

## Equity Strategies • Small Cap Value

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 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 equity markets ended the fourth quarter with a thud as the Russell 2000 and Russell 2000 Value were down 20.2% and 18.7%, respectively. The harsh correction during the quarter turned what was shaping up to be a terrific year for small caps into the worst since the Great Recession in 2008, and the Russell 2000 and Russell 2000 Value ended the year down 11.0% and 12.9%, respectively. The Small Cap Value portfolio also had a tough fourth quarter, down 20.0%, and ended the year down 8.6% (both gross of fees). *(The portfolio was down 20.6% and 11.3% (net of fees), respectively, over the same time periods. Net of fees calculated using the highest applicable annual bundled fee of 3.00%. See performance disclosures on p.3 for fee description; actual investment advisory fees may vary.)*

We entered 2018 on the back of a strong and expanding economy, one of the longest on record, and the tailwind of tax reform which had investors rather optimistic. With this in mind, we were fearful of the possibility of a melt-up in the market and the first few weeks reinforced that concern as the S&P 500 rose sharply, up over 7.0% by late January, and the Russell 2000 was up approximately 5.0%. The rally ended quickly as the equity markets experienced their first correction of the year in late January/early February as tariff concerns surfaced, startling investors. It proved to be short-lived as investors reverted back to the same names that had led the markets during the past 12-18 months and continued the wide bifurcation between growth and value. The sharp correction in small caps that started in late September and lasted through the fourth quarter helped recalibrate the bifurcation in the market but still left some dispersion between the Russell 2000 Growth, down 9.31%, and Value, down 12.86%.

There were many reasons why the equity markets pulled back during the quarter, from rising rates, tariffs and trade wars, global economies slowing, to a slowdown in housing. The reality is the future is always uncertain and the concerns are either over- or under-appreciated. What is clear is that investor sentiment started the year extremely greedy and is now suddenly very fearful. Fortunately, the strength of the economy resulted in solid earnings growth for businesses and the recent pullback provides more attractive valuations. For fundamental long-term investors, which we are, the current environment provides more opportunities.

Looking forward, we expect continued economic expansion as monetary policy nears normalization and fiscal policy continues its friendlier stance on the business community. We expect inflation and inflation expectations to remain near current levels, which supports market valuations. We also see volatility returning to the norm and being more in line with 2018 than the preceding couple of years. As always, we remain focused on company-specific fundamentals and valuations, and believe the current market will provide us with opportunities to buy quality companies at reasonable prices.

Continued on page 2...

**Portfolio Commentary continued...**

Similar to the broad markets, Small Cap Value also experienced wide dispersion in performance across its holdings with the same underlying dynamics: cheap businesses became cheaper and the fastest growing businesses attracted more investors. As we mentioned last quarter, in the third quarter we took advantage of the sharp move upward in price and valuation in a number of businesses by selling and repositioning into more attractive opportunities. This flurry of activity is uncommon but the market strength resulted in valuations that warranted taking profits. The recent sell-off in the fourth quarter was broad-based without a lot of discernment between businesses, which is not uncommon; however, the overall valuations of the portfolio are much more attractive.

There was only one change during the quarter as we sold Astec Industries to raise proceeds for FrontDoor, Inc. FrontDoor, a company that was recently spun-out from ServiceMaster, provides home warranty plans that cover most home appliances and HVAC systems. The company's product offerings most familiar to the public are typically warranties purchased during the home-buying process to cover the purchased home's appliances and systems during the first year of ownership. However, the use cases for FrontDoor's products actually go beyond the transactional real estate market and we believe the company will improve upon its leadership position in the home warranty industry. The business generates ample cash flow with negative

working capital attributes and very low capital requirements to sustain growth. The company's primary competitive advantages are its network of repair specialists and its deep penetration into real estate agent networks. In our view, the company was generally run for cash while it was part of the larger ServiceMaster. As such, we see opportunities for the company to accelerate growth and markedly improve its IT systems, which will allow the company to conduct dynamic pricing, expand its product offering and better target potential customers. Over time, we believe the company can expand its operating margins with these investments, and we took advantage of the recent spin-out to add shares to the portfolio.

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

Security	Avg Weight	Contribution
<b>Top 5</b>		
FrontDoor, Inc.	1.74	0.68
i3 Verticals, Inc.	1.91	0.13
Bank of Marin Bancorp	3.21	(0.02)
Black Knight, Inc.	0.86	(0.10)
Natus Medical Inc.	3.14	(0.10)
<b>Bottom 5</b>		
Neenah, Inc.	2.70	(0.90)
Innophos Holdings Inc	1.71	(0.95)
e.l.f. Beauty, Inc.	2.88	(0.98)
John Bean Technologies Corporation	2.83	(1.33)
Cambrex Corporation	2.85	(1.54)

*(Contribution data shown from a sample account)*

**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.** 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. 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. There can be no assurance that a purchase of the stocks in this portfolio will be profitable, either individually or in the aggregate, or that such purchase will be more profitable than alternative investments, including the risk that our estimate of intrinsic value may never be realized by the market or that the price goes down. **Indices:** The Russell 2000, Russell 2000 Value and Russell 2000 Growth 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.

## Equity Strategies • Small Cap Value

### 10 Largest Portfolio Holdings (as of 12/31/18)

Company	Market Capitalization (\$ billions)	Portfolio Weight
Morningstar, Inc.	4.69	4.0%
FrontDoor Inc.	2.25	4.0%
SJW Group	1.58	3.7%
Northwest Natural Holding Co.	1.74	3.6%
Raven Industries, Inc.	1.30	3.5%
Allied Motion Technologies Inc.	0.42	3.4%
Movado Group, Inc.	0.73	3.3%
Cannae Holdings, Inc.	1.23	3.3%
Thermon Group Holdings, Inc.	0.66	3.3%
Gladstone Commercial Corp.	0.53	3.3%

The listing of "10 Largest Holdings" is not a complete list of all stocks in the portfolio or which Confluence may be currently recommending. Furthermore, 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 12/31/18

	Pure Gross-of-Fees <sup>1</sup>	Net-of-Fees <sup>2</sup>	R2000	R2000 Value
QTD	(20.0%)	(20.6%)	(20.2%)	(18.7%)
YTD	(8.6%)	(11.3%)	(11.0%)	(12.9%)
1-Year	(8.6%)	(11.3%)	(11.0%)	(12.9%)
3-Year*	10.6%	7.3%	7.3%	7.4%
5-Year*	7.7%	4.5%	4.4%	3.6%
10-Year*	13.1%	9.8%	12.0%	10.4%
15-Year*	10.0%	6.8%	7.5%	6.9%
20-Year*	10.3%	7.2%	7.4%	8.2%
Since Inception**	11.7%	8.5%	8.5%	9.4%

#### Confluence claims compliance with the Global Investment Performance Standards (GIPS®).

The Small Cap Value Strategy was inception 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. 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.

<sup>1</sup> Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

<sup>2</sup> 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 and/or fully compliant GIPS® presentations are available upon request. Additional information regarding policies for calculating and reporting performance 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 a market capitalization 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.

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

	Pure Gross-of-Fees <sup>1</sup>	Net-of-Fees <sup>2</sup>	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
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%
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%
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%
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%
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%
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%
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%
2011	(0.9%)	(3.8%)	(4.2%)	(5.5%)	3.3%	85	\$18,032	\$937,487	21.8%	25.0%	26.0%	1.2%
2010	24.6%	20.9%	26.9%	24.5%	(2.3%)	83	\$19,208	\$751,909	23.3%	27.7%	28.4%	1.5%
2009	29.6%	25.8%	27.2%	20.6%	2.4%	54	\$9,823	\$533,832	20.9%	24.8%	25.6%	2.3%
2008	(21.8%)	(24.0%)	(33.8%)	(28.9%)	12.0%	61	\$8,568	\$291,644	14.0%	19.8%	19.1%	N/A
2007	(1.7%)	(4.4%)	(1.6%)	(9.8%)	(0.1%)	543	\$84,018		7.5%	13.2%	12.6%	1.1%
2006	19.1%	15.9%	18.4%	23.5%	0.8%	694	\$117,282		7.1%	13.8%	12.3%	1.1%
2005	8.2%	5.3%	4.6%	4.7%	3.6%	722	\$111,469		9.0%	15.1%	14.1%	1.6%
2004	23.2%	19.9%	18.3%	22.2%	4.9%	572	\$101,835		12.7%	19.0%	17.5%	1.4%
2003	36.2%	32.5%	47.3%	46.0%	(11.1%)	464	\$71,199		15.4%	21.6%	18.4%	0.9%
2002	(11.4%)	(13.8%)	(20.5%)	(11.4%)	9.1%	434	\$48,944		N/A	N/A	N/A	0.7%
2001	12.6%	9.6%	2.5%	14.0%	10.1%	395	\$56,254		N/A	N/A	N/A	0.7%
2000	34.4%	30.7%	(3.0%)	22.8%	37.4%	374	\$47,699		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%
1998	(4.2%)	(6.8%)	(2.5%)	(6.5%)	(1.6%)	1,080	\$111,513		N/A	N/A	N/A	1.7%
1997	46.5%	42.5%	22.4%	31.8%	24.1%	353	\$63,832		N/A	N/A	N/A	1.1%
1996	20.7%	17.4%	16.5%	21.4%	4.2%	249	\$39,188		N/A	N/A	N/A	1.0%
1995	24.2%	20.8%	28.4%	25.8%	(4.3%)	267	\$34,667		N/A	N/A	N/A	0.8%
1994**	(3.3%)	(3.9%)	(1.9%)	(3.0%)	(1.4%)	389	\$41,690		N/A	N/A	N/A	N/A

\*\*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 Jan 2001.

#### Portfolio Benchmarks

**Russell 2000® Index** – A capitalization-weighted index comprised of 2000 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.

#### ABOUT CONFLUENCE INVESTMENT MANAGEMENT LLC

Confluence Investment Management LLC is an independent Registered Investment Advisor located in St. Louis, Missouri that was founded in 2007. Confluence provides professional portfolio management and advisory services to institutional and individual clients. The firm'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, fundamental company-specific approach. Confluence's portfolio management philosophy begins by assessing risk and follows through by positioning clients to achieve their income and growth objectives. The Confluence team has more than 500 years of combined financial experience and 300 years of portfolio management experience.