21.8%	13.2%	(2.0%)	2,254	$698,440	$5,944,479	8.5%	9.9%	10.3%	0.4%
2018	(3.8%)	(6.6%)	(4.4%)	(8.6%)	0.6%	2,539	$699,689	$5,486,737	9.8%	10.8%	11.1%	0.3%
2019	29.9%	26.0%	31.5%	26.2%	(1.6%)	3,193	$1,079,861	$7,044,708	10.9%	11.9%	12.0%	0.4%
2020	10.7%	7.4%	18.4%	2.9%	(7.7%)	3,269	$1,159,219	$6,889,798	16.5%	18.5%	20.0%	0.8%
2021	22.6%	19.0%	28.7%	25.3%	(6.1%)	2,083	$891,288	$7,761,687	16.0%	17.2%	19.3%	0.5%

**Average annualized returns*

***Inception is 10/1/2009*

See performance disclosures on last page.

Portfolio Benchmarks

S&P 500® Index – A capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Russell 3000® Value Index – A capitalization-weighted index designed to measure performance of those Russell 3000® Index companies with lower price-to-book ratios and lower forecasted growth values. *(Source: Bloomberg)*

Disclosures

Market & Strategy Commentary—*Figures 10 and 11:* Charts from Ned Davis Research show the S&P 500 Index split by each constituents' dividend policy. Returns are based on monthly equal-weighted geometric average of total returns of S&P 500 component stocks, with components reconstituted monthly. Dividends are assumed to be reinvested. Dividend rates are not guaranteed payments, nor can they guarantee a rate of return. *Dividend Paying* and *Non-Paying* stocks are defined by each stock's dividend policy determined on a rolling 12-month basis. The dividend figure used to categorize the stock is the company's indicated annual dividend, which may be different from the actual dividends paid. *Dividend Growers/ Initiators* is a subset of dividend-paying stocks and include stocks that increased their dividend any time in the last 12 months. Once an increase occurs, it remains classified as a grower for 12 months or until another change in dividend policy. For illustrative purposes only & not representative of any specific investment.

Information is presented as supplemental information to the disclosures required by GIPS® standards. Individual holding performance and contribution methodology as well as a list of every holding's contribution to the strategy can be obtained by contacting Confluence. Material is published solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or investment product. Opinions and estimates are as of a certain date and subject to change without notice. Past performance is no guarantee of future results.

Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable. It is important to review your investment objectives, risk tolerance, and liquidity needs before choosing an investment style or manager. All investments carry a certain degree of risk, including possible loss of principal, that investors should be prepared to bear. Equity securities are subject to market risk and may decline in value due to adverse company, industry, or general economic conditions. There can be no assurance that any investment objective will be achieved or that any investment will be profitable or avoid incurring losses.

Indices: The S&P 500 Index and Russell 3000 Value Index are shown as additional information. These indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only & do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

[1] **Annual Dividend Statistics—***Figure 9:* As of 12/31/2021, the methodology has been changed to show dividend growth based on when the increase was announced versus the previous methodology which used dividend pay dates. Using the announced date should be more timely and could impact which year a dividend increase falls within, but should not change a company's overall history of increasing dividends. Annual dividend income history is available upon request. 'YTD 2022' shows statistics for the portfolio at 6/30/2022.

[2] **Contribution—**Table showing the top 5 contributors/detractors reflects the strategy's best and worst performers, based on each holding's contribution to the sample account for the period stated. Holdings identified do not represent all of the securities purchased, sold or recommended. Individual client portfolios in the strategy may differ, sometimes significantly, from these listings. Contact Confluence for a complete list of holdings.

[3] **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 Increasing Dividend Equity Account (IDEA) strategy was incepted on October 1, 2009, and the Increasing Dividend Equity Account (IDEA) Composite was created on October 1, 2009. 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.
[4] Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.
[5] 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: 0.60% on the first $500,000; 0.55% on the next $500,000; and 0.50% 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. 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.
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 IDEA Composite contains fully discretionary IDEA wrap accounts. The IDEA portfolio is selected from a universe of stocks, from all market capitalizations, meeting minimum criteria of paying & increasing dividends over the last 10 years.
**Results shown for the year 2009 represent partial period performance from October 1, 2009, through December 31, 2009. 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.

About Confluence Investment Management LLC

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

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