

## Equity Strategies • Small Cap Value

The Small Cap Value portfolio is focused on companies that generally have capitalizations below \$3 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 intrinsic value. The portfolio typically is comprised of 30-35 holdings and is expected to result in low to moderate turnover. The portfolio is suitable for clients whose primary objective is capital appreciation.

### Portfolio Commentary

The small cap indexes posted a Hollywood finish to the year as the Russell 2000 and Russell 2000 Value were up 8.8% and 14.1%, respectively, for the fourth quarter. This resulted in an extremely strong year for the Russell 2000 and Russell 2000 Value as they finished the year up 21.3% and 31.7%, respectively. The Small Cap Value strategy also performed well for the quarter, up 6.4%, and full year, up 23.7% (gross of fees).

*For detailed performance information and disclosures see:*  
<http://www.confluenceinvestment.com/products-performance/equity-strategies>

The fourth quarter capped off a memorable year that caught many by surprise and small cap stocks were the near-term beneficiaries, dramatically outperforming their large cap brethren as the S&P 500 was up “only” 3.8% for the quarter and 12.0% for the year. The performance of the equity markets outpaced the underlying fundamentals as estimates for domestic economic GDP growth are around 2.0% and S&P earnings estimates are 7.0% for the full year. The market’s strength, specifically post-election, appears to be driven by optimistic views that the new administration will be successful in pushing its agenda on tax, deregulation, infrastructure and trade that will provide a strong tailwind to economic and earnings growth, along with the Fed’s continued monetary policy movements toward normalization. This was evidenced by the strength of the highly regulated banking sector post-election, which explains the bulk of the outperformance of the Russell 2000

Value relative to the Russell 2000 and our Small Cap Value strategy, given the much larger weighting the value indexes have in the financial services sector.

For our Small Cap Value strategy, we still maintain a healthy cash position as we prudently wait for opportunities to deploy. While there were no wholesale changes to the portfolio during the quarter, we did selectively add to a few existing names in the portfolio as the opportunities arose.

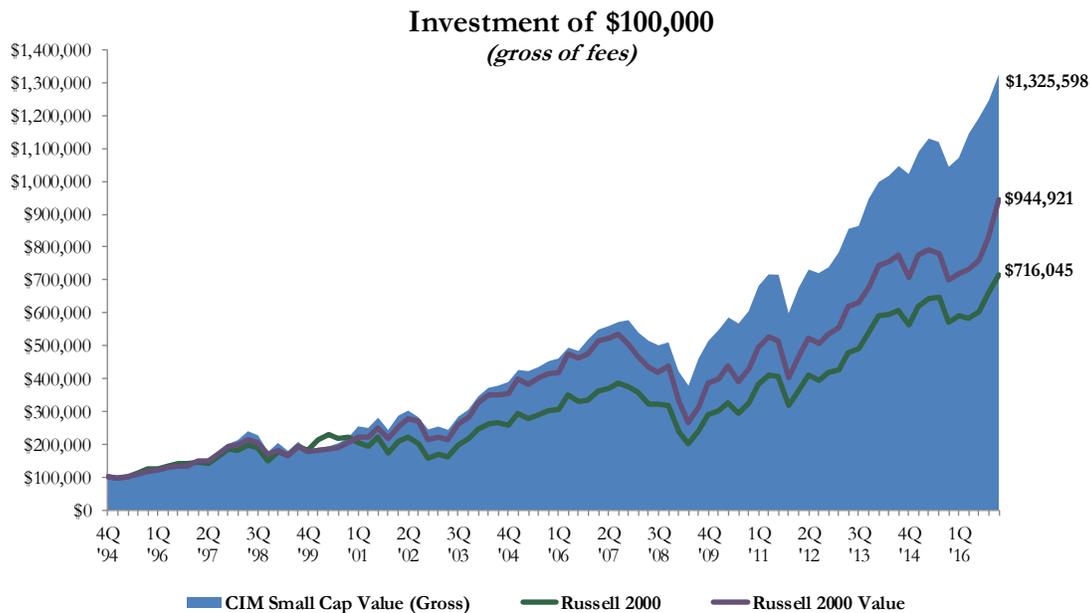
The unexpected outcomes of 2016 (Brexit, Trump, Chicago Cubs) are a reminder of how difficult it is to predict future events, even for the best prognosticators. Importantly, this acknowledgement is fundamental to our investment philosophy. It is why we demand certain characteristics of the companies we invest in, such as financial flexibility, sustainable competitive advantages, excess free cash flow, capable management teams with good capital allocation skills and reasonable valuations. These are all tools to help insulate companies and investors during periods of uncertainty.

Looking forward, we expect the markets to continue to be driven by the actions of the Federal Reserve and the pace it selects for raising interest rates. At Confluence, we continue to work diligently to put cash to work in a prudent fashion but acknowledge that it is taking a little longer than normal. As always, we remain focused on company-specific fundamentals and growth prospects.

## CIM • Small Cap Value

## Top 10 Portfolio Holdings (as of 12/31/16)

Company	Market Capitalization (\$ billions)	Portfolio Weight
RE/MAX Holdings, Inc	0.99	4.0%
VCA Antech Inc	5.57	3.9%
Bank of Marin (CA)	0.43	3.9%
MTS Systems Corp.	0.95	3.4%
Mueller Industries Inc	2.29	3.4%
Raven Industries Inc	0.91	3.4%
Snyder's-Lance Inc	3.68	3.4%
Brown & Brown Inc	6.29	3.2%
Patterson Companies Inc	4.02	3.2%
Corporate Executive Board Co.	1.95	3.1%



## Confluence Investment Management LLC

Confluence Investment Management LLC is an independent, SEC Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics and geopolitical analysis with a value-driven, fundamental company-specific approach. The firm's portfolio management philosophy begins by assessing risk, and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.

This 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. Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable.