

Alternative Investments • Specialty Finance BDC

This portfolio is focused on a niche of the financial sector known as business development companies, or BDCs. BDCs lend to and invest in the private debt and equity markets. The majority, if not all, of holdings in this portfolio are in BDCs, typically involving 20-30 positions with a moderate level of turnover. The BDC portfolio is suitable for clients seeking alternative investment exposure to the private markets, one that involves high levels of income from an equity portfolio with above-average volatility. Most of the portfolio income will be in the form of non-qualified dividends.

Portfolio Commentary

The equity markets began 2016 in a downtrend. Concerns ranged from global central bank policies (negative interest rates) to declining oil prices to overly aggressive Fed tightening. But around the middle of February, markets began to turn. Investors evaluated the broad landscape and determined that their concerns were perhaps overblown. “Riskier” markets – equities, corporate bonds, junk bonds and commodities – all rallied, while Treasury bond prices retreated. The Fed provided an added boost later in the quarter, telegraphing a relatively easy monetary policy for the foreseeable future.

BDCs followed a similar pattern, but had a nice recovery and finished the quarter with good returns. The benchmark WFBDC Index posted a 4.5% return for the first quarter, while the BDC Specialty Finance portfolio composite came in at 3.6% (gross of fees). Both were higher than the S&P 500, which had a 1.3% return over the same period.

For detailed performance data and disclosures see:
http://www.confluenceinvestment.com/all_investment_strategies#prod_164

During the quarter we exited two positions, Apollo Investment and Kohlberg Capital. These BDCs have exposure to riskier loans and although both stocks trade at low

valuations, we believed there were better alternatives. We also sold positions in Solar Senior Capital. Although Solar Senior has a high-quality portfolio, we believed a similar company, PennantPark Floating Rate Capital, was more attractive.

In addition to purchasing PennantPark Floating Rate Capital, we added to positions in American Capital and TICC Capital. These BDCs have been responding to activist investors who have been pushing management teams to unlock more value for shareholders. We were also able to selectively add to positions in Ares, Golub and TCP Capital. These high-quality BDCs continue to perform well and we took advantage of market volatility to build positions.

Most of the 25 BDCs owned in the portfolio during 2015 held their dividends steady. Of the 25 holdings, 21 maintained dividends, two increased dividends and two decreased dividends. In addition, four companies paid extra “special” dividends during the year. These dividend trends reflect good operating fundamentals among BDCs. The portfolio’s yield at quarter end was approximately 10.3%.

Top 5 Portfolio Holdings (as of 3/31/16)

Company	Market Capitalization <i>(\$ billions)</i>	Portfolio Weight
New Mountain Finance Corp.	1.4	7.9%
Golub Capital BDC, Inc	0.9	7.9%
TCP Capital Corp.	0.7	6.7%
Ares Capital Corp.	4.7	6.7%
Solar Capital Ltd.	0.7	6.4%

BDC Dividend Statistics at 12/31

Year	Holdings	Port. Yield	Dividend Trends*				Initiated
			Increase	Flat	Decrease	Special**	
2014	29	9.8%	5	14	1	8	5
2015	25	10.8%	2	21	2	4	0

* some BDCs were in more than one category

** special dividends paid by companies that have maintained or increased their dividends

Confluence Investment Management LLC

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