

## Equity Strategies • Large Cap Value

The Large Cap Value portfolio is focused on seasoned companies that generally have capitalizations above \$10 billion. These companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess substantial competitive advantages and that are trading at discounts to intrinsic value. The portfolio typically is comprised of 23-25 holdings and is expected to result in low to moderate turnover. The portfolio is suitable for clients whose primary objective is capital appreciation and whose secondary objective is dividend income.

### Portfolio Commentary

Macro concerns remain at the forefront and have pressured stock prices throughout the summer. Among them are: 1) global debt concerns, with Greece and the European periphery as the prime focus; 2) a slowing Chinese economy; 3) high unemployment, low consumer confidence and anemic growth within the developed economies; and 4) anxieties related to the unknowns of a world with diminished fiscal and monetary support. Balance sheet recessions, like the one we recently emerged from, take a long time to resolve and their subsequent recoveries tend to lack vigor because future growth is constrained by the burdens of past spending. Low growth environments are inherently less stable and therefore more susceptible to macro shocks like the ones listed above.

Although stock prices have retrenched, opposing forces exist. Consumer balance sheets continue to improve, interest rates are very low, and corporate profits are at record highs. Stock valuations are compelling, barring a severe recession. As we continue to focus on individual companies and their unique growth prospects, the slow grind of deleveraging should provide us with ample opportunities to invest in these companies at attractive valuations. We continue to focus on companies with strong balance sheets and consistent free cash flow generation. Year-

to-date, the Confluence Large Cap Value portfolio returned -4.0% (gross of fees), which compares to the -8.7% return in the S&P 500 Index over the same period. (For detailed performance data and disclosures see: [www.confluenceim.com/equity\\_strategies#prod\\_40](http://www.confluenceim.com/equity_strategies#prod_40).)

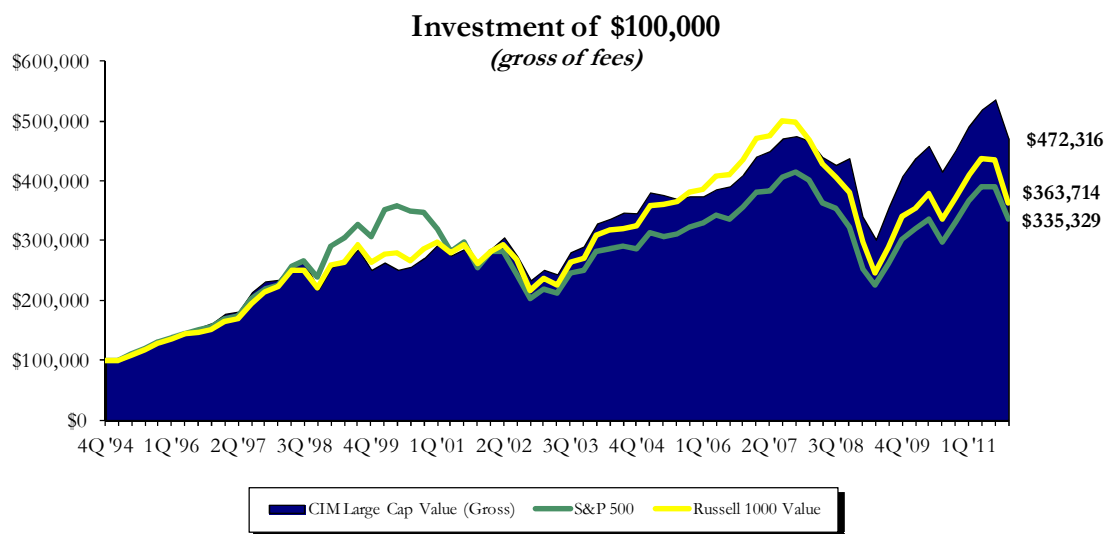
Positions in Bed Bath & Beyond, TJX Companies and Google posted the strongest gains during the quarter. Each company is taking market share in its respective industry and growing at a rate well in excess of the general economy. Further, they all have large net cash positions which are growing. Despite such enviable characteristics, current valuations remain reasonable.

Vulcan Materials and Emerson Electric were the weakest holdings during the quarter. Vulcan's underperformance is related to ongoing weakness in the construction markets and uncertainty regarding the timing and magnitude of highway improvement projects. Shares of Emerson Electric have been weak due to global growth concerns.

We continue to believe large US companies are relatively inexpensive and offer attractive risk adjusted returns. New additions to the portfolio include Leucadia National and MasterCard International. New positions were funded with the sale of Pfizer and Quest Diagnostics.

Top 10 Portfolio Holdings (as of 9/30/11)

Company	Market Capitalization <i>(\$ billions)</i>	Portfolio Weight
TJX Companies Inc	21.1	4.8%
Bed Bath & Beyond Inc	14.3	4.8%
Diageo (Adr 1:4)	48.1	4.4%
Google Inc	172.6	4.3%
WR Berkley Corp	4.2	4.3%
Chevron Corp.	185.5	4.2%
Waters Corp.	6.9	4.2%
American Express	53.6	4.1%
Sigma Aldrich Corp	7.5	4.1%
Tyco International Ltd.	18.9	4.0%



**Confluence Investment Management LLC**

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