First Quarter

2024

Small Cap Value • Value Equity Strategies

Small Cap Value is focused on smaller companies that generally have capitalizations below $3 billion at the time of purchase. 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

In the first quarter of 2024, the equity markets saw a continuation of the Santa Claus rally that ended 2023, with the S&P 500 Index posting a rare back-to-back quarterly gain in the double-digits. The rally was sparked in late October 2023 when the Federal Reserve signaled the end of policy tightening as the downward trend in inflation (aka disinflation) was expected to continue toward the Fed's target of 2.0%. In short order, market participants were pricing in six interest rate cuts for 2024 (see *Figure 1*), which increased the probability of a soft landing. And although recent datapoints indicate that elevated levels of inflation may be sticky (see *Figure 2*), hence the reduction during the quarter in the number of expected rate cuts to three, the equity markets continued to rally.

Why would stocks remain strong when elevated inflation data is pointing to the possibility that the Fed will keep rates higher for a longer period? There are a handful of possible reasons, but we suspect it is the belief that the Fed is bluffing on its inflation target. More specifically, investors doubt the validity of the Fed maintaining its stated 2.0% inflation target, believing the Fed will instead settle for a higher inflation target and move forward with rate cuts despite inflation stalling at levels well above 2.0%. This would clearly benefit the economy near-term and support revenue and earnings growth. As a result, we are seeing a continued tailwind for stocks, with the S&P 500 up 10.6% in the first quarter and 28% from the low in late October 2023.

Figure 1 **U.S. Interest Rate (%)**

(Source: Financial Times, 3/19/2024)

Unlike much of the past several years, recent returns have been broader-based. Both large caps and small caps, as measured by the Russell 1000 and 2000 indexes, respectively, are up approximately 30% off the October low. Although growth has outperformed value, the gap was much narrower than the recent past as Apple (AAPL) was up only 2% and Tesla (TSLA) posted a loss of 15.2%, which helped narrow the gap to "only" 5.3%, with the Russell 1000 Growth up 31.4% versus the Russell 1000 Value up 26.1%.

Figure 2 **Consumer Price Index, Change From a Year Earlier**

(Source: Wall Street Journal, 4/10/2024)

See GIPS Report on pages 5-6.

Market Commentary continued...

There are still pockets of excess speculation specifically around artificial intelligence (AI) and cryptocurrency, perhaps best evidenced by two "small cap" names, Super Micro Computer (SMCI) and MicroStrategy (MSTR), which are up +320% from the October low and now sport market capitalizations of $60 billion and $30 billion, respectively. And yet these two companies are still included in the Russell 2000 Index, a small cap index with a median market cap of approximately $956 million, and are impacting the index's returns. Both companies also have checkered histories as SMCI was delisted from the NASDAQ in 2019 for accounting irregularities, while MSTR leader Michael Saylor has used the company's balance sheet to acquire bitcoin (and, more recently, issued stock and convertible bonds to acquire even more bitcoin), all while actively selling his own shares. This revival of bitcoin and the recent Reddit IPO lends further credence to the sense that speculation still abounds.

On the other hand, fixed income markets were more sanguine in light of the recent inflation datapoints, giving back some of their recent gains. Recall that the 10-year Treasury yield fell from 4.98% in late October 2023 to 3.88% by year-end, providing a boost to financial assets and the Santa Claus rally. However, during the first quarter of 2024, the 10-year Treasury yield rose to 4.20% (see *Figure 3*). With inflation remaining at elevated levels, the backup in yields was rather muted and has some pundits pointing to the limited supply of longer-term notes as the Treasury Department shifted refunding to favor short-term bills. This shift helped suppress long-term yields which aided longer-duration bonds as well as stocks. At current levels, the 10-year Treasury is trading more in line with levels preceding the Great Financial Crisis in 2008-09 and provides a real rate of return that has been absent for much of the past 15 years and has benefited financial engineering over operating acumen.

Figure 3 **Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity**

(Source: Federal Reserve Economic Data, 3/31/2024)

Outlook

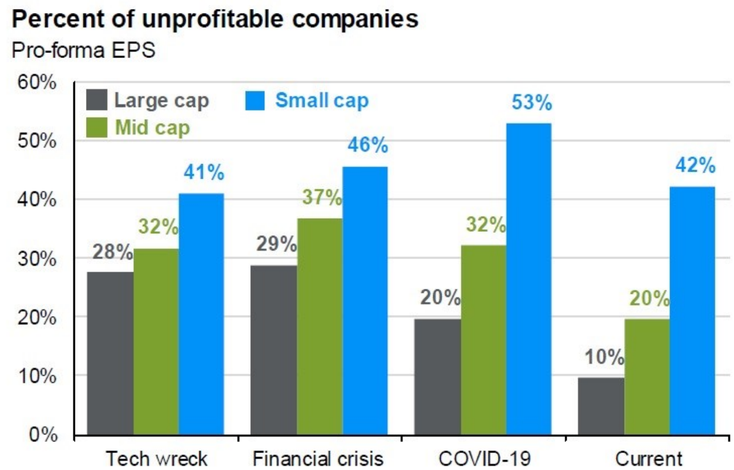
Thus far, the economy has avoided a recession in the face of a sharp rise in interest rates, while employment has remained strong and inflation levels have been trending downward. This environment has benefited the equity markets; however, the disinflation of the past year and a half appears to be stalling. Thus, the primary focus remains on inflation and how future datapoints will impact the timing and magnitude of Fed actions. While the broadening of the equity markets over the past few months is a positive sign, the strength has outpaced earnings growth which has pushed up valuations and leaves equities susceptible to a pullback. Given the spotlight on inflation, the geopolitical backdrop, with conflicts in Russia/Ukraine, the Middle East, and China/Taiwan, and elections occurring in 2024 for half of the world's population, we anticipate some added volatility which also means opportunities for long-term investors. Of course, we will continue to stay focused on our investment philosophy which has always been centered on business and valuation analysis.

Strategy Commentary

Following an impressive rally in the fourth quarter of 2023, small capitalization stocks continued their upward trajectory into the first quarter of 2024. The Russell 2000 posted a gain of 5.2%, with the Russell 2000 Growth (+7.6%) outperforming its value-focused counterpart, the Russell 2000 Value (+2.9%), by 4.7%. Notably, the Technology sector, fueled by the ongoing AI frenzy, was a key driver behind the disparity. Super Micro Computer (SMCI), the small cap poster child for AI, saw an astonishing surge of 255% in the quarter, propelling its market capitalization to nearly $60 billion. And MicroStrategy (MSTR), the bitcoin proxy, surged 170% and sports a market cap of approximately $30 billion. As a result, SMCI and MSTR have been significant contributors to the Russell 2000 performance, an index with a median market cap of $956 million.

Amidst the speculative excess prevailing across the various segments of the market, US small cap stocks continue to appear attractively valued both in absolute terms and relative to their large cap counterparts. Despite the dominance of mega-cap stocks over the years, small cap stocks have recently demonstrated resilience, boasting a 30.7% increase since the recent low in late October 2023 through the first quarter of 2024 compared to the Russell 1000 Index's 28.9% growth over the same period. While small cap valuations are not at the bargain levels they once were, the asset class continues to trade at a discount to its long-term median. Moreover, Confluence's Small Cap Value strategy stands out in comparison to its benchmark that has evolved into a riskier measure, characterized by a higher portion of unprofitable, or "zombie," companies compared to their large and mid-cap counterparts (refer to *Figure 4*). We have just recently published a *Value Equity Insights* report, "Magnificent...Small Caps? Why Now and Why Confluence," which delves into the rationale behind this conviction.

Figure 4



(Source: J.P. Morgan Asset Management; Guide to the Markets®, U.S. 2Q 2024, as of March 31, 2024)

Confluence's Small Cap Value strategy had a strong start to the year. While we remain cautious about drawing any significant conclusion from short-term performance results, positive or negative, especially considering the challenging performance observed in the fourth quarter of 2023, it's certainly encouraging to kick off the new year on a positive note. Confluence Small Cap Value achieved an increase of 9.3% (gross of fees) in the first quarter of 2024, outperforming both the Russell 2000 and the Russell 2000 Value indexes, as cited above. [*The strategy's net-of-fees return for the same period was 8.4% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

The strategy's first quarter outperformance stemmed from robust stock selection, particularly from three recent portfolio additions: The AZEK Company (AZEK), Tripadvisor (TRIP), and UFP Technologies (UFPT). Each company delivered solid earnings results with a promising outlook for the business. AZEK, a composite decking manufacturer, is steadily increasing its market share as demand shifts away from wood-based products, providing a favorable long-term outlook. TRIP, known for its global brand Tripadvisor.com and its growing online travel agent, Viator, reported strong earnings as its core metasearch business showed stability and Viator shone brightly. News of a potential takeover transaction further boosted TRIP's stock price. UFPT, a company that specializes in custom-engineered components and packaging for the medical sector, continues to see solid growth in its med-tech business.

Furthermore, aiding our strategy's performance was the overweight position in Industrials, a sector that showed strong performance during the quarter due to the economy's resilience and investors' anticipation of future interest rate cuts. This, coupled with solid stock selection, significantly bolstered our overall performance. Additionally, the reversal of the previous quarter's bank rally, which had negatively impacted our relative performance, proved beneficial this quarter. Our underweight to banks, combined with solid gains from the overweight position in insurance holdings, fueled overall performance.

On the flip side, J&J Snack Foods (JJSF), a producer of niche snack foods, and RBC Bearings (RBC), a manufacturer of specialized bearings for the industrial and aerospace markets, both underperformed due to weaker-than-expected short-term revenue growth. Despite this, both companies are backed by strong management teams and solid balance sheets, reinforcing our positive outlook for their long-term potential. [*See contribution table on page 5.*]

Strategy Commentary continued...

Additionally, the strategy underperformed in the Energy sector. After lagging last year, Energy was one of the top-performing sectors in the Russell 2000 Index, driven by the run-up in oil prices during the quarter. Our sole energy holding, Core Laboratories (CLB), a market-leading energy services provider, failed to keep pace.

In terms of portfolio changes, we replaced Northwest Natural Holding Company (NWN) with what we believe will be a more promising investment in Sapiens International Corp. (SPNS), a leading provider of insurance carrier software. SPNS stands out with its unique business model and high client retention rates. By prioritizing reliability and proven technology, SPNS is well-positioned to capitalize on the ongoing trend of insurance carriers outsourcing internal software and transitioning toward cloud-based solutions.

Outlook

There is a widely held belief that we are on track for a soft landing with central banks expected to navigate the current cycle without causing a recession. However, history has shown that attempting to predict macroeconomic outcomes is fraught with uncertainty. Our focus lies in the fundamental, bottom-up analysis of individual companies, valuations, and management assessment with a focus on buying competitively advantaged businesses at attractive prices. This disciplined approach views risk through the lens of capital preservation, or more specifically, the probability of a permanent loss of capital. By prioritizing these factors, we are less reliant on the unpredictability of macroeconomic forecasting. While we can't predict short-term results, we are confident that our investment process will yield attractive risk-adjusted returns over the long term, as we have demonstrated over the team's nearly 30-year history of managing small caps. We appreciate the continued trust and confidence placed in our team.

Contribution[1]

(YTD as of 3/31/2024)

The top contributors and detractors for the portfolio in 2024 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
Top 5		
UFP Technologies Inc.	3.09	1.33
Azek Co. Inc.	3.96	1.16
TripAdvisor Inc.	4.12	1.12
Gates Industrial Corp. plc	3.46	1.04
Brown & Brown Inc.	3.47	0.76
Bottom 5		
Perficient Inc.	2.84	(0.40)
MGP Ingredients Inc.	2.65	(0.41)
SJW Group	3.02	(0.46)
RBC Bearings Inc.	5.10	(0.47)
J & J Snack Foods Corp.	3.39	(0.53)

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

Performance Composite Returns[2] (For Periods Ending March 31, 2024)

	Since Inception**	25-Year*	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Small Cap Value *Pure Gross-of-Fees[3]*	11.0%	10.5%	9.2%	12.4%	7.9%	5.6%	1.2%	12.5%	9.3%	9.3%
Max Net-of-Fees[4]	7.8%	7.3%	6.1%	9.0%	4.7%	2.5%	(1.8%)	9.2%	8.4%	8.4%
Russell 2000	8.9%	8.4%	8.0%	12.9%	7.6%	8.1%	(0.1%)	19.7%	5.2%	5.2%
Russell 2000 Value	9.5%	9.1%	7.5%	12.1%	6.8%	8.1%	2.2%	18.7%	2.9%	2.9%

Calendar Year	Pure Gross-of-Fees[3]	Max Net-of-Fees[4]	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%
2021	16.9%	13.4%	14.8%	28.2%	2.1%	378	$124,263	$7,761,687	20.2%	23.3%	25.0%	1.3%
2022	(16.3%)	(18.8%)	(20.5%)	(14.5%)	4.1%	361	$98,842	$6,931,635	21.6%	26.0%	27.3%	0.5%
2023	5.7%	2.6%	16.9%	14.6%	(11.1%)	277	$75,681	$7,200,019	18.2%	21.1%	21.8%	0.9%

**Average annualized returns* ***Inception is 10/1/1994* *See performance disclosures on last page.*

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)*

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Disclosures

Market & Strategy Commentary—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.

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Indexes: The Russell 2000 and Russell 2000 Value 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] **Contribution—**Table showing the top 5 contributors/detractors reflects the strategy's best and worst performers (net), 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.

[2] **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, 2022. 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 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.

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

[4] 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 $3 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.

The investment strategies described herein are those of Confluence Investment Management. These materials are being provided for illustrative and informational purposes only. The information contained herein is obtained from multiple sources that are believed to be reliable. However, such information has not been verified, and may be different from the information included in documents and materials created by the sponsor firm in whose investment program a client participates. Some sponsor firms may require that these Confluence materials are preceded or accompanied by investment profiles or other documents or materials prepared by such sponsor firms, which will be provided upon a client's request. For additional information, documents and/or materials, please speak to your Financial Advisor.