Confluence Investment Management

Fourth Quarter 2020

Large Cap Value • Value Equity Strategies

Large Cap Value is focused on seasoned companies that generally have capitalizations above $10 billion. Companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess substantial competitive advantages and that are trading at discounts to our estimate of intrinsic value. The portfolio typically comprises 23-25 holdings and is expected to result in low to moderate turnover. The strategy is appropriate for clients whose primary objective is capital appreciation and whose secondary objective is dividend income.

Market Commentary

Following an arduous start to 2020, equity markets strung together three quarters in a row of solid returns, including a strong finish in the fourth quarter with the S&P 500 Index up 12.1% and the Russell 1000 Value Index up 16.2%. The quarter helped drive results for the year, with the S&P 500 up 18.4% in 2020, well ahead of the Russell 1000 Value which was up 2.8%.

The year 2020 will be a year many will never forget. It was also a year that, ironically, began with broad enthusiasm driven by the continued economic expansion, the longest in history, highlighted by low unemployment and low inflation. This was reflected in equity market sentiment, aided by the extremely strong returns generated in 2019 (S&P 500 +31.5% and Russell 1000 Value +26.5%). Any apprehension generally centered around possible actions of the Federal Reserve and/or geopolitical concerns surrounding trade and tariffs. In fact, one of our concerns was the possibility of a melt-up in the equity markets given the optimism and backdrop. Of course, the best laid plans for 2020 were put to rest early as a new and deadly coronavirus quickly spread around the globe, turning sentiment from optimism to fear and anxiety. As Mike Tyson once stated, "Everyone has a plan until they get punched in the face." The contagious and life-threatening virus, combined with the actions of world leaders to shut down large parts of the economy, put the global economy on its back in short order. If not for the quick and decisive actions by the Federal Reserve to inject liquidity in late March and the broad stimulus enacted by Congress, the path to economic stability would have been elongated. Instead, we will have likely had a full economic and market cycle in a matter of months.

It was harrowing at times as equities posted dramatic losses with the sharpest decline since the 1930s. People were fearful for the health of themselves and their loved ones, which took a toll on their wellbeing and the economy as fear and lockdowns halted activity. While monetary and fiscal stimulus provided the ballast for the economy and aided the underlying equity markets, the response to the lockdowns and remote economy clearly benefited a narrow subset of businesses that tended to be asset-light and "new"-economy focused. These businesses performed extremely well throughout the year, so it is no surprise they attracted investor interest at the expense of the more traditional or mature companies, producing a wide bifurcation in equity returns. These asset-light, new-economy businesses tend to trade at higher valuations and are more representative of the "growth" style, thus they were well represented in the Russell 1000 Growth Index which was up 38.5% in 2020, creating a chasm of over 35% between the Russell 1000 Growth and Value indexes, the largest in its history dating back to 1979. The gap was larger than the technology bubble in 1999 when growth outperformed value by "only" 26%. Even more striking, the outperformance was driven by a relatively few mega-cap, technology-oriented businesses with heavy influence in market cap-weighted indexes. More specifically, the top five companies (Microsoft, Apple, Amazon, Facebook, Alphabet) were up on average over 50% and now represent approximately 22% of the S&P 500, accounting for 56% of the index's return despite representing just 1% (5/500) of the companies in the index.

While we cannot predict the future or when a trend will end, we are able to recognize when the divergence becomes extreme and caution is warranted. For example, if we look back to the late 1990s when growth also dominated, there was no specific event that occurred at the top (March 2000) that triggered the end of the tech bubble. What we do know is that it was an extremely crowded trade that simply ran out of new demand from investors, and with no support from valuations it led to precipitous losses for investors.

Historically, valuations have not been the sole driver of inflection points. In this environment, we can point to a few concerns which may stem the tide, although they are more recognition of issues investors are aware of, yet willing to discount. First, big tech serves the "old"-economy businesses, whether it be cloud hosting (MSFT, AMZN, GOOG), reliance on advertising spend (FB, GOOG), or reliance on the consumer (AAPL, AMZN). As the economy improves, investors could shift from concerns, which seem to be focused on lockdown risk, and diversify, which will broaden the market. We could also see anti-trust concerns resurface, which had bipartisan interest pre-COVID-19. With that said, it is more likely the snake we are looking at is not the one that will bite.

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Market Commentary continued...

For the quarter, the equity market strength can be attributed to growing optimism surrounding the successful development of vaccines which will accelerate herd immunity and allow for a return to normal sooner rather than later. While the path is unlikely to be smooth, the stimulus provides the bridge to economic recovery and ultimately expansion as society gradually normalizes. Equities began to discount these developments in Q4 as evidenced by the strength and, more importantly, the broadening of the market as cyclicals and financials led the way, which helped value outperform growth.

Strategy Commentary

Confluence Large Cap Value also posted a strong finish to the year, up 12.4% in the fourth quarter, which garnered the bulk of its return for the calendar year as the strategy was up 13.0% in 2020 (both gross of fees). [*Net-of-fees returns for the same periods were +11.6% QTD and +9.7% YTD. See disclosures on p.3 for fee description; actual investment advisory fees may vary.*]

This past year certainly tested the of nerves of many investors but ultimately rewarded those who stayed the course. As past market dislocations have shown, adherence to an investment process provides the highest probability of a good outcome, and that was the case in 2020. We have also found it beneficial to take advantage of these dislocations by upgrading the quality of the portfolio. We were able to do just that with the addition of Booking Holdings, Charles River Laboratories, and IHS Markit in the spring at attractive entry points.

We also made some changes during the fourth quarter as we completed the purchase of Dun & Bradstreet (DNB) using proceeds from the sale of Compagnie Financière Richemont. DNB provides commercial data, analytics, and insights for businesses with an extensive history and dataset used to aid businesses with risk management and operations. We have long been attracted to the company but had concerns with the number of leadership changes over the past decade. These apprehensions were alleviated when Bill Foley led an investor group to acquire and install new management.

The top contributors and detractors during the quarter:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Booking Holdings Inc.	3.73	1.15
NXP Semiconductors N.V.	4.39	1.12
Starbucks Corporation	4.40	1.04
Brookfield Asset Management Inc.	4.11	0.96
The TJX Companies, Inc.	3.91	0.85
Bottom 5		
Markel Corporation	2.72	0.17
Black Knight, Inc.	5.30	0.13
Lowe's Companies, Inc.	4.98	(0.12)
Compagnie Financière Richemont SA	Sold	(0.16)
Dun & Bradstreet Holdings, Inc.	3.08	(0.18)

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

The portfolio benefited from the prospect of the economy reopening with the advancement of vaccines. This boosted sentiment for a handful of our consumer-oriented holdings, such as travel-related Booking Holdings and retail-oriented Starbucks and TJX Companies. A few of the laggards were prior leaders Lowe's, which had benefited from the stay-at-home movement, and mortgage software provider Black Knight as well as new addition Dun & Bradstreet.

Reflecting on 2020, we're reminded of the canard of attempting to forecast the future with any degree of certainty. While a pandemic was a probability, albeit a low one, the response was unprecedented. This is why our focus has always been on fundamentals and valuations, with an emphasis on owning competitively advantaged businesses that are conservatively financed and guided by good stewards. Our valuation efforts seek to acquire these businesses at discounts to intrinsic value and we focus on risk mitigation, with risk defined as *the probability of a permanent loss of capital.* It is a philosophy and process our team has consistently deployed over the past few decades, surviving three bear markets.

It is important to note that our focus on value is based on a company's discount to our estimate of its intrinsic value, and when overlaid with the type of competitively advantaged businesses we seek, we are more akin to an "absolute" value approach as opposed to "deep discount" or "relative" value. This differs from the methodology of most value indices which are primarily focused on low valuations with little to no regard for the quality of the business or intrinsic value. From our perspective, a low valuation should not infer underpriced; a low valuation may be fairly priced or overvalued based on the business prospects. With the substantial economic disruptions in 2020, higher quality companies that were more likely to survive or thrive performed much better with little consideration toward valuations. Our focus on quality aided in the relative outperformance to the value benchmark but our discipline on valuations hurt our relative performance to the broad benchmark. Meanwhile, the early stages of an economic cycle generally benefit the lower quality and/or more highly levered businesses that have more exposure to the value indices; this appears to have occurred during the fourth quarter and explains the value outperformance.

Looking forward, we remain committed to our pragmatic approach which strives to temper emotions by focusing on the underlying businesses and what they're worth. Our task is to construct a portfolio of names that we believe have the wherewithal to survive the inevitable downturns, while providing ample opportunities to grow and expand over time. By most accounts it looks like a recovery is underway and poised to gain steam as vaccine distribution accelerates and disrupted supply chains regain efficiency. Continued loose monetary policy and elevated household savings rates further support an economic recovery in 2021. As always, we're grateful for the trust and confidence you've placed in our team.

10 Largest Holdings (as of 12/31/20)

Company	Market Capitalization	Portfolio Weight
	($ billions)	
Lowe's Companies, Inc.	117.6	4.6%
Starbucks Corporation	125.6	4.6%
Black Knight, Inc.	13.9	4.5%
Stryker Corporation	92.1	4.4%
Fastenal Company	28.0	4.3%
NXP Semiconductors N.V.	44.5	4.2%
Booking Holdings Inc.	91.2	4.2%
IHS Markit Ltd.	35.6	4.2%
Brookfield Asset Management Inc.	62.4	4.2%
The TJX Companies, Inc.	82.0	4.2%

The listing of "10 Largest Holdings" is not a complete list of all stocks in the portfolio or which Confluence may be currently recommending. 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.

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 12/31/20

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	S&P 500	R1000 Value
Since Inception**	11.5%	8.4%	10.4%	9.6%
25-Year*	10.8%	7.6%	9.6%	8.8%
20-Year*	9.4%	6.2%	7.5%	6.8%
15-Year*	10.9%	7.6%	9.9%	7.3%
10-Year*	13.6%	10.2%	13.9%	10.5%
5-Year*	12.8%	9.5%	15.2%	9.7%
3-Year*	13.2%	9.8%	14.2%	6.1%
1-Year	13.0%	9.7%	18.4%	2.8%
YTD	13.0%	9.7%	18.4%	2.8%
QTD	12.4%	11.6%	12.1%	16.2%

**Average annualized returns*

***Inception is 10/1/1994*

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 1000® Value Index – A capitalization-weighted index designed to measure performance of those Russell 1000® Index companies with lower price-to-book ratios and lower forecasted growth values.

(Source: Bloomberg)

Calendar Year	Pure Gross-of-Fees[1]	Net-of-Fees[2]	S&P 500	R1000 Value	Difference (Gross-S&P500)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	S&P 500 3yr Std Dev	R1000V 3yr Std Dev	Composite Dispersion
1994**	3.4%	2.6%	(0.0%)	(1.6%)	3.4%	122	$10,206		N/A	N/A	N/A	N/A
1995	32.7%	29.1%	37.6%	38.3%	(4.9%)	178	$24,073		N/A	N/A	N/A	1.1%
1996	29.9%	26.4%	23.0%	21.6%	6.9%	417	$63,132		N/A	N/A	N/A	1.7%
1997	31.9%	28.3%	33.4%	35.2%	(1.5%)	973	$151,053		N/A	N/A	N/A	2.1%
1998	9.0%	6.0%	28.6%	15.6%	(19.6%)	2,360	$297,953		N/A	N/A	N/A	1.8%
1999	2.9%	0.1%	21.0%	7.3%	(18.1%)	2,138	$260,171		N/A	N/A	N/A	1.7%
2000	11.5%	8.4%	(9.1%)	7.0%	20.6%	1,104	$159,096		N/A	N/A	N/A	2.3%
2001	(2.5%)	(5.1%)	(11.9%)	(5.6%)	9.4%	1,065	$145,683		N/A	N/A	N/A	1.1%
2002	(12.2%)	(14.6%)	(22.1%)	(15.5%)	9.9%	1,027	$125,161		N/A	N/A	N/A	0.6%
2003	30.9%	27.3%	28.7%	30.0%	2.2%	1,010	$163,840		15.8%	18.1%	16.0%	1.0%
2004	15.7%	12.6%	10.9%	16.5%	4.8%	1,052	$197,447		13.7%	14.9%	14.8%	1.0%
2005	(1.6%)	(4.3%)	4.9%	7.1%	(6.5%)	1,064	$188,332		8.7%	9.0%	9.5%	0.6%
2006	17.8%	14.5%	15.8%	22.2%	2.0%	957	$198,952		5.8%	6.8%	6.7%	0.6%
2007	5.9%	3.0%	5.5%	(0.2%)	0.4%	834	$174,711		6.7%	7.7%	8.1%	0.6%
2008	(27.0%)	(29.1%)	(37.0%)	(36.8%)	9.9%	119	$25,562	$291,644	13.2%	15.1%	15.4%	N/A
2009	28.6%	24.8%	26.5%	19.7%	2.2%	149	$53,387	$533,832	17.7%	19.6%	21.1%	1.4%
2010	12.1%	8.8%	15.1%	15.5%	(3.0%)	192	$76,040	$751,909	19.7%	21.9%	23.2%	0.4%
2011	6.4%	3.2%	2.1%	0.4%	4.3%	228	$89,145	$937,487	17.1%	18.7%	20.7%	0.3%
2012	19.0%	15.4%	16.0%	17.5%	3.0%	249	$143,568	$1,272,265	13.5%	15.1%	15.5%	0.4%
2013	37.6%	33.6%	32.4%	32.6%	5.2%	373	$208,844	$1,955,915	10.6%	11.9%	12.7%	0.9%
2014	10.7%	7.5%	13.7%	13.4%	(2.9%)	618	$278,339	$2,589,024	8.6%	9.0%	9.2%	0.5%
2015	1.6%	(1.4%)	1.4%	(3.8%)	0.2%	858	$352,556	$3,175,419	10.1%	10.5%	10.7%	0.5%
2016	8.6%	5.4%	12.0%	17.3%	(3.4%)	1,003	$396,038	$4,413,659	10.0%	10.6%	10.8%	0.4%
2017	16.1%	12.6%	21.8%	13.6%	(5.7%)	1,049	$380,737	$5,944,479	9.0%	9.9%	10.2%	0.6%
2018	(4.6%)	(7.4%)	(4.4%)	(8.3%)	(0.2%)	1,029	$364,805	$5,486,737	10.4%	10.8%	10.8%	0.6%
2019	34.5%	30.5%	31.5%	26.5%	3.0%	1,118	$525,944	$7,044,708	11.8%	11.9%	11.8%	0.6%
2020	13.0%	9.7%	18.4%	2.8%	(5.4%)	1,229	$647,076	$6,889,798	18.8%	18.5%	19.6%	0.9%

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, 2019. 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 Large Cap Value Strategy was incepted on October 1, 1994, and the current Large Cap Value Composite was created on August 1, 2008. Performance presented prior to August 1, 2008, occurred while the Portfolio Management Team was affiliated with a prior firm and the Portfolio Management Team members were the primary individuals responsible for selecting the securities to buy and sell. 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.
[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 (2.75% prior to 7/1/08). 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 Large Cap Value Composite contains fully discretionary Large Cap Value wrap accounts. Large Cap Value is a value-based, bottom-up portfolio that utilizes stocks with market capitalizations typically exceeding $10 billion. **Results shown for the year 1994 represent partial period performance from October 1, 1994, through December 31, 1994. 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 and/or performance was calculated quarterly prior to January 2001.

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. 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. 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. Investing in securities involves the risk of loss of the amount invested that investors should be prepared to bear. 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 1000 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.*