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

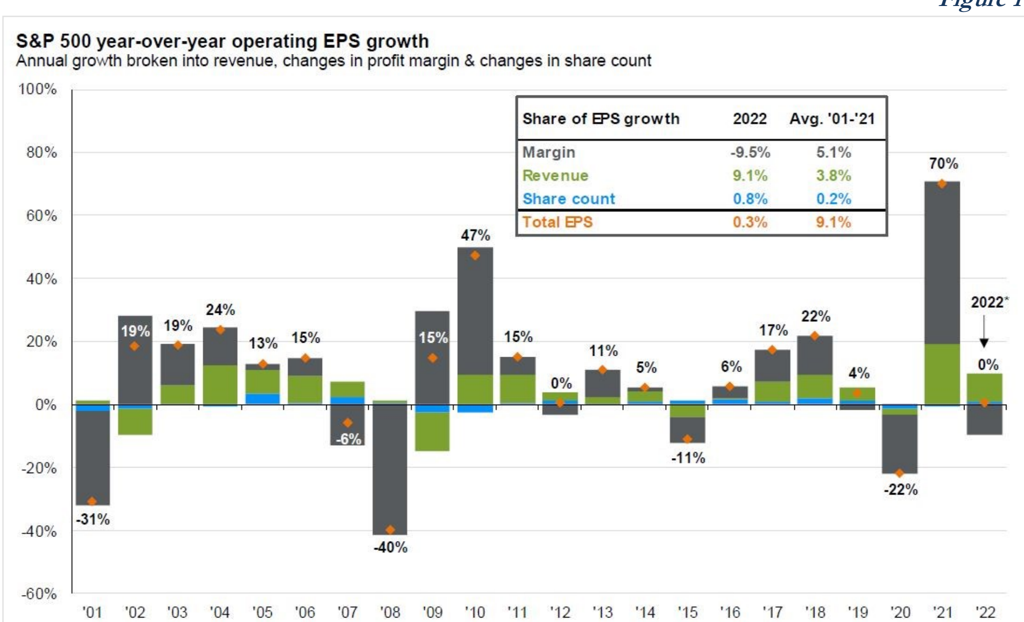
"Waiting for the bottom is folly. What, then, should be the investor's criteria? The answer's simple: if something's cheap — based on the relationship between price and intrinsic value — you should buy, and if it cheapens further, you should buy more."

- Howard Marks, co-founder at Oaktree Capital Group LLC

The broad equity markets remain in bear market territory as investors continue to grapple with inflation and the ensuant monetary policy response. The Federal Reserve remains adamant that it will take the necessary actions needed to curtail inflation, and while market participants appear reticent of that fact, they are eager for the Fed to pivot toward friendlier monetary policy. This is apparent in the handful of market rallies, five thus far in 2022, that were precipitated by a weak economic data point and lifted the markets between 6% and 17%. These rallies have proven to be short-lived as inflation remains stubbornly elevated and the Fed steadfast in its monetary policy tightening. The Fed has raised the federal funds rate in 2022 from a floor of 0-0.25% to 3.00-3.25%, with the latest increase of 75 bps in late September. The net effect has been upward pressure on longer rates as the 10-year Treasury yield is up from 1.52% at the beginning of the year to 3.83% at quarter end, which has weighed on equity markets and resulted in three consecutive quarters of negative returns for the broad market, as measured by the S&P 500 Index (Q1 -4.6%, Q2 -16.1%, and Q3 -4.9%). Such a poor start to the year was last witnessed in 2008 and leaves the S&P 500 down 23.9% for the year.

The policy tools available to the Federal Reserve to stem inflation, and inflation expectations, are limited and primarily influence demand through the level of rates and/or liquidity (Quantitative Easing/Tightening). Thus far in 2022, the policy effects have been limited as the drawdown in equity markets has been driven primarily by a contraction in the multiple that investors are willing to pay for earnings. As reflected by this first chart from J.P. Morgan Asset Management (*Figure 1*), revenue and earnings growth have remained positive despite the sharp pullback in the equity markets. Meanwhile, the chart on the next page (*Figure 2*), also from J.P. Morgan Asset Management, shows the sharp decline in the forward P/E from over 22x to 15.15x. This reflects the dramatic shift in sentiment, as well as concern, for future demand and earnings as Fed policy operates with a lag.

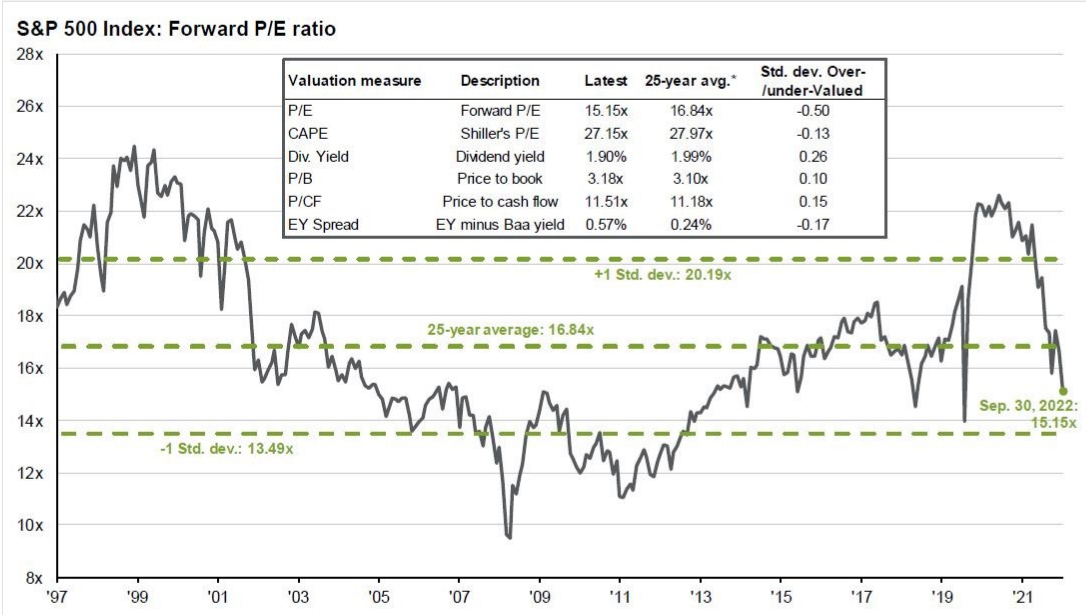
Figure 1



(Chart source: J.P. Morgan Asset Management; Guide to the Markets®, U.S. 4Q2022, as of September 30, 2022)

Market Commentary continued...

Figure 2

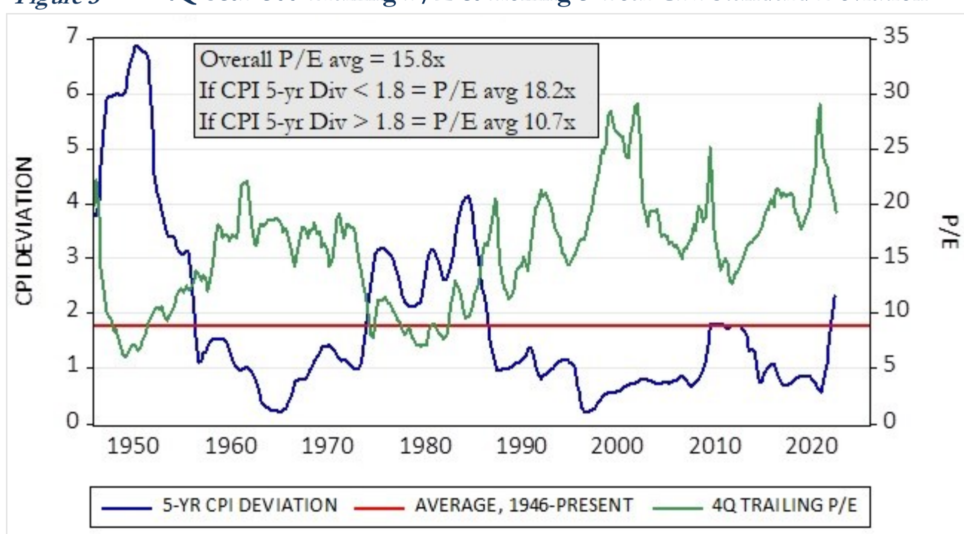


(Chart source: J.P. Morgan Asset Management; Guide to the Markets®, U.S. 4Q2022, as of September 30, 2022)

For investors, the importance of containing inflation is rather straightforward as the present value of a dollar returned in the future is worth less in an inflationary environment. As inflation rises, a higher required return is sought, which elevates the discount rate and lowers the present valuation, i.e., lower earnings multiple. If inflationary expectations become engrained, behavior also changes as purchasing an item at today's price is more advantageous than waiting and paying a higher price later. This lifts current demand and puts additional pressure on supply, causing prices to move even higher and thus triggering an inflation spiral.

This chart from the Confluence Investment Management macro team (*Figure 3*) shows the negative impact on P/E multiples during periods of volatile or uncertain inflation. The graph maps the deviation of the Consumer Price Index (CPI) from the five-year rolling CPI and reflects an inverse relationship of lower multiples when the deviation is higher. Investors naturally prefer lower levels of inflation, and inflation expectations, as reflected by the higher multiples afforded in those environments.

Figure 3 **4Q S&P 500 Trailing P/E & Rolling 5-Year CPI Standard Deviation**



Sources: Robert Shiller, Haver Analytics, CIM

Reining in inflation and expectations of inflation has been the policy aim of the Federal Reserve's actions to date. While the impact to the economy will take time to be fully felt, the key issue is how staunch Fed Chair Powell will remain should inflation stay elevated and the economy retracts. The answer may not lie with economics but rather behavioral science as his desire to remain in good stead in Washington is also a factor. For equity investors, the market declines have been sharp and broad-based, with the Energy sector as the exception, and now provide even more compelling valuations for long-term investors. Fortunately, these types of environments often create opportunities for long-term, fundamental investors to uncover some great companies trading at attractive valuations.

Strategy Commentary

The stock market continued to sell off in the third quarter of 2022, with high inflation and rising interest rates as the primary culprits. Over the past 25 years, stock market sell-offs have usually been met by the "Fed put" (interest rate cuts) to support asset prices, but now inflation is holding the Fed's feet to the fire to stay the course on higher interest rates. With the dramatic increase in the federal funds rate in 2022 and core inflation hopefully pulling back, the U.S. could have a real (i.e., above-inflation) interest rate in 2023, which would be a return to pre-2008 normalcy and may give the Fed an opportunity to pause.

Despite higher inflation, rising interest rates, and a bear market (defined as a 20% decline from the market high), the companies held in the Increasing Dividend Equity Account (IDEA) strategy continued to grow their dividends. As shown in the table (*Figure 4*), 34 of the 49 companies in the current portfolio have raised their dividend year-to-date as of 9/30/2022, with an average announced growth rate of 9.8%. 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.

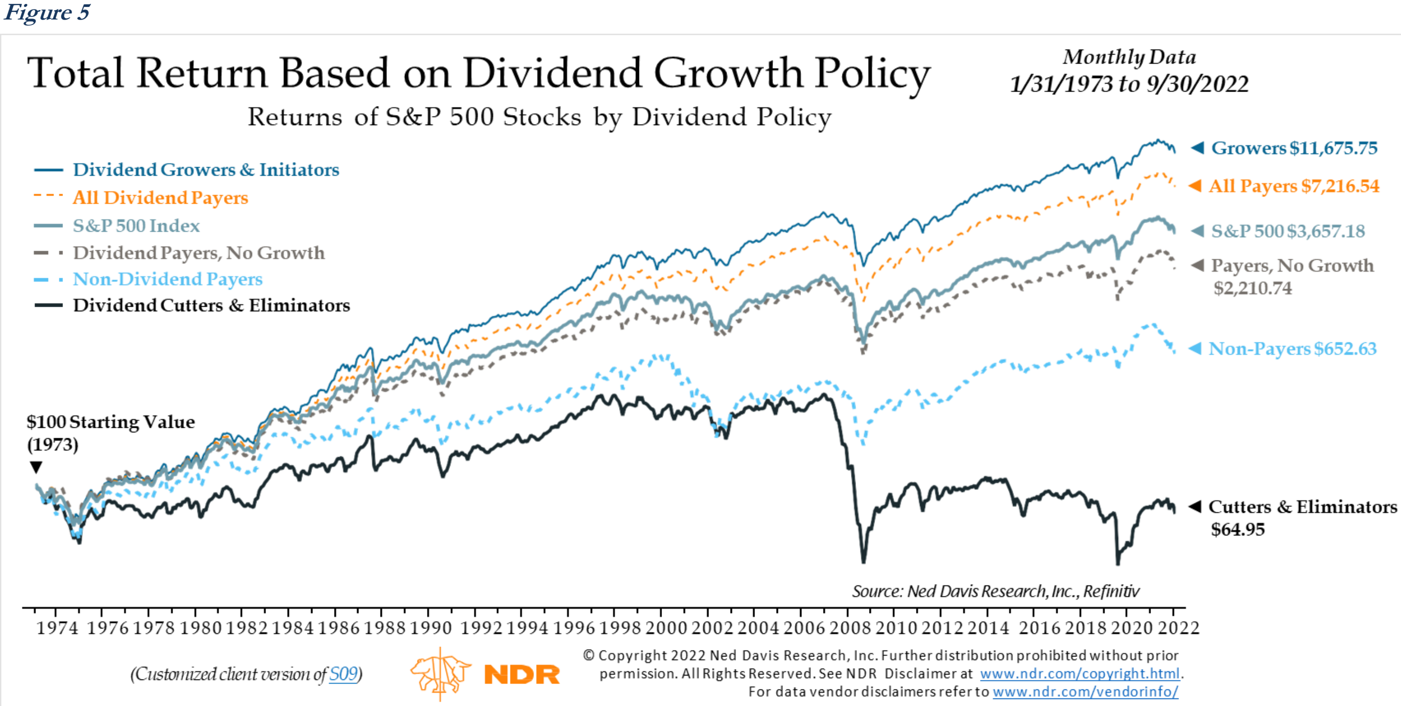
Figure 4 **Annual Dividend Statistics for IDEA Portfolio at 12/31** ***(Dividend Growth Using Announcement Date)*** [1]

			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*	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 (9/30/22)	49	2.3%	34	-	0	9.8%

** '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 5*), $100 invested in dividend growers in 1973 is now worth $11,675, while $100 invested in dividend cutters is only worth $65 today.

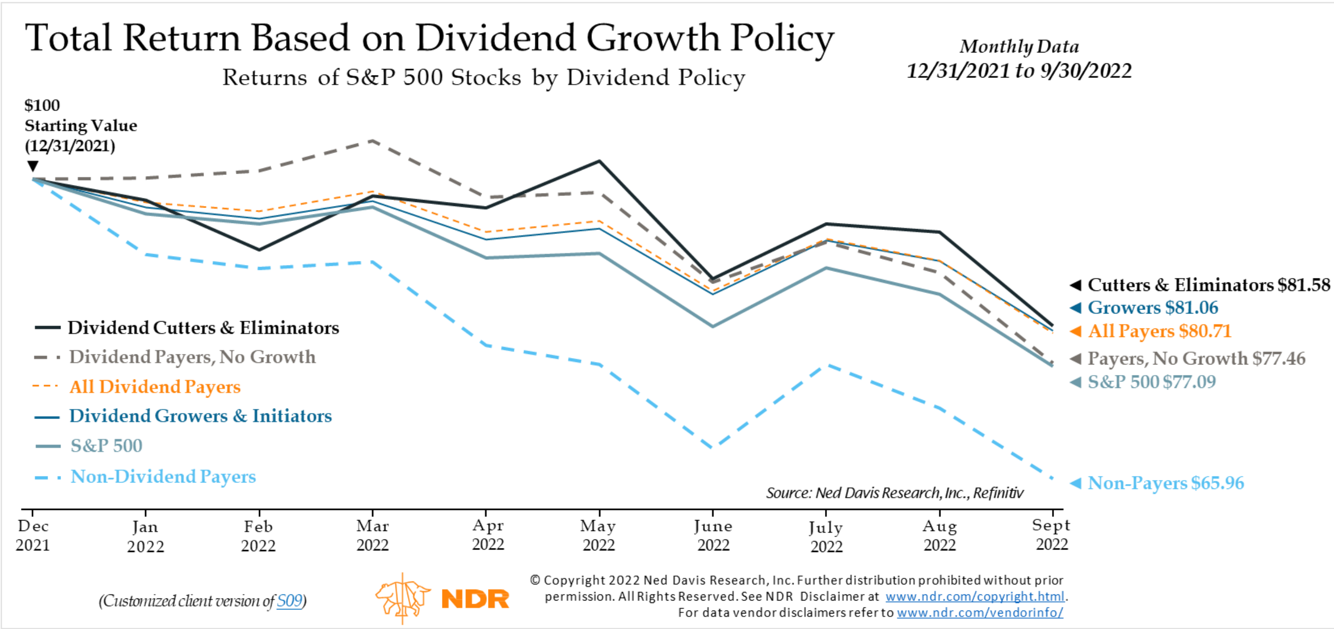
Figure 5



Strategy Commentary continued...

Through the third quarter, investors continued to move toward quality companies with attractive valuations, strong cash flow, low leverage, and dividends and away from expensive high-growth stocks and speculation, which tend not to pay dividends. This is reflected in the chart below (*Figure 6*), with non-dividend-paying stocks down 34.0% year-to-date, while dividend-paying stocks were down 19.3%.

Figure 6



In comparison, Confluence IDEA is down 17.8% year-to-date following a 3.6% decline in the third quarter (both gross of fees), outperforming the S&P 500 Index, which is down 23.9% year-to-date after falling 4.9% during the quarter. [*Net-of-fees returns for the same periods were -4.3% QTD and -19.6% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

A focus on increasing dividends has driven the outperformance year-to-date as our bank and insurance holdings outperformed in the Financials sector, and a lack of exposure to non-dividend-paying Technology and Communications stocks also benefited relative performance. This outperformance was partially offset by less exposure to the Energy and Health Care sectors, where long-term rising dividends are harder to come by. From a security-specific perspective, the strongest contributors this year have been more defensive companies (Chevron, Hershey, Lockheed Martin) and banks that benefit from rising interest rates (M&T Bank, Cullen/Frost). Conversely, the weakest contributors are businesses that are hurt by rising interest rates and their impact on housing (Fortune Brands), company valuations (Nike, Expeditors International, American Water Works), and the stock market (T. Rowe Price).
[*See contribution data on the next page.*]

As shown in the "Forward P/E ratio" chart (*Figure 2*) in the **Market Commentary** section, valuations in aggregate (around 15x earnings) have reverted to levels that should begin to provide some downside support. This can also be seen in our IDEA portfolio, which is currently trading around 16x earnings for a collection of growing dividend companies that we believe are higher quality and have lower debt and stronger sustainable growth than the S&P 500 in aggregate. We are always looking to purchase these types of companies at attractive valuations. As a result, during the third quarter, we made some opportunistic additions that are still in process which we will discuss in next quarter's commentary.

Outlook

With price-to-earnings multiples now back to more reasonable levels, the next area of focus will be the earnings outlook over the next six months as the rapid increase in the fed funds rate starts to take hold. Ironically, with the economy at full capacity (supply chain, labor, etc.), high demand, which is usually a good thing, can be detrimental because it drives higher inflation. Stated another way, strong economic demand is a good problem to have if the Fed can just get inflation in check without causing a severe recession.

In this bear market, the companies in the IDEA portfolio have provided downside protection, while continuing to grow their dividends. Increasing dividends provide growing income for investors and also indicate business attributes and competitive advantages that have historically driven long-term stock outperformance, including through periods of higher inflation.

Looking forward, as recession fears and the bear market drag on, at some point enough investors will capitulate to cause a bottom in the market and a base for growth from there. In the meantime, we continue to focus on owning high-quality companies that have pricing power, conservative balance sheets, and the ability to compound earnings and grow dividends over the long term. The current outlook is filled with uncertainty and anxiety in real time, but in hindsight these periods usually provide opportunities to buy great businesses with growing dividends at attractive prices.

Contribution[2]

(YTD as of 9/30/2022)

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

Security	Avg Weight (%)	Contribution (%)
Top 5		
Chevron Corp.	2.03	0.30
Hershey Co.	2.34	0.28
M&T Bank Corp.	1.64	0.20
Lockheed Martin Corp.	2.57	0.16
Cullen/Frost Bankers Inc.	2.24	0.11
Bottom 5		
American Water Works Co. Inc.	2.34	(0.77)
T. Rowe Price Group Inc.	1.52	(0.87)
Expeditors International of Washington Inc.	2.51	(0.95)
NIKE Inc.	1.59	(0.99)
Fortune Brands Home & Security	1.69	(0.99)

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

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

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
IDEA *Pure Gross-of-Fees[4]*	12.0%	11.3%	8.3%	5.6%	(8.9%)	(17.8%)	(3.6%)
Max Net-of-Fees[5]	8.7%	8.0%	5.1%	2.5%	(11.6%)	(19.6%)	(4.3%)
S&P 500	12.0%	11.7%	9.2%	8.1%	(15.5%)	(23.9%)	(4.9%)
Russell 3000 Value	9.7%	9.1%	5.1%	4.3%	(11.8%)	(18.0%)	(5.6%)

Calendar Year	Pure Gross-of-Fees[4]	Max 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)*

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Disclosures

Market & Strategy Commentary—*Figures 5 and 6:* 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.

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 4:* 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 9/30/2022.

[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.