Equity Strategies • Value Opportunities

Value Opportunities is a concentrated portfolio of businesses that range in market capitalization. Companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that are trading at substantial discounts to our estimate of intrinsic value and have near-term catalysts in which to unlock the value. The portfolio may have concentrations in both individual holdings and/or industries. It typically comprises 8-12 holdings and is expected to result in high annual turnover. The strategy is suitable for clients seeking an aggressive approach to generating capital appreciation.

Strategy Commentary

Equity markets had a rough first quarter with the S&P 500 and the Russell 3000 Value Indexes down 19.6% and 27.3%, respectively. By comparison, the Value Opportunities strategy declined 25.6% (gross of fees). (*The strategy was down 26.2% (net of fees). Net of fees calculated using the highest applicable annual bundled fee of 3.00%. See disclosures on p.3 for fee description; actual investment advisory fees may vary.*)

A look at a few other indexes provides some additional insight into the market's undercurrents in the first quarter. The Russell 3000 Growth Index (down 14.9%) and Russell 3000 Value Index (down 27.3%) show that value stocks, which have underperformed growth stocks for the past several years, have been punished even more in this selloff (energy and banks, in particular). While growth stocks outperformed in the first quarter, they have primarily been supported by the FAANG+ stocks which include the five largest market caps in the S&P 500 (Microsoft, Apple, Amazon, Google, Facebook). These "top five" account for 19.5% of the entire index and had a Q1 weighted average return around -6%. This FAANG+ overweight appears to be the primary reason the headline S&P 500 Index has held up better than the general experience of individual stocks, which is more accurately represented by the S&P 500 equal-weighted index return of -26.7% (the combined weight of these five names is roughly 1% of this index). While those top five FAANG+ stocks are uniquely positioned (both in their business models and balance sheets) for the unforeseen impact of social distancing, we believe a diversified portfolio should not have such high concentration in a narrow subgroup. Additionally, the Value Opportunities strategy is focused on companies that are trading at discounts to our estimate of intrinsic value and have potential near-term catalysts which could unlock that value, two characteristics that are not typically found in most FAANG+ stocks.

There are not many financial market events that are truly unprecedented, but a pandemic-induced global economic shutdown does indeed qualify as unprecedented in modern times. The unexpected spread of COVID-19 in the U.S. during February was soon followed by an oil price war initiated by Saudi Arabia on March 8 and a dramatic decline in interest rates, with the U.S. 10-year Treasury yield hitting an all-time low of 0.38% on March 9. These events greatly increased the odds of a recession and came on top of stock and debt markets that have had a strong tailwind from ZIRP over the past 10 years. All these factors combined to take the S&P 500 down 35% (from an all-time high on February 19) over the course of 23 trading days, breaking several records for daily changes and volatility along the way.

The U.S. stock market is often a leading indicator of the health of the economy, indicating bad or good things to come (like recessions or expansions) before they are readily apparent in everyday life. As a result, one benefit of this dramatic selloff is that it further prompted a massive response from public officials and Congress, both for healthcare mobilization and monetary and fiscal stimulus. This response should help minimize fatalities and, in the meantime, bridge the gap for the economy. Still the economic damage and recovery time will depend largely on the duration of the economic shutdown.

While the stock market is good at factoring in short-term events, it can overreact (panic) from a longer-term perspective. Fortunately, the intrinsic value of the high-quality businesses we own in the Value Opportunities portfolio depend more on the companies' long-term fundamentals than the results posted over the next six months. With this in mind, we continue to stay focused on buying good companies with capable management teams that are trading at (currently substantial) discounts to our estimate of intrinsic value.

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Strategy Commentary continued...

During the first quarter we sold MSC Industrial Direct, Black Knight, Spectrum Brands, and the three DowDupont spin-offs to opportunistically buy Dollar Tree, Cannae Holdings, Avanos Medical, Charles River Labs, Healthcare Services Group, and Booking Holdings. While that is a lot of activity in one quarter, the market selloff gave us a rare opportunity to buy some great companies at very attractive prices, in our view.

Dollar Tree has a long history of strong growth and margins at its namesake dollar stores, and in 2015 it acquired Family Dollar, a small-format discount retailer. Dollar Tree has several initiatives that continue to build on the success of its dollar stores and management has made solid progress with the Family Dollar turnaround. While Dollar Tree was added to the portfolio before the pandemic, both concepts should be well positioned as the stores remain open and have some countercyclical attributes.

Cannae Holdings is a private equity-like investment vehicle overseen by Bill Foley, a legendary capital allocator. His successful investments over the past 40 years are too numerous to discuss here, but the acquisition of Dun & Bradstreet in early 2019 is going very well and an eventual spin-off could provide a nice catalyst for the stock.

Avanos Medical and Charles River Labs are both niche healthcare product companies that are positioned for long-term growth and were added to the portfolio at a significant discount to our estimate of intrinsic value. Avanos manufactures innovative pain management, digestive health, and respiratory care products and is patiently looking to redeploy the proceeds from selling its low-growth surgical and infection products business in 2018. Charles River is a market leader in providing genetically tailored lab rodents for drug development and over the past 10 years has built a valuable business providing third-party drug development services.

Healthcare Services Group and Booking Holdings are great businesses that have been directly affected by the pandemic. Healthcare Services Group provides management of healthcare cleaning, laundry, and nutrition services at senior living skilled nursing facilities, in particular. These managers bring industry-leading best practices that increase quality and efficiency at customers' facilities, resulting in a long history of growing demand for the company's services. Booking Holdings operates Booking.com, an OTA (online travel agent) that specializes in helping travelers reserve hotels around the world. While asset-heavy hotels are at the epicenter of the pandemic-induced global economic shutdown, Booking is a high margin technology company that provides a crucial network for European boutique hotels, in particular. Both companies have strong balance sheets with substantial cash positions and were purchased at very attractive valuations, a good combination for successful investments in an unprecedented environment.

This quarter, the new positions in Charles River Labs and Healthcare Services Group proved to be good contributors. The weakest performers were some of the more cyclical or leveraged companies in the portfolio, which were the primary drivers of the strategy's underperformance relative to the S&P 500 with sector underperformance in Materials, Consumer Staples, and Technology. The strategy benefited from having no Energy exposure and outperformed meaningfully in the Financials sector.

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

Security	Avg Weight	Contribution
Top 5		
Charles River Laboratories International, Inc.	0.78	0.88
Healthcare Services Group, Inc.	0.99	0.86
Black Knight, Inc.	4.78	0.52
Booking Holdings Inc.	0.93	0.14
MSC Industrial Direct Co., Inc.	0.55	(0.19)
Bottom 5		
Markel Corporation	11.44	(2.24)
Frontdoor, Inc.	12.40	(3.33)
NXP Semiconductors N.V.	9.91	(3.47)
Axalta Coating Systems Ltd.	8.21	(3.80)
Spectrum Brands Holdings, Inc.	7.18	(4.39)

(Contribution data shown from a sample account)

5 Largest Holdings (as of 3/31/20)

Company	Market Capitalization	Portfolio Weight
	($ billions)	
Frontdoor, Inc.	3.0	11.7%
Cannae Holdings, Inc.	2.7	10.7%
Dollar Tree, Inc.	17.4	10.5%
Berkshire Hathaway Inc. (Class B)	442.9	10.4%
Markel Corporation	12.8	10.3%

The listing of "5 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 3/31/20

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	S&P 500	R3000 Value
Since Inception**	9.6%	6.4%	4.8%	5.5%
15-Year*	8.4%	5.3%	7.6%	5.3%
10-Year*	9.3%	6.1%	10.5%	7.5%
5-Year*	(0.0%)	(3.0%)	6.7%	1.6%
3-Year*	(6.9%)	(9.7%)	5.1%	(2.7%)
1-Year	(12.9%)	(15.5%)	(7.0%)	(18.0%)
YTD	(25.6%)	(26.2%)	(19.6%)	(27.3%)
QTD	(25.6%)	(26.2%)	(19.6%)	(27.3%)

**Average annualized returns*
***Inception is 4/1/2000*

Calendar Year	Pure Gross-of-Fees[1]	Net-of-Fees[2]	S&P 500	R3000 Value	Difference (Gross-S&P500)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	S&P 500 3yr Std Dev	R3000V 3yr Std Dev	Composite Dispersion
2000**	43.6%	40.7%	(11.1%)	7.3%	54.8%	1	$74		N/A	N/A	N/A	N/A
2001	1.1%	(1.7%)	(11.9%)	(4.3%)	13.0%	79	$7,097		N/A	N/A	N/A	0.4%
2002	(14.8%)	(17.1%)	(22.1%)	(15.2%)	7.3%	107	$7,786		N/A	N/A	N/A	0.9%
2003	40.4%	36.5%	28.7%	31.1%	11.7%	126	$23,976		25.2%	18.1%	16.0%	0.9%
2004	4.8%	2.0%	10.9%	16.9%	(6.1%)	189	$25,252		20.1%	14.9%	14.8%	1.0%
2005	4.4%	1.6%	4.9%	6.9%	(0.5%)	179	$23,399		11.7%	9.0%	9.7%	0.8%
2006	27.0%	23.6%	15.8%	22.3%	11.3%	171	$19,132		7.6%	6.8%	7.0%	1.7%
2007	2.1%	(0.7%)	5.5%	(1.0%)	(3.4%)	197	$20,510		8.4%	7.7%	8.3%	0.7%
2008	(22.3%)	(24.5%)	(37.0%)	(36.2%)	14.7%	29	$8,299	$291,644	18.6%	15.1%	15.5%	N/A
2009	31.5%	27.6%	26.5%	19.8%	5.0%	37	$14,001	$533,832	25.2%	19.6%	21.3%	2.0%
2010	6.9%	3.7%	15.1%	16.3%	(8.2%)	51	$7,429	$751,909	27.9%	21.9%	23.5%	0.7%
2011	(1.7%)	(4.6%)	2.1%	(0.1%)	(3.8%)	53	$7,694	$937,487	23.7%	18.7%	21.0%	0.6%
2012	28.5%	24.7%	16.0%	17.6%	12.5%	53	$9,576	$1,272,265	18.3%	15.1%	15.8%	0.9%
2013	32.3%	28.3%	32.4%	32.7%	(0.1%)	76	$18,299	$1,955,915	13.5%	11.9%	12.9%	0.4%
2014	31.6%	27.7%	13.7%	12.7%	17.9%	110	$31,040	$2,589,024	11.4%	9.0%	9.4%	0.9%
2015	2.3%	(0.7%)	1.4%	(4.1%)	1.0%	554	$113,587	$3,175,419	10.8%	10.5%	10.7%	0.3%
2016	15.4%	12.0%	12.0%	18.4%	3.4%	959	$207,565	$4,413,659	10.9%	10.6%	11.0%	0.5%
2017	14.5%	11.1%	21.8%	13.2%	(7.3%)	1,737	$359,636	$5,944,479	9.8%	9.9%	10.3%	0.8%
2018	(18.8%)	(21.2%)	(4.4%)	(8.6%)	(14.4%)	1,494	$236,097	$5,486,737	11.9%	10.8%	11.1%	0.8%
2019	28.6%	24.7%	31.5%	26.2%	(2.9%)	1,129	$230,991	$7,044,708	13.6%	11.9%	12.0%	0.7%

Portfolio Benchmarks

S&P 500 Index – A capitalization-weighted index of 500 stocks. The Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Russell 3000® Value Index – A capitalization-weighted index designed to measure performance of those Russell 3000® 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 Value Opportunities Strategy was incepted on April 1, 2000, and the current Value Opportunities 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 Value Opportunities Composite contains fully discretionary Value Opportunities wrap accounts. Value Opportunities is a concentrated, value-based, bottom-up portfolio that utilizes stocks from all market capitalizations with a focus on near-term catalysts. Catalysts include reorganizations, turnarounds and other unique situations that are anticipated to come to fruition in approximately six to 18 months. This short-term investment time frame often leads to high turnover. *Because of the concentrated positions, the portfolio is more susceptible to movements of any one holding.* **Results shown for the year 2000 represent partial period performance from April 1, 2000, through December 31, 2000. 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.