Confluence INVESTMENT MANAGEMENT

FIRST QUARTER

2021

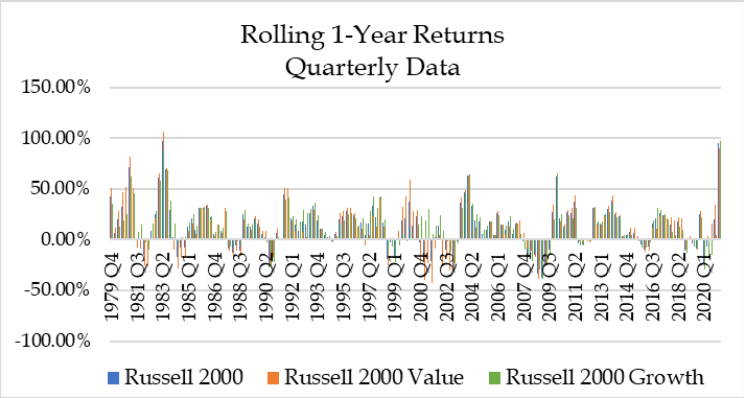
Small Cap Value • Value Equity Strategies

Small Cap Value is focused on companies that generally have capitalizations below $2 billion. These companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess competitive advantages and that are trading at substantial discounts to our estimates of intrinsic value. The portfolio typically comprises 30-35 holdings and is expected to result in low to moderate turnover. The strategy is appropriate for clients whose primary objective is capital appreciation.

Market Commentary

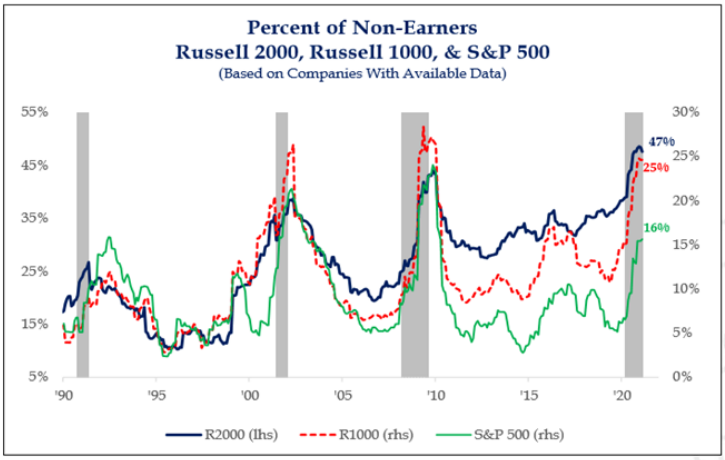
The start of 2021 was quite the contrast to that of 2020 as small caps posted an exceptionally strong first quarter, with the Russell 2000 and Russell 2000 Value Indexes up 12.7% and 21.2%, respectively, compared to the staggering losses posted to start 2020 when the index returns were -30.6% and -35.7%, respectively. The performance tables at the back of this report show the long-term performance history for both indexes along with the Confluence Small Cap Value strategy since inception. Of course, a novel coronavirus, COVID-19, surfaced in the first quarter of 2020 and led to a pandemic which ended the longest economic expansion in history as large parts of the economy were intentionally locked down. The notable shift in sentiment from fear and anxiety to hope and optimism began in late March 2020 in response to monetary policy actions and has been building with each successive monetary and fiscal policy enacted. The latest fiscal policy, the American Rescue Plan Act of 2021, passed in March 2021 and is a $1.9 trillion economic stimulus bill which adds to the unparalleled stimulus enacted during peace time. These policy goals aimed to shorten the duration and lessen the economic impact. Meanwhile, the development of herd immunity from vaccinations and natural infections is helping to reopen the economy safely and has only hastened investors' outlook for a return to normal. With this backdrop, investor sentiment has quickly shifted from panic in the first quarter of 2020 to exuberance in 2021.

This sentiment was well reflected in small caps as they dramatically declined in the first quarter of 2020 and have also reversed thus far in 2021. Sentiment was even more pronounced in the Russell 2000 Value Index, which has far more exposure to the cyclical and commodity-oriented entities and posted an even worse start to 2020 but also a sharper bounce in 2021. The stark turnaround is more reflective in the trailing one-year returns as the Russell 2000 and Russell 2000 Value are up a stunning 94.8% and 97.0%, respectively, as compared to the one-year returns ending last quarter of 19.9% and 4.6%, respectively. The following chart dates back to 1979, the inception of the Russell 2000 indexes, and puts the turnaround in historical perspective as the magnitude of the recent change was last witnessed in 1983 and illustrates the current optimism. It also puts the Russell 2000 and Russell 2000 Value approximately 31% and 23%, respectively, above the pre-pandemic highs reached in late August 2018.



(Source: FTSE Russell Performance Calculator, Confluence)

It is also worth noting that smaller businesses generally have less financial flexibility and struggle more going into a recession which tends to pressure returns relative to their larger cap brethren. As the economy bottoms and begins to recover, the rebound coming out of the recession is generally stronger for small caps. The current cycle is typical; however, the excess liquidity appears to be inducing pockets of excess exuberance. Research firm Strategas produced the following chart that reflects 47% of businesses in the Russell 2000 were not generating earnings, which is the highest level compared to the past few recessions (grey areas).



(Source: Strategas)

Continued on page 2...

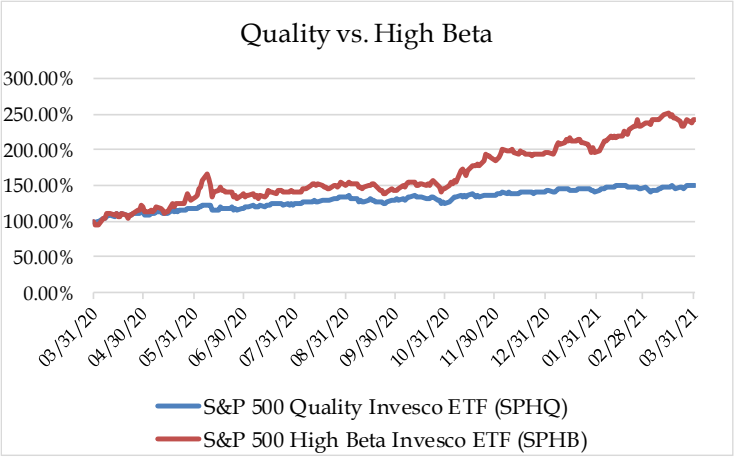
ABOUT CONFLUENCE INVESTMENT MANAGEMENT LLC

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.

20 ALLEN AVE., STE. 300, ST. LOUIS, MO 63119 • (314) 743-5090 WWW.CONFLUENCEINVESTMENT.COM

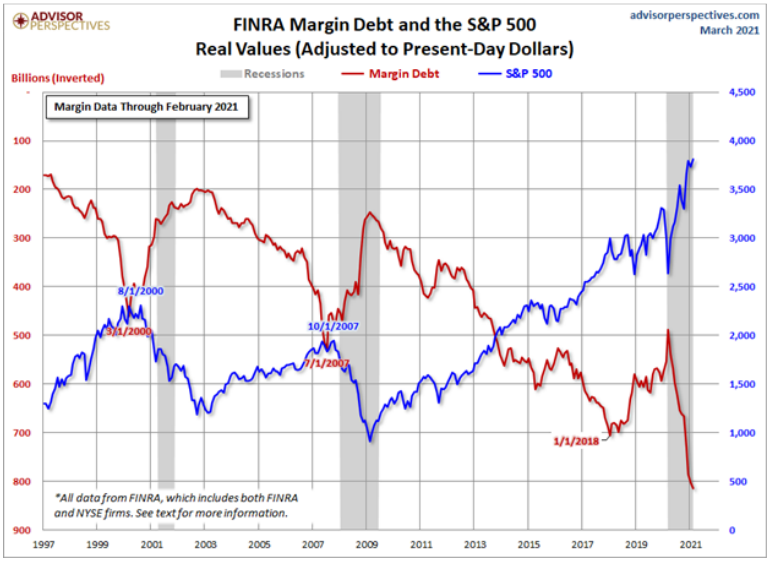
Market Commentary continued...

In fact, dissecting the market a little further, there is a clear bias for lower-quality/high-beta businesses versus higher-quality businesses as evidenced by the Invesco S&P Quality ETF (SPHQ) lagging the Invesco S&P High Beta ETF (SPHB), 50.5% versus 141.8%, respectively, over the trailing one-year period ending March 31, 2021.



(Source: FactSet, Confluence)

When overlaying the market strength with the extent to which investors have been utilizing margin (see the following chart on margin from *Advisor Perspectives*), we do get concerned that investors may be getting ahead of themselves. It is worth highlighting that margin declined during the prior two recessions, which is typical as consumers retrench. However, margin dramatically increased during the current recession, indicating the excess liquidity that is flowing into the equity markets. In this type of environment, it can be difficult to distinguish between smart alpha and leveraged beta, but as Warren Buffett stated, "Only when the tide goes out do you discover who's been swimming naked."



Strategy Commentary

Confluence Small Cap Value also had a strong start in the first quarter of 2021, up 9.0%, which was also quite in contrast to the -26.0% return reported in the first quarter of 2020 (both gross of fees). For the trailing one-year period, Small Cap Value performed quite well, posting a return of 53.9% (gross of fees). In a typical one-year period such returns would be well regarded, but this is an atypical period as discussed previously and brings into focus our investment philosophy as well as the indexes' construction methodology. [*Net-of-fees returns for the same periods were +8.1% Q1 2021, -26.5% Q1 2020, and +49.3% trailing one-year. See disclosures on p.4 for fee description; actual investment advisory fees may vary.*]

As we discussed in our previous quarterly commentary, businesses that were highly levered and/or deeply cyclical experienced severe price pressure in the first few months of 2020 as investors questioned their ability to survive. This is a typical response during the depths of recessions. However, Russell's construction methodology utilizes market capitalization to determine which businesses are placed in the Russell 1000 or Russell 2000, i.e., the largest 1,000 go into the Russell 1000 and the next 2,000 go into the Russell 2000 based strictly on market capitalization. Russell rebalances in late June based on May data and the spring panic of 2020 pushed several highly levered and deeply cyclical businesses into the small cap indexes. The subsequent rebound has been driven by these very businesses. For example, the Consumer Discretionary sector posted returns of +200%, Energy +140%, and Materials +130%—these are entire sectors! There were some spectacular returns generated over the period in some large businesses, such as GameStop (GME, +5,323%), At Home Group (HOME, +1,320%), Michaels (MIK, +1,259%), Penn National Gaming (PENN, +729%), and Caesars Entertainment (CZR, +507%).

Our investment philosophy is focused on understanding and valuing individual businesses with the emphasis of owning great businesses at bargain prices. This is a fundamental approach that views risk as the probability of a permanent loss of capital as opposed to tracking error of a benchmark. The attributes of great businesses that we look for (substantial competitive advantages, pricing power, free cash flow generation, and high returns on invested capital) are often difficult to find in commodity-oriented or highly regulated businesses in which pricing is contingent on factors outside management's control. This will often result in over/under-weighting certain areas of the market that either offer more attractive valuations or have superior underlying attributes. Subsequently, performance in any given time frame will be impacted by the market's perception of the value of these individual businesses compared to the broad market. Our focus on higher-quality names is reflected at these inflection points.

Continued on page 3...

Strategy Commentary continued...

For the quarter, the portfolio performed well but did lag the respective indexes and had a wide dispersion of returns across holdings. The relative performance is reflective of our focus on quality businesses, i.e., strong competitive positions and positive cash flow, as opposed to the commodity-oriented banks and energy that performed well in the quarter and have larger weightings in the indexes. Our weighting in Financial Services is healthy, approximately 22%, but it is skewed toward insurance, both brokers (Brown & Brown and BRP Group) and underwriters (James River Group), that are well positioned to benefit from an improving pricing environment but did not participate to the same extent as the banks. Also detracting from Financials was the position in Cannae, which is an investment portfolio primarily consisting of FinTech businesses and despite a handful of actions that were accretive to net asset value, shares have yet to respond accordingly. Lastly, the Energy sector led the indexes, up over 40%, on the continued strength in oil prices; the portfolio's lack of exposure detracted from relative performance.

The top contributors and detractors during the quarter:

Security	Avg Weight (%)	Contribution (%)
Top 5		
Movado Group, Inc.	3.04	1.72
Kadant Inc.	4.23	1.23
Winnebago Industries, Inc.	3.53	0.88
FARO Technologies, Inc.	3.33	0.69
Veritex Holdings, Inc.	2.24	0.58
Bottom 5		
James River Group Holdings, Ltd.	3.21	(0.22)
i3 Verticals, Inc.	3.81	(0.26)
SJW Group	3.17	(0.30)
BRP Group, Inc.	4.09	(0.44)
Cannae Holdings, Inc.	4.25	(0.53)

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

Going forward, we expect the economy to continue its recovery and equity markets to maintain a positive bias; however, the abrupt stop and subsequent start of the economy will present challenges from the supply chain to finding employees, which we believe will likely produce volatile economic data and equity markets. Of course, we remain focused on our core strength which is analyzing and valuing businesses. We continue to strive for finding good investment ideas and generating solid long-term results for our clients regardless of the environment as we have done over the past 26 years since the strategy's inception.

10 Largest Holdings (as of 3/31/21)

Company	Market Capitalization	Portfolio Weight
	($ billions)	
Kadant Inc.	2.14	4.7%
Frontdoor, Inc.	4.60	4.2%
Morningstar, Inc.	9.65	4.1%
Movado Group, Inc.	0.66	4.0%
Avanos Medical, Inc.	2.10	3.9%
Cannae Holdings, Inc.	3.63	3.7%
BRP Group, Inc.	2.61	3.6%
Winnebago Industries, Inc.	2.58	3.6%
John Bean Technologies Corporation	4.23	3.5%
RBC Bearings Incorporated	4.95	3.4%

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 March 31, 2021)

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	R2000	R2000 Value
Since Inception**	12.2%	9.0%	10.0%	10.4%
25-Year*	11.8%	8.6%	9.4%	10.0%
20-Year*	11.2%	8.0%	9.8%	9.5%
15-Year*	10.1%	6.9%	8.8%	7.4%
10-Year*	11.3%	8.0%	11.7%	10.0%
5-Year*	12.9%	9.5%	16.3%	13.5%
3-Year*	10.0%	6.7%	14.7%	11.5%
1-Year	53.9%	49.3%	94.8%	97.0%
YTD	9.0%	8.1%	12.7%	21.2%
QTD	9.0%	8.1%	12.7%	21.2%

**Average annualized returns*
***Inception is 10/1/1994*

Calendar Year	Pure Gross-of-Fees[1]	Net-of-Fees[2]	R2000	R2000 Value	Difference (Gross-R2000)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	R2000 3yr Std Dev	R2000V 3yr Std Dev	Composite Dispersion
1994**	(3.3%)	(3.9%)	(1.9%)	(3.0%)	(1.4%)	389	$41,690		N/A	N/A	N/A	N/A
1995	24.2%	20.8%	28.4%	25.8%	(4.3%)	267	$34,667		N/A	N/A	N/A	0.8%
1996	20.7%	17.4%	16.5%	21.4%	4.2%	249	$39,188		N/A	N/A	N/A	1.0%
1997	46.5%	42.5%	22.4%	31.8%	24.1%	353	$63,832		N/A	N/A	N/A	1.1%
1998	(4.2%)	(6.8%)	(2.5%)	(6.5%)	(1.6%)	1,080	$111,513		N/A	N/A	N/A	1.7%
1999	(7.1%)	(9.6%)	21.3%	(1.5%)	(28.4%)	745	$69,869		N/A	N/A	N/A	1.2%
2000	34.4%	30.7%	(3.0%)	22.8%	37.4%	374	$47,699		N/A	N/A	N/A	1.7%
2001	12.6%	9.6%	2.5%	14.0%	10.1%	395	$56,254		N/A	N/A	N/A	0.7%
2002	(11.4%)	(13.8%)	(20.5%)	(11.4%)	9.1%	434	$48,944		N/A	N/A	N/A	0.7%
2003	36.2%	32.5%	47.3%	46.0%	(11.1%)	464	$71,199		15.4%	21.6%	18.4%	0.9%
2004	23.2%	19.9%	18.3%	22.2%	4.9%	572	$101,835		12.7%	19.0%	17.5%	1.4%
2005	8.2%	5.3%	4.6%	4.7%	3.6%	722	$111,469		9.0%	15.1%	14.1%	1.6%
2006	19.1%	15.9%	18.4%	23.5%	0.8%	694	$117,282		7.1%	13.8%	12.3%	1.1%
2007	(1.7%)	(4.4%)	(1.6%)	(9.8%)	(0.1%)	543	$84,018		7.5%	13.2%	12.6%	1.1%
2008	(21.8%)	(24.0%)	(33.8%)	(28.9%)	12.0%	61	$8,568	$291,644	14.0%	19.8%	19.1%	N/A
2009	29.6%	25.8%	27.2%	20.6%	2.4%	54	$9,823	$533,832	20.9%	24.8%	25.6%	2.3%
2010	24.6%	20.9%	26.9%	24.5%	(2.3%)	83	$19,208	$751,909	23.3%	27.7%	28.4%	1.5%
2011	(0.9%)	(3.8%)	(4.2%)	(5.5%)	3.3%	85	$18,032	$937,487	21.8%	25.0%	26.0%	1.2%
2012	16.0%	12.6%	16.3%	18.1%	(0.4%)	105	$26,346	$1,272,265	15.6%	20.2%	19.9%	0.3%
2013	27.4%	23.6%	38.8%	34.5%	(11.5%)	113	$31,217	$1,955,915	12.2%	16.4%	15.8%	0.5%
2014	9.3%	6.1%	4.9%	4.2%	4.4%	140	$34,077	$2,589,024	8.6%	13.1%	12.8%	0.6%
2015	(1.7%)	(4.7%)	(4.4%)	(7.5%)	2.7%	158	$34,928	$3,175,419	10.3%	14.0%	13.5%	0.4%
2016	23.7%	20.0%	21.3%	31.7%	2.4%	198	$56,608	$4,413,659	11.6%	15.8%	15.5%	1.2%
2017	19.5%	16.0%	14.6%	7.8%	4.9%	354	$103,862	$5,944,479	10.8%	13.9%	14.0%	0.9%
2018	(8.6%)	(11.3%)	(11.0%)	(12.9%)	2.5%	400	$88,885	$5,486,737	13.1%	15.8%	15.8%	0.8%
2019	27.0%	23.2%	25.5%	22.4%	1.5%	449	$124,071	$7,044,708	14.5%	15.7%	15.7%	0.8%
2020	4.5%	1.4%	19.9%	4.6%	(15.4%)	400	$122,151	$6,889,798	21.6%	25.3%	26.1%	1.5%

Portfolio Benchmarks

Russell 2000® Index – A capitalization-weighted index measuring performance of approximately 2,000 companies in the Russell 3000® Index.

Russell 2000® Value Index – A capitalization-weighted index designed to measure performance of those Russell 2000® Index companies with lower price-to-book ratios and lower forecasted growth values.

(Source: Bloomberg)

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.

GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

The Small Cap Value Strategy was incepted on October 1, 1994, and the current Small 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: 1.00% on the first $500,000; 0.90% on the next $500,000; and 0.75% 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 Small Cap Value Composite contains fully discretionary Small Cap Value wrap accounts. Small Cap Value is a value-based, bottom-up portfolio that utilizes stocks with market capitalizations typically less than $2 billion. *Smaller capitalization companies, due to their size, are generally more vulnerable to adverse general market or economic developments than larger, more established companies.*

**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 Russell 2000 and Russell 2000 Value Indexes 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.*