Confluence INVESTMENT MANAGEMENT

SECOND QUARTER

2020

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 equity markets experienced a sharp turnaround in the second quarter of 2020 following a tumultuous first quarter. The Russell 2000 Value and Russell 2000 indexes were up 18.9%% and 25.4%, respectively, for the second quarter. This helped offset the weak first quarter in which the Russell 2000 Value and Russell 2000 were down 35.7% and 30.6%, respectively, bringing the year-to-date returns to -23.5% for the Russell 2000 Value and -13.0% for the Russell 2000.

The past two quarters produced drastically different results as investor focus shifted from economic prospects, or lack thereof, to policy influence—monetary and fiscal. The year began with optimistic expectations of continued economic expansion which was abruptly halted by COVID-19 and the ensuing lockdowns. Businesses quickly switched from an upbeat tone highlighted by a growing shortage of workers to a sharp spike in unemployment. It wasn't until the Federal Reserve stepped in to provide liquidity in late March and indicated its willingness to provide additional monetary policy programs to support main street businesses that the equity markets began their turnaround. Congress followed with their own fiscal policy programs to support individuals and businesses. Today, many questions still abound regarding the pace and magnitude of the turnaround, but the commitment of the Federal Reserve and Congress gives investors the confidence to look past the near-term impact of the lockdowns and focus on the future.

The current recession was caused by the mandated lockdowns in order to protect the health of U.S. citizens; it was truly unprecedented. The sudden closure of large segments of the economy provided a headwind for many businesses; however, a small segment of the economy benefited from the ensuing shift to working and schooling remotely, which accelerated a few trends already in place such as enterprise movement to cloud computing and the remote economy. These new economy businesses tend to be asset-light and require less working capital relative to their more mature and asset-intensive brethren.

The lockdowns caused capital and liquidity concerns for many entities that took advantage of lower interest rates to optimize their capital structures, so it comes as no surprise that a bifurcation resulted in the broad markets as evidenced by the year-to-date returns of the Russell 3000 Growth, +9.0%, versus the Russell 3000 Value, -16.7%. Despite the broad-based snapback in the second quarter, the underlying valuation disparities continued. In fact, this bifurcation has been in place over the past few years as the Russell 3000 Growth has outperformed the Russell 3000 Value by a cumulative 79% from the end of 2016 through the second quarter of 2020. This outperformance has been driven by the mega-cap tech names, which now claim the top five spots by market capitalization in the S&P 500 with a cumulative weighting of approximately 22% of the index, compared to 17% at year-end 2019, and posted a weighted average return of 25.4% year-to-date. In this environment, investors appear more focused on lockdown risks than valuation risks.

The wide divergence is also occurring among market capitalizations as the S&P 500 has outperformed the Russell 2000 by 37% and the Russell 2000 Value by 60%, cumulatively, since the end of 2016. During the second quarter rebound, however, the small capitalization area of the market did perform better relative to large caps, with the Russell 2000 up 25.4% compared to the Russell 1000 up 21.8%. Nevertheless, the small cap markets echoed the broader markets in terms of style as growth outperformed value, evidenced by the second quarter and year-to-date returns of the Russell 2000 Growth, +30.6% and -3.1%, respectively, versus the Russell 2000 Value, +18.9% and -23.5%, respectively.

Continued on page 2...

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

Small Cap Value • Value Equity Strategies

Strategy Commentary

The Small Cap Value strategy also generated solid returns in the second quarter, up 15.1%, following a tough first quarter where the strategy was down 26.0%, bringing its year-to-date return to -14.8% (all gross of fees). (*Net-of-fees returns for the same periods were +14.3%, -26.5%, and -16.1%. See disclosures on p.3 for fee description; actual investment advisory fees may vary.*)

In past market dislocations, we have found it beneficial to use these opportunities to upgrade the quality of the portfolio and that was the case this past quarter. We added Edgewell Personal Care Company, Perficient and FARO Technologies to the portfolio, funded by the sales of MTS Systems and Patterson Companies as we felt the new ideas presented better risk/reward opportunities over the next three to five years.

Edgewell Personal Care Company competes in the wet shave, sun care, skin care and feminine care categories, with brands that include Schick, Edge, Banana Boat, Hawaiian Tropic, Wet Ones and Carefree. The company generates strong free cash flow and has a global manufacturing and distribution network in place, along with shareholder friendly management that has historically repurchased shares. Its end-markets are experiencing disruption due to consumer behavior and a competitive landscape, which have pressured the whole industry. Despite its portfolio of strong brands, Edgewell trades at an unusual discount to its competitors, even after taking into account that its products are usually in a strong second position behind a large competitor. As such, we believe the company is currently undervalued compared to its competitive position within the industry.

Perficient is a leading digital transformation consulting firm serving enterprise customers. The company has strong free cash flow characteristics and a management team focused on growing with a revamped sales force and enhanced cross-sell with current clients. It has a high cash conversion rate, consistently in double-digit percentages of free cash flow to revenue, and has minimal debt, utilizing cash to purchase tuck-in acquisitions and share repurchases in a normalized environment. We view the company as a unique business trading at an attractive valuation.

FARO Technologies is a small cap tech company that specializes in the metrology and factory automation industries. It makes laser scanners used for public safety (think measuring crime scenes), manufacturing and construction. These laser scanners provide 3D measurement, allowing construction companies to monitor project progress and identify potential issues earlier in the process. Similarly, it helps manufacturing companies produce parts with tight tolerances through continual measurement with its probes and laser scanners. The company is undergoing a management transition after the co-founder and previous management team embarked on a failed vertical segment strategy that bloated its infrastructure and hurt profitability. In mid-2020, FARO hired a CEO that has successfully turned around three small cap technology companies in the last 15 years, with a great track record of streamlining costs, growing revenues and providing outsized returns to shareholders. Although we are typically reluctant to invest in turnaround stories, FARO has excellent base technology, a good reputation in the industry and high gross margins consistently above 50%, indicative of a company that has pricing power within its product offering. A restructuring occurred in February (refreshed its product offering, scuttled the previous vertical business unit strategy, streamlined its salesforce), thus we expect margins to lift systematically over the next 18 months and believe the company will trade closer to its intrinsic value as cost synergies take effect and sales growth resumes. At the time of purchase, the stock was trading at a discounted valuation that should help mitigate the downside risk even if the turnaround is not fully achieved.

The remaining activity was focused on bringing names that were below full position size due to valuations up to full positions. With that said, we also have a handful of names currently being vetted by the investment committee for possible inclusion. As always, we remain focused on company-specific fundamentals and growth prospects, and believe the current market will continue to provide us with opportunities.

The top-performing and worst-performing positions during the quarter were as follows:

Security	Avg Weight	Contribution
Top 5		
i3 Verticals Inc.	4.13	2.04
BRP Group, Inc.	2.76	1.90
Allied Motion Technologies Inc.	2.94	1.27
RE/MAX Holdings, Inc.	3.30	1.27
Frontdoor, Inc.	4.82	1.24
Top 5		
Natus Medical Inc.	1.97	(0.11)
Movado Group, Inc.	2.05	(0.25)
Northwest Natural Holding Company	3.69	(0.29)
MTS Systems Corporation	0.43	(0.54)
Varex Imaging Corporation	1.90	(0.78)

(Contribution data shown from a sample account)

10 Largest Holdings (as of 6/30/20)

Company	Market Capitalization	Portfolio Weight
	($ billions)	
Cannae Holdings, Inc.	3.70	5.3%
Frontdoor, Inc.	3.78	4.8%
i3 Verticals, Inc.	0.83	4.6%
BRP Group, Inc.	1.31	4.1%
Morningstar, Inc.	6.03	4.1%
James River Group Holdings, Ltd.	1.37	3.9%
Avanos Medical, Inc.	1.40	3.7%
SJW Group	1.77	3.7%
Brown & Brown, Inc.	11.55	3.6%
Kadant Inc.	1.14	3.5%

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 6/30/20

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	R2000	R2000 Value
Since Inception**	11.3%	8.1%	8.4%	8.6%
25-Year*	11.2%	8.1%	8.2%	8.4%
20-Year*	10.8%	7.6%	6.7%	7.6%
15-Year*	8.9%	5.8%	7.0%	5.0%
10-Year*	10.7%	7.4%	10.5%	7.8%
5-Year*	7.0%	3.8%	4.3%	1.2%
3-Year*	3.2%	0.1%	2.0%	(4.4%)
1-Year	(8.9%)	(11.6%)	(6.7%)	(17.5%)
YTD	(14.8%)	(16.1%)	(13.0%)	(23.5%)
QTD	15.1%	14.3%	25.4%	18.9%

**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%

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 claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Confluence has been independently verified for the periods of 8/1/2008 through 12/31/2018. A copy of the verification report is available upon request. Verification assesses whether: 1. the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis, and 2. the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. 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. Additional information regarding policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. The annual composite dispersion is an equal-weighted standard deviation calculated for accounts in the composite for the entire year. 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. 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.*