

Equity Strategies • Increasing Dividend Equity Account (IDEA)

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 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 portfolio is suitable for clients seeking total return from dividend income and capital appreciation.

Portfolio Commentary

The IDEA portfolio increased 7.2% year-to-date in 2018 following a 5.4% return in the third quarter (gross of fees). By comparison, the S&P 500 returned 10.6% and 7.7%, respectively, over the same periods. *(The portfolio was up 4.8% and 4.6% (net of fees), respectively, over the same time periods. Net of fees calculated using the highest applicable annual bundled fee of 3.00%. See performance disclosures on p. 3 for fee description; actual investment advisory fees may vary.)*

The broad equity markets have been strong over the past 18-24 months as the economic backdrop, aided by tax reform and regulatory relief, provided a nice tailwind for earnings growth. Although strength in the domestic economy has been relatively broad based, equity returns have not. At this stage in the bull market, investors are increasingly leaning toward businesses that exhibit above-average sales growth/momentum while paying less attention to valuations. In fact, the Russell Growth indices have been handily outperforming their Value counterparts the past two years (see table below).^[1]

Index	2017	2018 (thru Sept)
S&P 500	21.8%	10.6%
Russell 3000 Value	13.2%	4.2%
Russell 3000 Growth	29.6%	17.0%
Dividend Payers*	16.8%	4.0%
Non-Payers*	13.1%	14.8%

**Equal-weighted returns of S&P 500 component stocks*

During the quarter, fears of a trade war and ongoing Fed rate increases continued to hang over the markets. Still, the S&P 500 rebuked the old adage of “sell in May and go away” as it set new all-time highs.

China’s entry into the WTO in 2001 brought a boom in global trade, the benefits of which are now being

reevaluated. While this global trade growth brought prosperity and relative peace to the developing world and low inflation globally, it also exacted a heavy toll on labor’s share of national income and intellectual property rights in the West. Efforts to balance these factors are now manifesting politically around the world.

Despite these concerns, in August the NFIB Small Business Optimism Index broke the 45-year record high set in 1983. Similarly, valuations in the stock market are consistently at the high end of the historical range with few pockets of undervalued companies. Looking forward, we expect continued economic expansion as monetary policy remains accommodative and fiscal policy leans toward a friendlier business climate, resulting in a more optimistic business outlook. We also expect inflation and inflation expectations to remain in check near current levels, which supports market valuations. With these economic blue skies it is easy to become complacent, but we continue to stay focused on owning good companies with growing dividends at reasonable prices and will patiently wait for attractive buying opportunities.

The IDEA portfolio has mostly kept up with the S&P 500 year-to-date despite rising interest rates (which tend to pressure dividend-paying stocks) and market returns that have been concentrated in three sectors: information technology, consumer discretionary (mostly Amazon* and Netflix,* which are about 75% of the sector’s return in 2018) and healthcare. *(*neither name is owned in IDEA)*

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Portfolio Commentary continued...

Given IDEA's focus on high-quality companies with a track record of paying and growing dividends, the portfolio tends to hold more financial and industrial companies and fewer information technology companies. As a result, this has been a drag on relative performance so far in 2018.

There were no portfolio changes during the quarter. From a holdings perspective, the top-performing and worst-performing positions during the quarter were as follows in the table to the right:

Security	Avg Wgt	Return	Contrib
Top 5			
Mastercard Inc.	2.74	13.44	0.32
Medtronic plc	2.25	15.55	0.33
Microsoft Corporation	2.54	16.70	0.41
Donaldson Company, Inc.	1.71	29.61	0.46
The TJX Companies, Inc.	2.85	18.11	0.49
Bottom 5			
Polaris Industries Inc.	2.20	(16.92)	(0.41)
MDU Resources Group, Inc.	1.78	(9.80)	(0.18)
Schlumberger Ltd.	1.58	(8.44)	(0.14)
T. Rowe Price Group, Inc.	2.47	(5.35)	(0.13)
The Southern Company	1.60	(4.57)	(0.07)

(Attribution data shown from a sample account)

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. This 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. Information is presented as supplemental information to the disclosures required by GIPS® standards. Opinions and estimates are as of a certain date and subject to change without notice. Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable. Past performance is no guarantee of future results. There can be no assurance that a purchase of the stocks in this portfolio will be profitable, either individually or in the aggregate, or that such purchase will be more profitable than alternative investments, including the risk that our estimate of intrinsic value may never be realized by the market or that the price goes down.

Indices: The S&P 500 and Russell 3000 Value 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. **Table/Chart Data Sources:** ⁽¹⁾ Source: CIM, Ned Davis.

ANNUAL DIVIDEND STATISTICS FOR IDEA PORTFOLIO ON 12/31

Year	Holdings	Avg. Yield	Dividend Change from Prior Year*					Annual Dividend Increases Over Past 10 Years*			
			# of companies with			Avg. Growth	Indexed Growth**	# of companies with			Avg. 10 yr Growth
			Increase	Flat	Decrease			10 years	9 years	< 9 years	
2009	49	2.8%	45	4	0	8.1%	\$3,026	38	6	5	13.3%
2010	49	2.8%	45	4	0	8.0%	\$3,267	38	3	8	12.6%
2011	49	2.8%	46	3	0	9.6%	\$3,581	38	4	7	12.5%
2012	48	3.1%	46	2	0	9.1%	\$3,907	39	5	4	12.8%
2013	49	2.3%	48	1	0	10.0%	\$4,297	41	3	5	13.1%
2014	49	2.4%	48	1	0	10.3%	\$4,739	39	3	7	12.7%
2015	49	2.8%	47	2	0	9.7%	\$5,201	40	3	6	11.9%
2016	50	2.3%	46	4	0	7.2%	\$5,575	39	1	10	11.4%
2017	48	2.1%	45	3	0	7.5%	\$5,994	37	1	10	10.5%

*Excludes impacts of special dividends and spin-offs.

**The Indexed Growth column is an estimate of annual dividends based on the cumulative growth of an account initially funded with \$100,000 on 12/31/2008. It does not represent actual results.

Yield data source: FactSet. Weighted average dividend yield of holdings in the portfolio, calculated based on annualized current dividends.

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10 Largest Portfolio Holdings (as of 9/30/18)

Company Name	Ticker	Weight	Company Sector	Yield	Sectors	
The Home Depot, Inc.	HD	2.5%	Consumer Discretionary	2.0%	Consumer Discretionary	14.1%
The TJX Companies Inc.	TJX	2.5%	Consumer Discretionary	1.4%	Consumer Staples	8.8%
Becton, Dickinson and Company	BDX	2.4%	Health Care	1.1%	Energy	5.1%
Stryker Corporation	SYK	2.4%	Health Care	1.1%	Financials	18.0%
Analog Devices, Inc.	ADI	2.4%	Information Technology	2.1%	Health Care	10.6%
Donaldson Company, Inc.	DCI	2.3%	Industrials	1.3%	Industrials	16.0%
Brown & Brown, Inc.	BRO	2.3%	Financials	1.1%	Information Technology	13.0%
Mastercard Inc.	MA	2.3%	Information Technology	0.4%	Materials	5.8%
NIKE, Inc. (Class B)	NKE	2.2%	Consumer Discretionary	0.9%	Real Estate	0.0%
Medtronic plc	MDT	2.2%	Health Care	2.0%	Communication Services	0.0%
					Utilities	5.5%

Portfolio Statistics

# of Holdings	49
Average Dividend Yield	2.2%
Average Price to Earnings-LTM	23.0
Average Price to Book	6.1

Portfolio Changes in Q3 2018

No Changes	
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Market Capitalization

Large Cap	77%
Mid Cap	18%
Small Cap	2%
Weighted Average (\$ billions)	101.2
Largest	877.0
Median	60.7
Smallest	1.0

The listing of "10 Largest Holdings" is not a complete list of all stocks 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. Sector weightings and holdings of individual client portfolios in the program may differ, sometimes significantly, from these listings. Contact Confluence for a complete list of holdings. Yield data source: FactSet. Weighted average dividend yield of holdings in the portfolio, calculated based on annualized current dividends.

All investments carry a certain degree of risk, including possible loss of principal. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager. Equity securities are subject to market risk and may decline in value due to adverse company, industry or general economic conditions.

Performance Composite Returns For Periods Ending 9/30/18

	Pure Gross-of-Fees ¹	Net-of-Fees ²	S&P 500	R3000 Value
QTD	5.4%	4.6%	7.7%	5.4%
YTD	7.2%	4.8%	10.6%	4.2%
1-Year	14.8%	11.4%	17.9%	9.4%
3-Year*	16.9%	13.4%	17.3%	13.7%
5-Year*	13.2%	9.8%	13.9%	10.6%
Since Inception**	14.4%	11.0%	14.3%	12.3%

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

The Increasing Dividend Equity Account (IDEA) Composite was created on October 1, 2009. 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.

¹ Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

² 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 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 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 and 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.

	Pure Gross-of-Fees ¹	Net-of-Fees ²	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
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%
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%
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%
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%
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%
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%
2011	8.9%	5.7%	2.1%	(0.1%)	6.8%	325	\$68,562	\$937,487	N/A	N/A	N/A	0.5%
2010	16.8%	13.3%	15.1%	16.3%	1.7%	138	\$33,407	\$751,909	N/A	N/A	N/A	0.4%
2009**	7.5%	6.7%	6.0%	4.2%	1.4%	40	\$7,190	\$533,832	N/A	N/A	N/A	N/A

Portfolio Benchmarks

S&P 500 Index – A capitalization-weighted index of 500 stocks. The Index is 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.

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. The Confluence team has more than 400 years of combined financial experience and 200 years of portfolio management experience.