Small Cap Value

Value Equity Strategies

First Quarter 2025

Small Cap Value is focused on companies that have small market capitalizations consistent with the Russell 2000 Index or the S&P SmallCap 600 Index 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

Financial markets exhibited signs of anxiety during the first quarter of 2025 as concerns began to surface around artificial intelligence (AI) financial models as well as uncertainty surrounding the new administration's economic agenda. The release of the DeepSeek chatbot by its Chinese developer in early January garnered praise for its innovative and, more importantly, cost-effective approach to model development. This prompted investors to reconsider their assumptions regarding AI's capital intensity. In February, tariff discussions began to gain traction, culminating in an announcement of an official release date in early April. This uncertainty triggered a sell-off in broad equity markets, with the S&P 500 declining by approximately 4.3% for the quarter, while the Treasury market rallied as the yield on the 10-year Treasury fell by 33 basis points to 4.24%, reflecting a flight to safety.

The most significant event of the quarter was the DeepSeek release, which introduced a novel approach that could challenge existing AI capital investment requirements and impact returns on prior investments. Since late 2022, equity markets have been heavily influenced by AI developments and the associated capital expenditures required to support them, producing outsized returns in select market segments. Consequently, any downward revision of these lofty expectations could disproportionately affect broader markets. DeepSeek's introduction spurred a market rotation away from the leading technology-oriented Magnificent 7 (M7) stocks toward less expensive areas of the market. A rotation should be viewed as healthy, and overdue for value investors, given the large concentration in the M7.

This shift resulted in value stocks outperforming growth stocks and yield/dividend-oriented businesses leading over non-payers and lower-yielding companies. Moreover, heightened uncertainty kept large cap stocks ahead of small caps, while tariff-related developments favored international markets over domestic ones. (See *Figures 1* and *2*.)

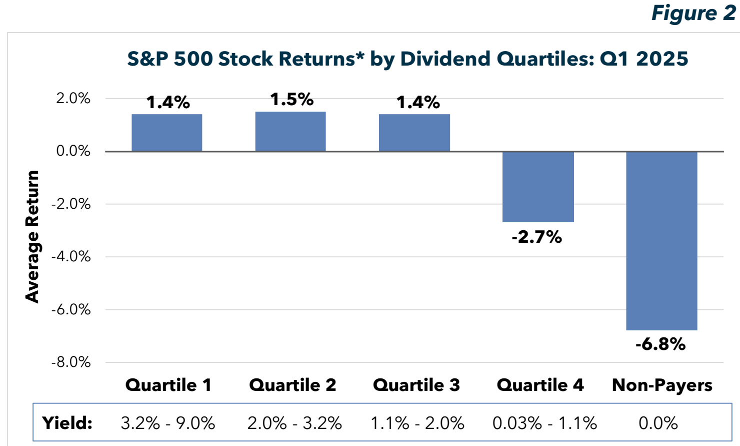
The rotation also influenced sector performance, with the three sectors that hold the M7 stocks – Communication Services (Alphabet and Meta), Consumer Discretionary (Amazon and Tesla), and Information Technology (Microsoft, NVIDIA, and Apple) – emerging as the worst performers during the quarter (see *Figure 3*, sector returns table).

Figure 1

Index	*Q1 2025*	*Index*	*Q1 2025*
Russell 1000	(4.5%)	Russell 2000	(9.5%)
Russell 1000 Growth	(10.0%)	Russell 2000 Growth	(11.1%)
Russell 1000 Value	2.1%	Russell 2000 Value	(7.7%)
S&P 500	(4.3%)	MSCI World ex-US (net)	6.2%

(Sources: Confluence, FTSE Russell, S&P Dow Jones Indices, MSCI)

Figure 2



*Actual Historical Constituents. *Returns through 3/31/2025. (Sources: Confluence, Ned Davis Research)*

Figure 3 – Returns by Sector

	Energy	Materials	Financials	Industrials	Cons. Disc.	Tech.	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	3.7%	2.0%	14.7%	8.5%	10.3%	29.6%	9.2%	2.3%	11.2%	6.1%	2.5%	100.0%	Weight
Russell Growth weight	0.5%	0.7%	7.7%	4.9%	14.9%	46.2%	12.7%	0.6%	7.8%	3.9%	0.2%	100.0%	
Russell Value weight	7.1%	4.2%	23.2%	14.1%	5.8%	8.7%	4.5%	4.7%	14.8%	8.2%	4.8%	100.0%	
Russell 2000 weight	5.1%	3.9%	19.8%	17.6%	9.1%	12.3%	2.6%	6.4%	16.7%	3.2%	3.2%	100.0%	
QTD	10.2	2.8	3.5	-0.2	-13.8	-12.7	-6.2	3.5	6.5	5.2	4.9	-4.3	Return (%)
YTD	10.2	2.8	3.5	-0.2	-13.8	-12.7	-6.2	3.5	6.5	5.2	4.9	-4.3	

(Source: J.P. Morgan Asset Management; Guide to the Markets®, US 2Q 2025, as of March 31, 2025)

Administration's Impact on Investor Sentiment

While AI dominated attention early in Q1, investor anxiety was heightened when the new administration unveiled its agenda. As this commentary is being written, financial markets remain highly volatile following the end of the quarter — a topic worthy of brief discussion here. For more detailed insights, we encourage readers to follow the regular updates published by our macroeconomic team.

The tariff agenda was revealed in early April and is an attempt to restructure the global order. But why such an aggressive policy when the economy and financial markets appeared to be in good shape? The shift reflects the populist movement that has been gaining momentum for years as global trade has disproportionately benefited capital at labor's expense. *Figure 4* illustrates this trend: Labor's share of total economic output (blue line) remained stable at around 60% from World War II until China joined the World Trade Organization (WTO) in 2001, after which it declined significantly while capital thrived. This imbalance fueled populist movements globally, including the rise of both Bernie Sanders and Donald Trump in 2015 and Brexit across the Atlantic.

The initial step toward benefiting Main Street is a tariff policy designed to rebalance US trade by supporting re-industrialization and thereby creating "good jobs." It also aims to reduce US reliance on critical imports (an issue highlighted during COVID-19), while generating revenue to help address fiscal deficits. Essentially, tariffs act as a consumption tax and production subsidy that should reduce imports, while incentivizing domestic production. *Figure 5* highlights America's persistent trade imbalance, currently over $1.2 trillion.

Fiscal Challenges

The agenda also addresses fiscal deficits and national debt levels that have become unsustainable under existing policies. *Figure 6* shows US national debt approaching 100% of GDP alongside fiscal deficits exceeding 5% — a rarity outside wartime or severe crises. The situation must be addressed at some point, or the burden of servicing the debt will undermine our ability to provide the social safety nets of Medicare, Medicaid, and/or Social Security.

The first part of the agenda has shaken markets given the bold attempt to address the above issues. Future steps on the agenda will entail deregulation and tax policy reforms aimed at addressing inflation and boosting economic growth through measures such as tariffs to support domestic industries, inflation control to lower yields and ease the debt burden, spending cuts, and restoring fiscal discipline.

Market Outlook

The administration's audacious attempts to tackle these issues challenge the framework developed over generations by leveraging geopolitics to reshape America's global position. While risky, this approach seeks to rebuild American manufacturing sectors harmed by unfair trade practices — especially those involving China — and reset post-World War II global economic structures. Resistance and potential missteps are inevitable; however, we believe long-term investors should view volatility as an opportunity, a principle central to our investment philosophy.

Figure 4

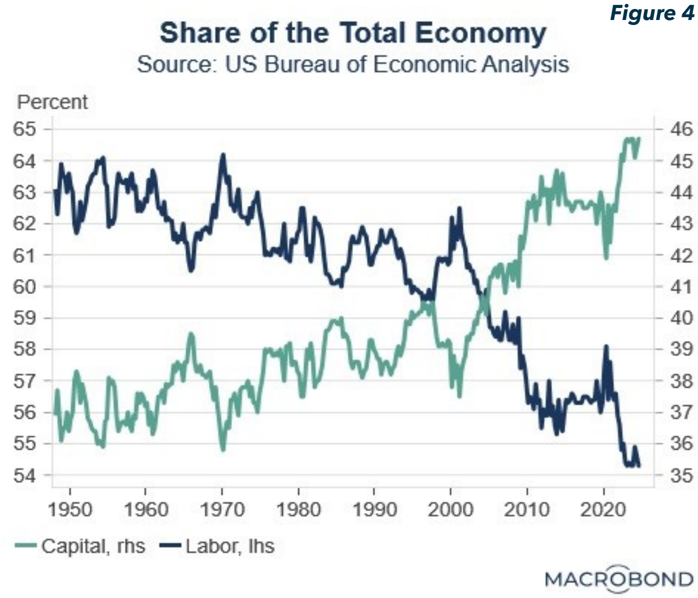


Figure 5

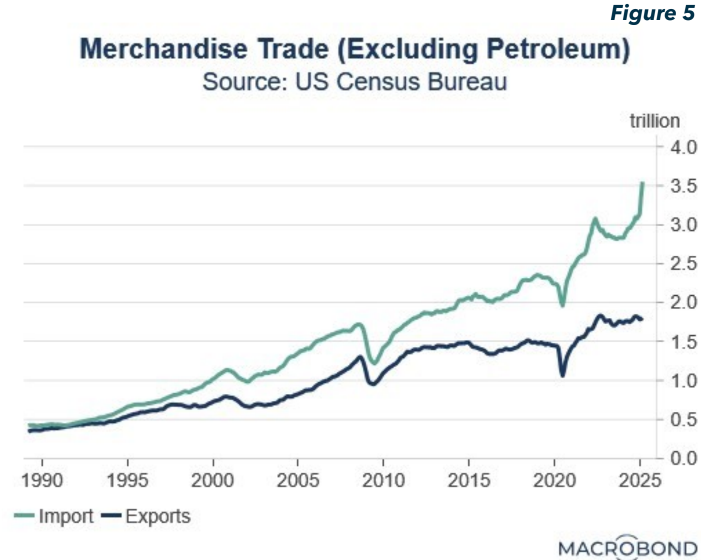
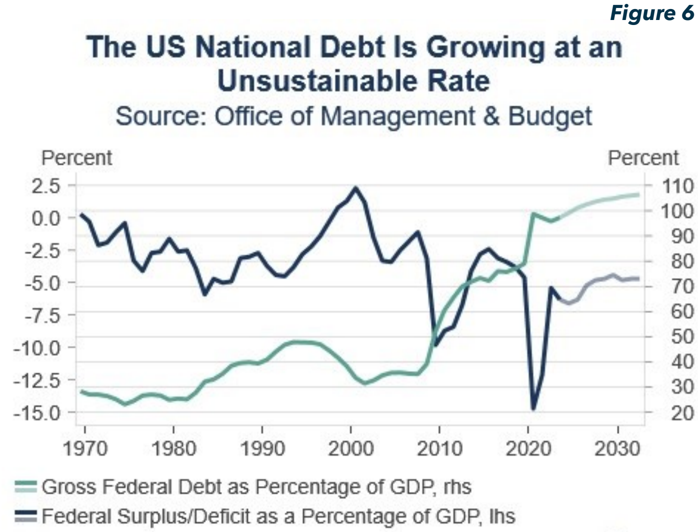


Figure 6



(Sources: Confluence, Macrobond)

Strategy Commentary

The first quarter of 2025 proved highly volatile, marking a noticeable shift in market sentiment. What began as a moderately optimistic start quickly reversed course in February as economic and political uncertainties resurfaced. Investor enthusiasm surrounding generative AI also faced a sudden setback due to the emergence of an obscure Chinese AI company, DeepSeek. This unexpected event triggered a sell-off in established AI names and negatively impacted business across other sectors linked to the AI-driven market enthusiasm.

The impact was felt most acutely in small cap equities. The Russell 2000 Index declined by 9.5% and the Russell 2000 Value Index fell by 7.7%. The underperformance of small caps relative to large caps continued, an ongoing trend from last year, although there was a notable shift in leadership from growth to value. As is often the case during downturns, value stocks exhibited greater resilience with the Russell 2000 Growth Index declining 11.1%, underperforming its value counterpart by more than 300 basis points.

At the sector level, performance was overwhelmingly negative, with nearly every sector in the Russell 2000 detracting from returns. Utilities stood out as the only sector to post a positive return. As expected in a risk-off environment, more defensive sectors such as Utilities, Consumer Staples, and Real Estate held up better than their more cyclical counterparts, which experienced steeper declines.

Against this challenging backdrop, Confluence's Small Cap Value strategy posted a return of -4.7% (gross of fees) for the quarter. While absolute performance was negative, the strategy significantly outperformed both the Russell 2000 and Russell 2000 Value indexes by 500 and 300 basis points, respectively. This relative strength highlights the effectiveness of our downside protection and capital preservation focus. [*The strategy's net-of-fees return for the same period was –5.4% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Our financial services holdings performed well on a relative basis. While the benchmark's Financials sector posted a loss for the quarter, our financial services stocks in aggregate were up in the low single-digits and contributed positively to overall performance. We maintain a healthy weighting in the sector, roughly a quarter of the portfolio, with a skew toward insurance companies such as Brown & Brown (BRO) and Baldwin Insurance Group (BWIN), both of which were among our top performers this quarter. We do not own any banks in this strategy given the more commodity-like nature of the business. This proved beneficial as banks underperformed during the quarter due to their greater sensitivity to weaker macroeconomic conditions stemming from rising credit concerns and weaker loan growth.

Cavco Industries (CVCO), a leader in manufactured housing, saw its stock rise during the quarter, outperforming significantly in a tough environment for the Consumer Discretionary sector. After a challenging prior year, Cavco's fundamentals have shown improvement. We continue to see long-term tailwinds for affordable housing, particularly in a tight housing market. The company operates in an oligopolistic industry with rational competitors and a high variable cost structure. As the industry continues to recover from trough levels, we believe Cavco is well-positioned to benefit from the growing need for affordable housing.

Another top performer this quarter was RBC Bearings (RBC), a leading manufacturer of precision-engineered bearings and components. The company delivered solid quarterly results, exceeding expectations on both the top and bottom line. Management noted early signs of recovery in its industrial markets, along with continued growth in its aerospace and defense end markets. RBC benefits from a strong competitive moat, driven by its focus on highly technical products and its role as a critical suppler. The company is led by a founder-owner operator who has a proven track record of excellent capital allocation, and we believe he is well-positioned to continue creating long-term shareholder value.

Among the primary detractors from performance this quarter were a couple Consumer Discretionary holdings, American Outdoor Brands (AOUT) and Winnebago Industries (WGO). AOUT, which owns a portfolio of outdoor and hunting-related brands, gave back some of its strong gains from last quarter. The decline was not driven by company-specific issues but rather broader investor sentiment turning away from consumer-related names. Despite the pullback, AOUT continues its gradual post-COVID recovery, supported by solid product innovation and increasing shelf space with retailers. Similarly, WGO, a leading RV manufacturer, remained under pressure as fundamentals continue to struggle. Demand at the end-consumer level remains soft, and dealers are still working through elevated inventory levels following the COVID-era boom.

Spectrum Brands Holdings (SPB), a global branded consumer products company, also weighed on performance. While results were mixed across its segments with decent growth in Home and Garden and softer trends in Pet Care, investor concern centered around tariff-related uncertainty. The company's Home and Personal Care division, which has the most exposure to imports from China, could impact its profitability and strategic plans. SPB has been pursuing a separation of this business, but the current environment may delay it or require the company to retain the division for a longer period.

Strategy Commentary continued...

During the quarter, we initiated two new positions in Knowles Corporation (KN) and Haemonetics Corporation (HAE), and we completed our purchase of Valvoline (VVV). We are also in the process of building a full position in another name that we look forward to discussing once complete.

Knowles is now a more focused industrial technology company specializing in components such as microphones for hearing aids and high-performance capacitors for the industrial end markets following its recent divestiture of its low-margin, volatile consumer electronics microphone business. This move enhances the company's margin and return profile and simplifies the business. With disciplined capital allocation, a strong balance sheet, and limited sell-side coverage, we believe Knowles is underappreciated at its current $1 billion market cap.

Haemonetics is a name we've owned before and re-entered based on an attractive valuation, improved business mix, and a new CEO. The company is the dominant player in the high-ROIC, razor-and-blade plasma collection equipment and consumables market. After prior missteps, a new CEO has streamlined operations, exited non-core assets, and added higher growth healthcare device businesses. While near-term earnings face headwinds from the company losing a material customer and the wind-down of its whole-blood business, we believe the valuation doesn't reflect the company's long-term quality and leadership of this franchise.

Valvoline has transformed into a pure-play oil change retailer after divesting its motor oil business in 2023. The Valvoline Instant Oil Change business offers stable, high-return growth, supported by 18 consecutive years of same-store sales gains. While EV adoption poses a long-term risk, we believe it is gradual and manageable, with opportunities to offset through market share gains and unit expansion. As an industry-leading oil change retailer, Valvoline can now focus on delivering strong revenue and earnings growth over the long term.

During the quarter, we also exited two holdings, Healthcare Services Group (HCSG) and Core Laboratories (CLB). HCSG, a leading provider of outsourced services to skilled nursing facilities, exhibited many key attributes we look for in a business, including dominant market share, profitable and cash-generating operations, and a strong balance sheet. However, the company has struggled to regain growth post-COVID as its customer base remains under financial pressure. Given limited visibility into its recovery, we chose to reallocate capital toward better opportunities.

Core Labs, a late cycle oilfield services provider focused on international reservoir analysis, has faced slower-than-expected industry recovery and customer budget constraints. Additionally, commoditization in its perforating gun segment has eroded margins. As a result, we chose to sell our shares.

Outlook

As of this writing, tariff-related headlines from President Trump have added fuel to an already volatile market environment. Markets tend to react poorly to uncertainty…and for good reason. With limited visibility, business leaders and consumers alike face difficulty planning and making investment decisions, which can ultimately lead to a slowdown in global economic growth.

While these developments can feel unsettling and we haven't faced this exact scenario before, markets have successfully navigated many different periods of uncertainty. Though no one can predict how this will unfold, we believe conditions will ultimately stabilize, just as they have following other periods of market stress. In our view, volatility often creates long-term opportunities. Valuations, which had remained elevated for some time, have started to normalize, potentially revealing a broader set of attractive risk/reward opportunities.

Our investment team stands ready to deploy our disciplined philosophy and investment process to identify high-quality businesses trading at a discount to intrinsic value. Our approach remains grounded in patience, discipline, and deep fundamental research. We seek to invest in companies with durable competitive advantages, strong free cash flow generation, conservative balance sheets, and management teams committed to long-term value creation.

This time-tested strategy not only helps navigate turbulent market environments, but also positions the portfolio for long-term compounding as conditions improve. As Warren Buffett said, "Be fearful when others are greedy, and greedy when others are fearful."

We believe our Small Cap Value strategy is well-positioned, and we remain prepared to make adjustments that enhance the quality and long-term return potential. We appreciate the continued trust and confidence you have placed in our team.

Contribution[1]

The top contributors and detractors for the portfolio in Q1 2025 are shown in the following table:

(YTD as of 3/31/2025)

Security	Avg Weight (%)	Contribution (%)
Top 5		
Brown & Brown Inc.	4.38	0.86
Cavco Industries Inc.	5.02	0.70
RBC Bearings Inc.	5.48	0.57
Baldwin Insurance Group Inc.	3.51	0.52
SJW Group	2.51	0.27
Bottom 5		
Movado Group Inc.	3.28	(0.52)
Winnebago Industries Inc.	2.16	(0.64)
Knowles Corp.	1.72	(0.64)
Spectrum Brands Holdings Inc.	4.25	(0.65)
American Outdoor Brands Inc.	3.42	(0.69)

Performance Composite Returns[2] (For Periods Ending March 31, 2025)

	Since Inception**	30-Year*	25-Year*	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Small Cap Value *Pure Gross-of-Fees[3]*	10.3%	10.5%	9.8%	8.1%	8.6%	5.9%	8.1%	(0.8%)	(7.6%)	(4.7%)	(4.7%)
Max Net-of-Fees[4]	7.2%	7.3%	6.7%	4.9%	5.3%	2.8%	4.9%	(3.8%)	(10.4%)	(5.4%)	(5.4%)
Russell 2000	8.4%	8.5%	6.8%	7.5%	9.0%	6.3%	13.2%	0.5%	(4.0%)	(9.5%)	(9.5%)
Russell 2000 Value	9.1%	9.2%	8.5%	6.8%	8.2%	6.0%	15.3%	0.0%	(3.1%)	(7.7%)	(7.7%)

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
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%
2024	5.9%	2.8%	11.5%	8.0%	(5.6%)	195	$56,489	$7,280,773	20.5%	23.3%	23.4%	0.6%

**Average annualized returns   **Inception is 10/1/1994. Additional years of performance available on our website.* *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.

All investments carry a certain degree of risk, including possible loss of principal. It is important to review your investment objectives, risk tolerance & liquidity needs before choosing an investment style or manager. Equity securities are subject to market risk & 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.

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—**Contribution data shown from a sample account, based on individual stock performance and portfolio weighting. 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, 2023. 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 US 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.

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