

## Value Opportunities • Value Equity Strategies

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 appropriate for clients seeking an aggressive approach to generating capital appreciation.

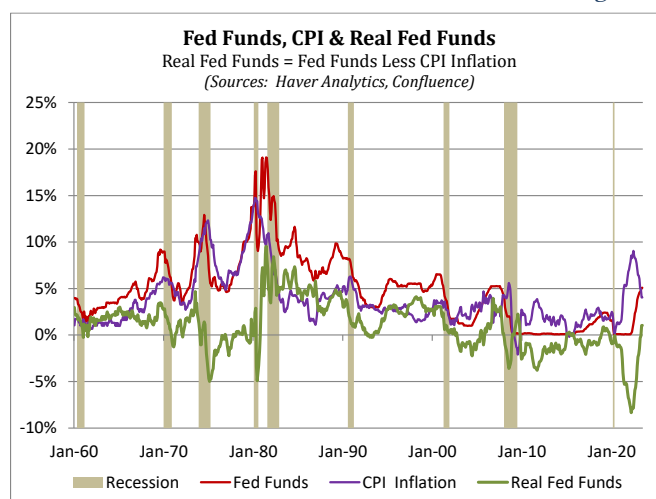
### Market Commentary

*“The majority of advanced technologies follow a predictable life cycle of hype, disillusionment, realism, and, eventually, productivity.”*

– Gartner analyst Jackie Fenn, 1995

Risk markets continued their upward trend during the quarter as many of the concerns that pressured the markets in 2022 are gradually receding, while the economy continues to advance. Inflation, and the Federal Reserve’s aggressive response, was the primary worry but now that we are past the peak and inflation is trending downward, the Fed has recently decided to pause its rate hikes (*Figure 1*). The domestic debt ceiling also loomed over the financial markets but was resolved in the waning hours in typical Washington, D.C. fashion. The war in Ukraine is progressing more favorably than originally feared and commodity markets have adjusted. Meanwhile, employment remains plentiful and wage growth robust, which have aided the economic advance despite the sharp rise in short-term interest rates and the banking sector stumbles in March. This is likely due to the fact that the last stage of the cycle was not driven by credit expansion but rather liquidity injections, both fiscal and monetary. This would explain why banks were so flush with deposits but have yet to experience credit issues despite the spike in rates. Suffice it to say, the wall of worry has been fading which has boosted investor sentiment as exhibited by the risk markets, per the quilt chart shown below (*Figure 2*).

*Figure 1*



Risk market returns were broadly positive but widely dispersed with more speculative and longer-duration assets leading the pack. For equity markets, the reduced uncertainty and economic resilience combined with the excess liquidity provided support for equities, but the hype surrounding artificial intelligence (AI) with the release of ChatGPT sparked a frenzy in technology-oriented names, mainly mega caps. These mega cap names have been labeled the “Magnificent Seven” (M7) by none other than CNBC’s Jim Cramer and they are Apple (AAPL), Microsoft (MSFT), Amazon (AMZN), Alphabet (GOOG), Nvidia (NVDA), Tesla (TSLA), and Meta (META). In fact, the M7 has added \$4.0 trillion (yes, trillion) in market cap year-to-date!

*Figure 2*

**Quarterly Asset Class Returns as of 6/30/2023**

	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023
Cash	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.5%	0.8%	1.1%	1.2%
U.S. Short-Term Bonds	0.3%	0.2%	0.0%	0.1%	0.1%	-0.5%	-2.6%	-0.6%	-1.5%	0.9%	1.5%	-0.3%
U.S. Intermediate-Term Bonds	1.1%	0.7%	-4.1%	2.4%	-0.1%	-0.2%	-6.5%	-4.4%	-5.0%	2.2%	3.3%	-1.2%
U.S. Long-Term Bonds	1.2%	1.0%	-10.8%	6.7%	-0.1%	2.3%	-10.9%	-11.5%	-9.4%	2.3%	5.7%	-1.4%
Speculative Grade Bonds	4.7%	6.5%	0.9%	2.8%	0.9%	0.7%	-4.5%	-10.0%	-0.7%	4.0%	3.7%	1.6%
REITs	1.4%	11.6%	8.9%	12.0%	1.0%	16.3%	-3.9%	-17.0%	-9.9%	5.2%	2.7%	2.6%
U.S. Large Cap Stocks	8.9%	12.1%	6.2%	8.5%	0.6%	11.0%	-4.6%	-16.1%	-4.9%	7.6%	7.5%	8.7%
U.S. Mid-Cap Stocks	4.8%	24.4%	13.5%	3.6%	-1.8%	8.0%	-4.9%	-15.4%	-2.5%	10.8%	3.8%	4.9%
U.S. Small Cap Stocks	3.2%	31.3%	18.2%	4.5%	-2.8%	5.6%	-5.6%	-14.1%	-5.2%	9.2%	2.6%	3.4%
Int'l Developed Market Stocks	4.8%	16.0%	3.5%	5.2%	-0.4%	2.7%	-5.9%	-14.5%	-9.4%	17.3%	8.5%	3.0%
Emerging Market Stocks	9.6%	19.7%	2.3%	5.0%	-8.1%	-1.3%	-7.0%	-11.4%	-11.6%	9.7%	4.0%	0.9%
Commodities	4.6%	14.5%	13.5%	15.7%	5.2%	1.5%	33.1%	2.0%	-10.3%	3.4%	-4.9%	-2.7%

(Source: [Confluence Asset Allocation Committee](#). See disclosures on last page for asset class composition.)

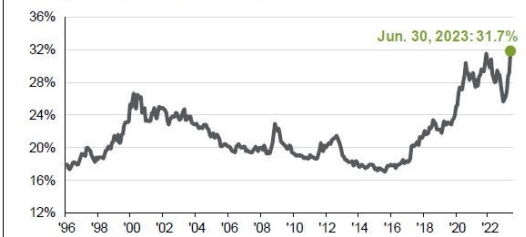
## Market Commentary continued...

The M7 impact on market cap-weighted indexes like the S&P 500 was meaningful and accounted for approximately 65% quarter-to-date and 73% year-to-date of the overall index return, while the impact on growth indexes was even more significant. The influence and valuations are reflected in the narrow concentration of the top 10 companies in the S&P 500, which now constitute a record 31.7%. J.P. Morgan Asset Management compiled a history of the valuations and weightings of the top 10 stocks, all of which are at the upper end of historical levels, aside from earnings contribution (Figure 3). The influence of the M7 is also apparent in the second quarter dispersion between the Russell 1000 Growth Index, up 12.8%, compared to the Russell 1000 Value Index, up 4.1%. More concisely, the difference is also evident in the S&P 500 Equal Weight Index, up 4.0%, versus the S&P 500, up 8.7%.

**P/E ratio of the top 10 and remaining stocks in the S&P 500**  
Next 12 months, 1996 - present



**Weight of the top 10 stocks in the S&P 500**  
% of market capitalization of the S&P 500



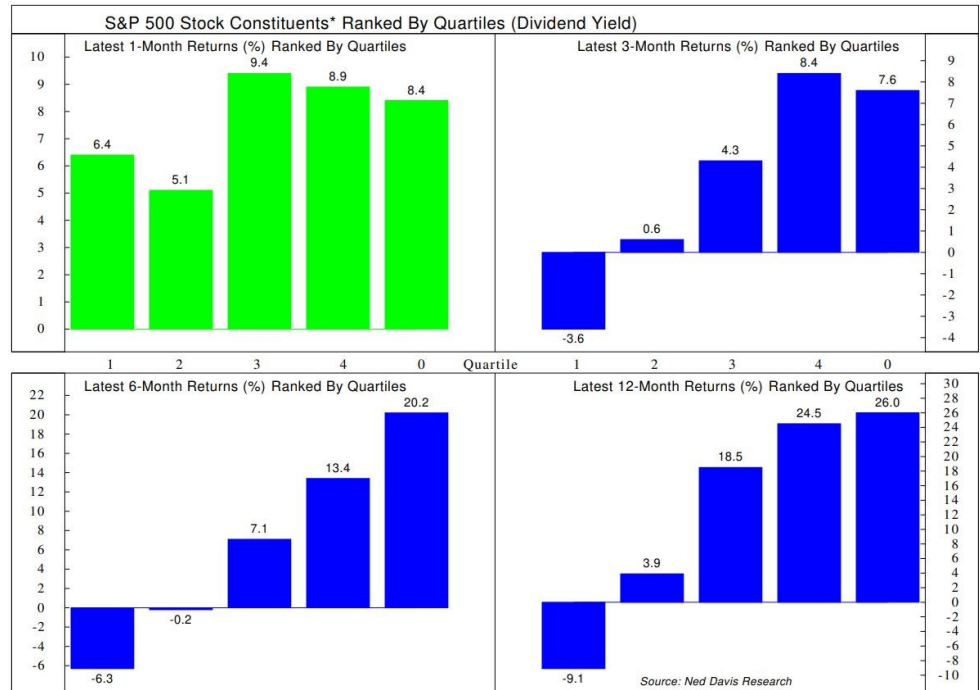
**Earnings contribution of the top 10 in the S&P 500**  
Based on last 12 months' earnings



(Source: J.P. Morgan Asset Management; Guide to the Markets®, U.S. 3Q 2023, as of June 30, 2023)

The variance in long-duration versus short-duration (i.e., businesses generating earnings/cash flow in the near-term versus later years) is also reflected in the S&P 500 yield quartiles, with the higher yielding equities lagging the low yield and non-dividend payers (Figure 4).

The hype of AI will likely disappoint investors in a similar fashion to prior “revolutions” of the past few hundred years. For example, railroad investors of the late 19th century saw more track laid than what is in existence today. More recently, the advent of the internet in the 1990s immensely benefited the businesses of semiconductors and networking yet the industry leaders in semis and networking, Intel and Cisco, trade at lower levels today than their peak almost 25 years ago. AI, much like the technological advances before it, will likely take the path stated in the quote at the beginning of this report: hype, disillusionment, realism, and, eventually, productivity. For an economy grappling with inflationary pressures driven by low unemployment and a splintering global economy, advances in productivity would be a welcome relief.



\*Actual Historical Constituents. Returns through 6/30/2023 (Source: Ned Davis Research)  
Returns of dividend payers in the S&P 500, ranked by quartile from highest dividend yield (bar 1) to lowest (4), compared to all S&P 500 stocks with zero dividends, reflected in the fifth bar (0).

The U.S. economy's avoidance of a recession so far despite the headwinds of monetary policy restraint speaks to its underlying strength. Consumers are benefitting from the tight job market which is leading to strong wage growth while also being supported by the excess savings built up during the pandemic. While inflation has rolled over from its peak, it remains well above the Fed's target of 2%. Future data will impact whether additional rate hikes are needed. For the equity markets, the near-term focus on long-duration, high-growth companies appears at odds with the rise in rates and inflation. The current earnings environment has met or exceeded expectations, but there are a handful of crosscurrents, including rising rates, wage pressures, and the normalization of the supply chain. As always, we remain focused on finding competitively advantaged businesses with pricing power to protect against inflation that are trading at attractive valuations.

## Strategy Commentary

The Confluence Value Opportunities strategy had a strong second quarter, up 8.0%, for a year-to-date return of 18.7% (both gross of fees). *[The strategy's net-of-fees returns for the same periods were 7.2% QTD and 16.9% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.]*

The S&P 500 Index increased 8.7% in the quarter and is up 16.9% year-to-date, but the index's performance was overwhelmingly driven by the largest M7 stocks (Apple, Microsoft, Amazon, Nvidia, Google, Tesla, and Meta, discussed in the Market Commentary), which account for 28% of the market cap-weighted S&P 500. By comparison, the S&P 500 Equal Weight Index (SPXEW), which weights all 500 stocks in the index equally, is up only 7.0% year-to-date. Over the past 30 years, SPXEW has outperformed the S&P 500 because growth tends to slow as companies get very large; after all, "no tree grows to the sky." Despite that, as seen in the accompanying chart (Figure 5), the mega cap M7 stocks have driven the S&P 500 (orange line) higher in 2023, while on average the 500 stocks in SPXEW (blue line) were flat through the end of May.

With the Federal Reserve's interest rate policy in flux, there have been many ups and downs this year. This chart demonstrates how these factors impacted the S&P 500 (which is heavily influenced by the M7) very differently than the equal-weighted average in the SPXEW index. As you can see, when the regional banking crisis hit in March, investors flocked to the "safe" mega cap stocks. Then recession fears in May, along with the AI frenzy, further drew investors into the top tech stocks. In particular, Nvidia and Tesla are up 189% and 112% year-to-date, and with market caps of \$1.05 trillion and \$830 billion, respectively, they are priced for a potential AI windfall with material downside if that comes up short. Only time will tell whether flocking back to the M7 stocks will work out well for investors or if it is just another speculative splurge from the free money-induced exuberance we have been navigating over the past six years.

Value Opportunities outperformed the S&P 500 year-to-date and also outpaced the more applicable performance of the SPXEW (up 7.0%) and the Russell 3000 Value Index (up 5.0%). While the portfolio trailed in the M7-heavy sectors, it more than made up for it with outperformance from Health Care (Charles River Labs (CRL), purchased during the quarter) and Industrials (Azek (AZEK), Clarivate (CLVT), and Gates (GTES)). In particular, Azek was added to the portfolio in the fourth quarter of 2022 and is up over 45% in 2023 as sustained demand for composite decking has been a solid catalyst for the stock. *[See contribution table on next page.]*

Spectrum Brands (SPB) has also been a strong contributor year-to-date, up over 25%. Spectrum was purchased in December 2022 as the company struggled to obtain FTC approval for a transformational deal to sell its lock business to a foreign buyer (for the details, see our commentary from [Q4 2022](#)). In June, the deal was cleared and completed, netting \$3.6 billion after taxes and fees to Spectrum, a company that was valued at \$2.4 billion when we purchased it and still has a market cap of only \$3.2 billion.

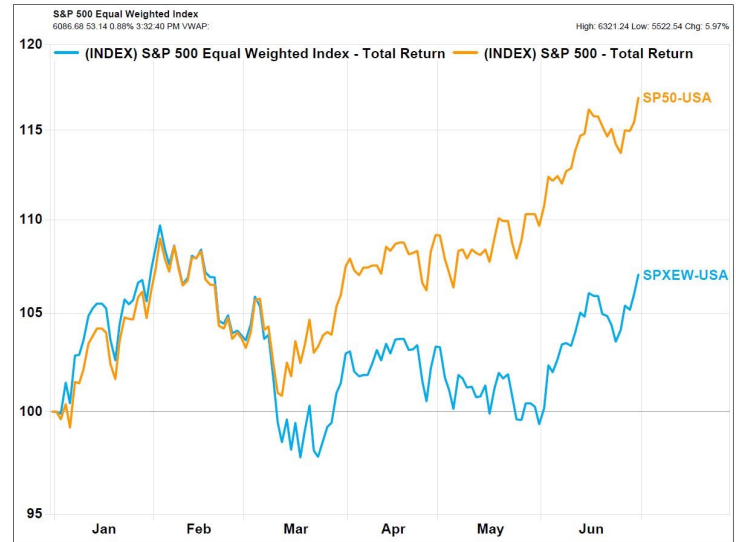
In late April, we added Charles River Laboratories to the portfolio. CRL is the leading provider of early-stage drug research and development services for biopharma, with leadership positions in animal research models, safety assessment, and various manufacturing segments. CRL has built a reputation for superior quality in an industry where quality is incredibly important, as the ultimate success of getting a drug to the market depends upon the testing performed in the very early stages of research. Over the years, management has efficiently reinvested the cash generated by the Research Models and Services (RMS) segment into faster-growing, higher-return segments in the preclinical market. This allowed the company to build out a unique portfolio across the research and development (R&D) continuum. In recent years, the company has made the investments needed to take a leadership position in cell and gene therapies; however, being ahead of the market often comes with risks. The slow integration of these new services has given us the opportunity to add CRL to the portfolio at a discount to its intrinsic value. In our view, CRL's portfolio is unmatched and has a significant runway for growth with just 13% market share in an estimated \$22.5 billion market. As the dominant share leader, we believe CRL should continue to benefit from the absolute growth of the market and the growing percentage of R&D being outsourced to contract research organizations.

## Outlook

As seen in the previous chart, the second quarter ended with a broad-based rally on glimmers of a "soft landing" (moderating inflation with continued economic growth and low unemployment). While this is possible, it will depend on how determined the Federal Reserve is to raise interest rates to force inflation even lower.

All these crosscurrents are just another reminder of why we don't attempt to market time our investments. Instead, we continue to stay focused on owning great companies with capable management teams purchased at a significant discount to intrinsic value. This philosophy and process have served us well over many years and delivered solid gains in the first half of 2023, despite ongoing uncertainty in the financial markets.

Figure 5



(Source: Confluence, FactSet)



## Value Opportunities • Value Equity Strategies

### Contribution<sup>1</sup>

(YTD as of 6/30/2023)

The top contributors and detractors for the portfolio thus far in 2023 are shown in this table:

Security	Avg Weight (%)	Contribution (%)
<b>Top 5</b>		
Vontier Corp.	8.48	4.50
NXP Semiconductors N.V.	11.82	3.50
Spectrum Brands Holdings Inc.	10.29	3.07
Azek Co. Inc.	6.55	2.93
Gates Industrial Corp. plc	9.25	1.57
<b>Bottom 5</b>		
Charles River Laboratories International Inc.	1.94	0.61
Dollar Tree Inc.	9.48	0.12
SL Green Realty Corp.	Sold	(0.01)
BRP Group Inc.	7.74	(0.06)
Cannae Holdings Inc.	1.90	(0.36)

(Contribution data shown from a sample account, based on individual stock performance and portfolio weighting)

### Performance Composite Returns<sup>2</sup> (For Periods Ending June 30, 2023)

	Since Inception**	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
<b>Value Opportunities</b> <i>Pure Gross-of-Fees<sup>3</sup></i>	9.9%	9.6%	9.5%	8.9%	2.7%	6.9%	14.8%	18.7%	8.0%
<i>Max Net-of-Fees<sup>4</sup></i>	6.8%	6.5%	6.2%	5.6%	(0.3%)	3.8%	11.4%	16.9%	7.2%
<b>S&amp;P 500</b>	6.8%	10.0%	10.9%	12.8%	12.3%	14.6%	19.6%	16.9%	8.7%
<b>Russell 3000 Value</b>	7.1%	8.5%	8.3%	9.1%	7.8%	14.3%	11.2%	5.0%	4.0%

Calendar Year	Pure Gross-of-Fees <sup>3</sup>	Max Net-of-Fees <sup>4</sup>	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%
2020	9.5%	6.2%	18.4%	2.9%	(8.9%)	745	\$165,389	\$6,889,798	20.0%	18.5%	20.0%	1.3%
2021	6.9%	3.8%	28.7%	25.3%	(21.7%)	532	\$132,656	\$7,761,687	18.3%	17.2%	19.3%	1.2%
2022	(22.3%)	(24.6%)	(18.1%)	(8.0%)	(4.1%)	331	\$61,497	\$6,931,635	21.1%	20.9%	21.5%	0.9%

\*Average annualized returns

\*\*Inception is 4/1/2000

See performance disclosures on last page.

### Portfolio Benchmarks

**S&P 500® Index** – A capitalization-weighted index of 500 stocks 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 Value Equities Investment Committee

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Daniel Winter, CFA	Tore Stole	Joe Hanzlik	Kaisa Stucke, CFA	Brett Mawhiney, CFA

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## Disclosures

**Market & Strategy Commentary**—Figure 2: Asset class representation: Cash (ICE BofA 3M T-Bill); Short-Term Bonds (ICE BofA 1-3 Year US Corp&Govt); Intermediate-Term Bonds (ICE BofA 5-10 Year US Corp&Govt); Long-Term Bonds (ICE BofA 10+Yr US Corp&Govt); Speculative Grade/High-Yield Bonds (ICE BofA US High Yield Master); REITs (FTSE NAREIT Equity); Large Cap (S&P 500); Mid-Cap (S&P MidCap 400); Small Cap (S&P Small Cap 600); Foreign Developed Country (MSCI EAFE); Emerging Markets (MSCI Emerging Markets); Commodities (S&P GSCI). Data source: Morningstar Direct.

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. Opinions and estimates are as of a certain date and subject to change without notice. Past performance is no guarantee of future results.

All investments carry a certain degree of risk, including possible loss of principal. It is important to review your investment objectives, risk tolerance & liquidity needs before choosing an investment style or manager. Equity securities are subject to market risk & may decline in value due to adverse company, industry or general economic conditions. There can be no assurance that any investment objective will be achieved.

**Indices:** The S&P 500 and Russell 3000 Value 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.

**<sup>1</sup>Contribution**—Table showing the top 5 contributors/detractors reflects the strategy's best and worst performers (net), based on each holding's contribution to the sample account for the period stated. Holdings identified do not represent all of the securities purchased, sold or recommended. Individual client portfolios in the strategy may differ, sometimes significantly, from these listings.

**<sup>2</sup>Performance Composite Returns**—Confluence Investment Management LLC claims compliance with the Global investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Confluence Investment Management LLC has been independently verified for the periods August 1, 2008, through December 31, 2021. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards.

Verification provides assurance on whether the firm's policies and procedures related to composite maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

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<sup>3</sup>Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

<sup>4</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 is available upon request. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. The annual composite dispersion is an equal-weighted standard deviation, using gross-of-fee returns, calculated for the accounts in the composite for the entire year. The three-year annualized standard deviation measures the variability of the composite gross returns over the preceding 36-month period. 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 6-18 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.