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

A late-year rally in 2023 produced the bulk of the outsized returns for equity markets following a very tumultuous 2022. The year began with continued concerns regarding both inflation and how the Federal Reserve's aggressive tightening actions would impact the economy. The impact was not clear amongst investors, however, as divergent paths became apparent in the fixed income and equity markets. A sharply inverted yield curve implied fixed income investors were concerned about a recession, while the equity markets had a more optimistic view of the economy following a strong Q4 in 2022 and expectations of earnings growth in 2023. Given these crosscurrents, and coupled with the Fed's continued rate increases in 2023, equity returns were unable to gain traction for most of the year, fluctuating between positive and negative. It was not until late October when the Fed gave a clear signal that rate hikes had likely peaked with rate cuts more probable in 2024, which provided the spark that led to strong rallies in financial assets. From the lows in late October, the 10-year Treasury rallied from a yield of approximately 5% to under 4% and equities were up in the mid-teens, with the S&P 500 up 16%, the S&P 500 Equal Weight up 18%, and the Russell 2000 up 24% during this period. Those returns during the quarter led to a solid year, with the S&P 500 up 26%, the S&P 500 Equal Weight up 14%, and the Russell 2000 up 17% for 2023.

The strong returns of 2023 helped to recoup much of the losses from 2022, leaving many of the large cap indexes essentially flat for the past couple of years, with the S&P 500 up 3% and the S&P 500 Equal Weight up 1%, whereas the small cap Russell 2000 is down 7% since the end of 2021. So, why the contrast between 2022 and 2023 when the economy avoided a recession? While 2022 may have sidestepped an official recession, there were factors at play that typically lead to or indicate recessions, such as: real incomes declined which eroded confidence following the sharp inflationary spike driven by stimulus demand; manufacturing and transport experienced normalization in 2022 following strong demand for goods over services in the prior year; housing and commercial real estate stalled due to the spike in rates; and mega-cap tech saw a sharp pullback as we witnessed a collapse in speculative IPOs, SPACs, meme stocks, and early stage and/or unprofitable businesses. Despite these headwinds, the economy continued to grow and employment remained strong, with unemployment staying below 4%. Many of these headwinds have now subsided or have shifted to tailwinds, allowing the Fed to pause on hikes and begin to contemplate cuts in 2024, which provided support for financial assets.

While equity returns were strong, the breadth was narrow. This is evidenced by the return difference between the equally weighted and market cap-weighted S&P 500 indexes at 14% versus 26%, respectively. Moreover, the S&P 500 ended the year at $41.7 trillion market cap, up $8.2 trillion, and $5.0 trillion of that growth came from the mega-cap tech businesses, primarily the Magnificent 7 (M7), which posted a cumulative 73% return. Hence, approximately two-thirds of the index's return came from just seven names, while the remaining 493 businesses contributed the remaining $3.2 trillion in market cap growth.

The dominance of the M7 is also reflected when looking at the sector contributions as Communication Services (GOOG, META), Technology (AAPL, MSFT, NVDA), and Consumer Discretionary (AMZN, TSLA) trounced all the other sectors (see table, *Figure 1*). It also shows that two of the defensive sectors, Consumer Staples and Utilities, were flat to negative. Energy was the only other sector to post a loss following a stellar 2022, when it returned over 60%.

Figure 1 **Returns and Valuations by Sector**

	Energy	Materials	Financials	Industrials	Cons. Disc.	Tech.	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index
S&P weight	3.9%	2.4%	13.0%	8.8%	10.9%	28.9%	8.6%	2.5%	12.6%	6.2%	2.3%	100.0%
Russell Growth weight	0.5%	0.7%	6.4%	5.9%	15.8%	43.5%	11.4%	0.9%	10.6%	4.1%	0.1%	100.0%
Russell Value weight	7.8%	4.9%	21.8%	13.9%	5.2%	9.5%	4.7%	5.0%	14.6%	7.9%	4.8%	100.0%
Russell 2000 weight	6.9%	4.5%	17.1%	17.0%	11.0%	13.6%	2.3%	6.2%	15.4%	3.4%	2.7%	100.0%
4Q23	-6.9	9.7	14.0	13.1	12.4	17.2	11.0	18.8	6.4	5.5	8.6	11.7
2023	-1.3	12.5	12.1	18.1	42.4	57.8	55.8	12.3	2.1	0.5	-7.1	26.3

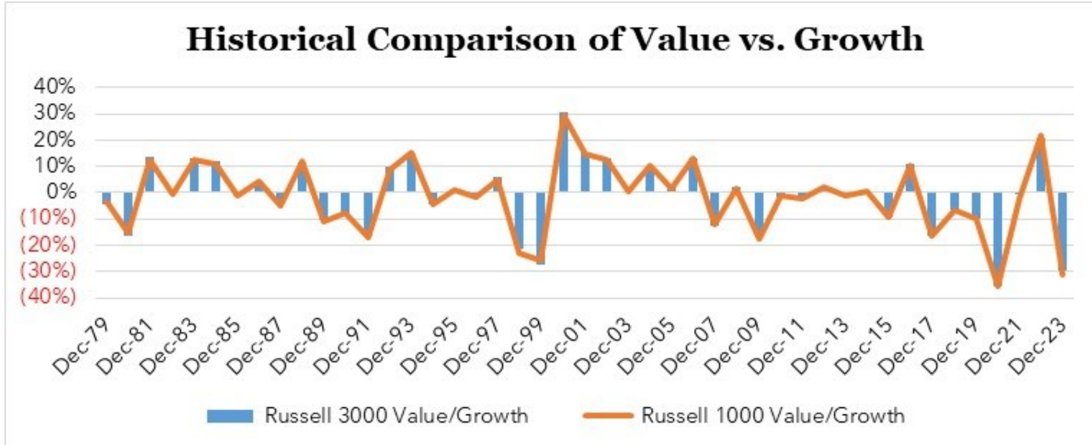
(Source: J.P. Morgan Asset Management; Guide to the Markets®, U.S. 1Q 2024, as of December 31, 2023)

See GIPS Report on pages 4-5.

Market Commentary continued...

It is worth noting that the M7 were the driving force behind the outperformance of large caps over small caps as well as the Growth style trouncing Value by one of the widest historical margins (see *Figure 2*).

Figure 2

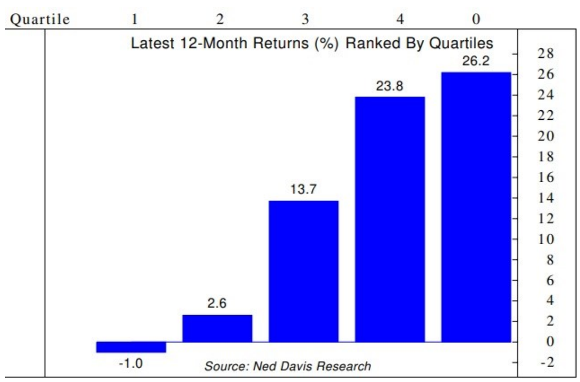


(Sources: Confluence, FactSet)

It is also worth highlighting the impact of the M7 on the dividend segment of the market as the M7 pay little to no dividends, except MSFT and AAPL. There was a clear benefit to the non-paying and lower dividend-yielding businesses as reflected in the following chart showing the S&P 500 returns ranked by yield quartile from Ned Davis Research (*Figure 3*), where higher-yielding quartiles are dramatically lagging the low-paying or non-paying quartiles. Their impact can also be seen when we look at dividend growers versus non-payers (see table, *Figure 4*) as companies that grow their dividends have lagged the non-paying dividend stocks.

Figure 3

S&P 500 Stock Constituents* Ranked by Quartiles (Dividend Yield)



*Actual Historical Constituents. *Returns through 12/31/2023*

Highest yielding in Quartile 1 and lowest in Quartile 4;
Non-dividend-payers are in Quartile 0

Figure 4

Returns of S&P 500 Stocks by Dividend Policy

Portfolio Performance Statistics
Analysis Dates: 12/31/2022 to 12/31/2023

Portfolio	Gain/Annum %	Growth of $100
Dividend Growers & Initiators	8.1%	$108.09
All Dividend-Paying Stocks	8.6%	$108.64
Dividend Payers w/No Change in Dividends	14.2%	$114.22
Dividend Cutters & Eliminators	(1.9%)	$98.10
Non-Dividend Paying Stocks	21.6%	$121.58

Returns based on monthly equal-weighted geometric average of total returns of S&P 500 component stocks, with components reconstituted monthly.

(Sources, Figures 3 and 4: Ned Davis Research)

Is It Different This Time?

The M7 have driven the broad indexes for the better part of the past seven years, so what causes a rotation? We have addressed this issue in a special *Value Equity Insights* report that offers some perspective on the bifurcation that has occurred in the current market along with historical context in order to help investors navigate the investment landscape more safely.

Outlook

As the Fed pauses and contemplates a shift toward more accommodative policy, the equity markets have rallied on the anticipation that this will result in a soft landing and continued earnings growth. The late-year rally was much broader in breadth than earlier moves and elicits the prospect that the market could broaden further should the economy continue to expand. Of course, 2024 brings with it many uncertainties from elections here and abroad to many simmering geopolitical hotspots, such as the conflicts in Ukraine and the Middle East and China's overtures toward Taiwan, all of which may incite events that impact the financial markets. Meanwhile, the domestic economy has been able to weather the recent spike in inflation and the ensuing monetary tightening without the typical rise in unemployment and ultimate recession, which may or may not continue in 2024. History has shown that uncertainties always abound, which is why it is important to remain steadfast in your investment discipline — something the team at Confluence has been doing for three decades. We remain committed to our philosophy of focusing on fundamentals and valuations as our emphasis is on identifying competitively advantaged businesses trading at attractive valuations.

Strategy Commentary

As discussed last quarter, in September the market started believing the Fed's "higher for longer" message, but that didn't last long as the 10-year U.S. Treasury yield topped 5% on October 23, the stock market bottomed on October 27, and then it was off to the races on expectations of significant rate cuts in 2024. As a result, on October 27, the S&P 500 Equal Weight Index was down 4.0% year-to-date and the S&P 500 Index was up 8.6%, but after the November/December rally the indexes ended up 13.9% and 26.3% for the full year, respectively. The unusually large difference between the two indexes was entirely from the outsized weighting in the S&P 500 of the M7 growth stocks (Apple, Microsoft, Amazon, Google, Meta, Tesla, and NVIDIA), whose aggregate market cap increased 73% in 2023.

As we wrote about a year ago, with value stocks outperforming in 2022 and the M7 down almost -40%, it looked like the five years of ZIRP/pandemic-induced speculation had finally come to an end. However, in 2023, the M7 came roaring back on excitement about AI followed by rate-cut hopes late in the year. This bifurcation is further reflected in the Growth versus Value imbalance, with the Russell 3000 Growth Index up 41.2% in 2023, while the Russell 3000 Value Index was up only 11.6%. By comparison, the Confluence Value Opportunities strategy was up 30.6% in 2023 (gross of fees). [*The strategy's net-of-fees return for the same period was 26.7% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

In 2023, Value Opportunities outperformed both the M7-heavy S&P 500 and the Russell 3000 Value. More importantly, Value Opportunities outperformed with a portfolio of quality, mostly mid-cap, companies purchased at a discount to intrinsic value, and notably without owning any of the M7 growth stocks.

The top contributors to performance in 2023 were: Vontier Corp. (VNT), which continues to rebound from an unduly low valuation in late 2022; Azek Company (AZEK), which was up strong in 2023 on sustained demand for composite decking; and Progressive (PGR), which was opportunistically purchased during a selloff in July. The primary detractors to performance in 2023 were Cannae (CNNE) and BRP Group (BRP), which were both sold during the year, and Dollar Tree, which was weak due to concerns in retail about consumer demand. [*See contribution table on next page.*]

In mid-September, we purchased Keysight Technologies (KEYS), the largest developer of software and hardware used for electronic design and test functions in research and development (R&D) labs around the world. We like to think about Keysight as a pick-and-shovel business that offers the technology needed to produce a good or service instead of the final output of product. In other words, we don't care who wins in the fast-growing electronic communication "gold rush" because Keysight sells test and measurement instruments and software used for R&D to almost all the manufacturers of the equipment and devices.

Keysight has over 30,000 customers and counts virtually every leading innovator among them. Its deep relationships with these customers allow the company to fulfill its ever-growing research and testing needs, making it even more intriguing from an investment standpoint. Keysight often has a dozen or more engineers working onsite with its largest customers in order to develop the tools necessary for prototyping, design verification, and field testing of new products. These strong customer relationships have enabled Keysight to push an increasing amount of software content into its products to achieve leading-edge product testing. This further entrenches the company's products within its customers' labs and creates an even more sticky offering. It also enables Keysight to gain valuable knowledge about where industry standards are moving, sometimes years in advance, and uses internal R&D spending to quickly expand its cutting-edge solution portfolio to its broader customer base.

We feel that these characteristics are evidence of a strong moat. Building on this moat is the fact that the industries and markets the company serves, including electric vehicles, autonomous vehicles, 5G wireless, 400Gb Ethernet, aerospace and defense modernization, and semiconductor process development, all have very favorable long-term growth characteristics. We expect Keysight to benefit from these trends for several years. A strong moat combined with a growing end-market is often a combination for compounding returns, especially when purchased at an attractive valuation.

Outlook

As is human nature, investors have talked themselves into the best outcome for 2024 — a "soft landing" — wherein inflation subsides, the economy grows, and the Fed cuts interest rates significantly, even absent a recession or something breaking in the financial system. This is possible (and would be great!), but it would also be unusual, if not unprecedented.

Despite the romp by the M7 growth stocks in 2023, we continue to believe that quality businesses with sustainable competitive advantages owned at attractive valuations will continue to outperform over the long run. While we do not attempt to time the market, there are several factors that indicate Growth's dominance over Value is at an extreme, reminiscent of the 1970s Nifty Fifty or the late 1990s Blue Chip/Tech Bubble (for more about this, see our recent *Value Equity Insights* report, "Is It Different This Time?"). Over the long term, we expect this imbalance to even out as it has historically. In the meantime, we will continue to stay focused on owning great companies with capable management teams purchased at a discount to intrinsic value.

Contribution[1]

(YTD as of 12/31/2023)

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

Security	Avg Weight (%)	Contribution (%)
Top 5		
Vontier Corp.	8.95	5.59
Azek Co. Inc.	7.19	5.31
Progressive Corp.	6.19	4.69
NXP Semiconductors N.V.	*Sold*	3.78
Spectrum Brands Holdings Inc.	10.74	3.54
Bottom 5		
Clarivate plc	7.68	0.95
SL Green Realty Corp.	*Sold*	(0.02)
Dollar Tree Inc.	8.54	(0.05)
BRP Group Inc.	*Sold*	(0.32)
Cannae Holdings Inc.	*Sold*	(0.38)

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

Performance Composite Returns[2] (For Periods Ending December 31, 2023)

	Since Inception**	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Value Opportunities *Pure Gross-of-Fees[3]*	10.1%	9.1%	11.6%	8.2%	8.8%	2.8%	30.6%	30.6%	14.5%
Max Net-of-Fees[4]	7.0%	5.9%	8.3%	5.0%	5.6%	(0.3%)	26.7%	26.7%	13.6%
S&P 500	7.0%	9.7%	14.0%	12.0%	15.7%	10.0%	26.3%	26.3%	11.7%
Russell 3000 Value	7.3%	8.0%	11.0%	8.3%	10.8%	8.8%	11.6%	11.6%	9.8%

Calendar Year	Pure Gross-of-Fees[3]	Max Net-of-Fees[4]	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%
2023	30.6%	26.7%	26.3%	11.6%	4.3%	250	$61,922	$7,200,019	19.5%	17.3%	16.7%	0.6%

**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

Mark Keller, CFA	Tom Dugan, CFA	John Wobbe	Dustin Hausladen	Brett Mawhiney, CFA
Daniel Winter, CFA	Tore Stole	Joe Hanzlik	Blair Brumley, CFA	Ben Kim, CFA

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See Territory Map on the Confluence website for sales coverage.

Disclosures

Market & Strategy Commentary—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.

Indexes: 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.

[1] **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.

[2] **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, 2022. 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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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.

[3] Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

[4] 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.