All Cap Value

Value Equity Strategies

Third Quarter 2024

All Cap Value is focused on companies that range in market capitalization to create a diversified portfolio of businesses with capital appreciation potential. These companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that possess substantial competitive advantages and are trading at discounts to our estimate of intrinsic value. The portfolio typically comprises 30-35 holdings and is expected to result in low to moderate turnover. The strategy is appropriate for clients whose primary objective is capital appreciation and whose secondary objective is dividend income.

Market Commentary

Continued economic strength combined with the disinflationary environment provided a tailwind that helped drive equity markets during the quarter. The broad equity markets posted solid gains as the S&P 500 Index was up 5.9% for the quarter, which brought its year-to-date return to 22.1% — the best performance through three quarters since 1997.

More importantly, equity market returns widened beyond the narrow leadership of the mega-cap technology stocks that has dominated previous periods. The Russell 1000 Growth Index lagged the Russell 1000 Value Index 3.2% versus 9.4%, respectively. The S&P 500 Equal Weight Index also outperformed the S&P 500 with a 9.0% gain for the quarter. While one quarter does not make a trend, and growth is still leading value for the year (Russell 1000 Growth 24.6% versus Russell 1000 Value 16.7%), the broadening of the market into new highs provides for a much healthier environment. In turn, we find it is also a more favorable environment for stock pickers and value-oriented strategies.

Notably, the quarter saw a healthy rotation into previously underperforming sectors. Ten of 11 large cap sectors finished higher in the third quarter, with Utilities (19.4%), REITs (+17.0%), Industrials (11.5%), and Financials (10.7%) leading the market. These sectors have a heavier weight in the value benchmarks and benefited from the decline in interest rates as the 10-year Treasury yield declined from 4.36% to 3.81% during the quarter (see *Figure 1*, sector returns table).

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	3.3%	2.3%	12.9%	8.5%	10.2%	31.7%	8.8%	2.3%	11.6%	5.9%	2.5%	100.0%
Russell Growth weight	0.4%	0.7%	6.4%	4.6%	14.3%	48.7%	12.8%	0.6%	7.8%	3.7%	0.2%	100.0%
Russell Value weight	6.7%	4.7%	21.1%	14.7%	6.3%	9.1%	4.2%	4.9%	15.5%	8.0%	4.8%	100.0%
Russell 2000 weight	5.3%	4.5%	17.9%	17.0%	10.1%	12.9%	2.7%	6.5%	17.4%	2.8%	2.8%	100.0%
QTD	-2.3	9.7	10.7	11.5	7.8	1.6	1.7	17.0	6.1	9.0	19.4	5.9
YTD	7.5	14.8	21.5	19.6	14.2	29.6	27.8	14.8	13.7	18.6	30.1	21.6

(Source: J.P. Morgan Asset Management; Guide to the Markets®, US 4Q 2024, as of September 30, 2024)

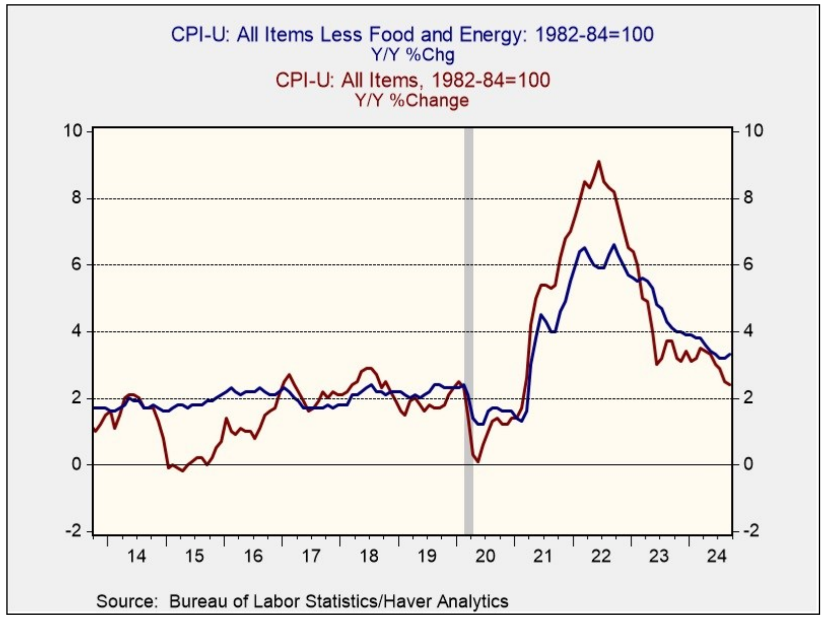
Small and mid-cap stocks, often overlooked during periods of mega-cap dominance, also performed well. The Russell 2000 Index and Russell Midcap Index outperformed the broader market, returning 9.3% and 9.2%, respectively, for the quarter. Small cap businesses, which are more levered than large cap businesses, benefited from the decline in short-term interest rates which should provide some earnings relief for floating rate debt as well as the perceived reduced probability of a recession. Despite the marginal outperformance of small caps, we believe they still offer an attractive valuation relative to large caps.

See GIPS Report on pages 4-5

Market Commentary continued...

The continued improvement in inflation levels also allowed the Federal Reserve to alter course and make its first interest rate cut this year. On September 18, 2024, 420 days after the last rate hike, the FOMC cut rates by an aggressive 50 bps. This followed the rapid increase in rates that started in March 2022 at 0% and lasted until July 2023, the last increase of which brought the fed funds rate to 5.25%. Of course, this action was needed to stem the rapid ascent of inflation following the liquidity infusion induced by the pandemic (see *Figure 2* from the Confluence macroeconomic team).

Figure 2



The equity markets have been rallying following the rate cut as the fixed income markets have been selling off (i.e., yields migrating upward). This indicates that equity investors are more optimistic that the Fed can tame inflation and avoid a recession, while fixed income investors are becoming more concerned about inflation. The aggressiveness of the 50 bps rate cut seems to have sent a mixed message regarding the strength of the economy and inflationary pressures over the near term.

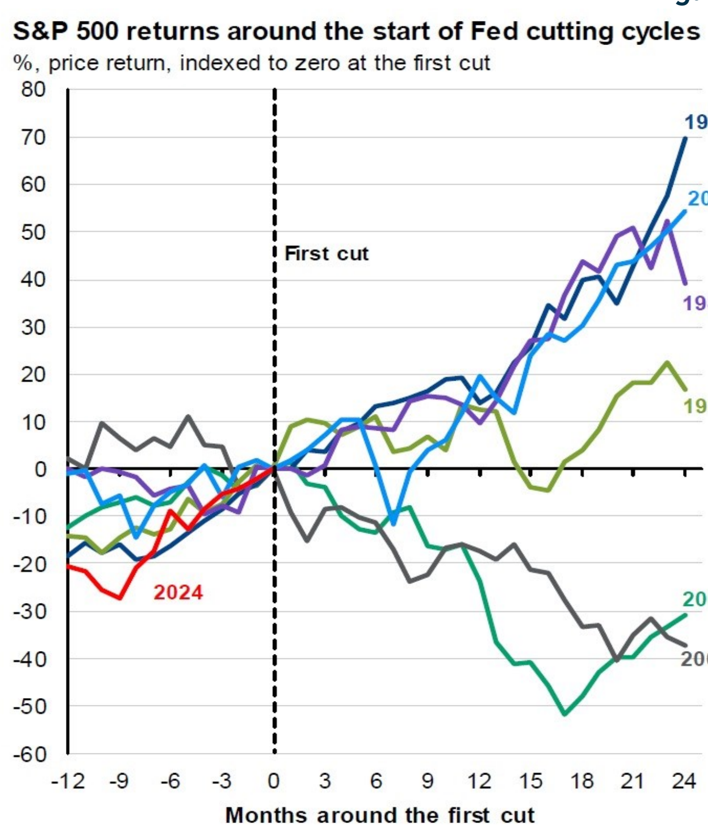
Moreover, there has been much discussion surrounding the historical impact on the equity markets following the first rate cut by the Fed. Many seem to focus on the positive implications for equities that lower rates offer. The reality is more nuanced as each period must consider the economic backdrop, employment, inflationary trends, valuation, and geopolitical events. The next chart (*Figure 3*) reflects the last six cycles dating back to 1984. Looking at this chart, the verdict is mixed six months after the first cut, with half posting positive returns and half posting negative returns. The current environment is unique given the low levels of unemployment, higher valuations, and recent experience with inflation.

We remain concerned about the longer-term pressure on structural inflation given the fracturing of global trade. Deglobalization elevates trade barriers, supply chains become less efficient, and production costs increase, which lead to higher prices for goods and services. In essence, these changes would reverse the disinflationary effects previously afforded by globalization over the past few decades, which would likely result in inflation running above the Fed's current 2% target and pressure longer-term rates. For investors, it elevates the importance of protecting purchasing power.

The Confluence macroeconomic team has been writing about these trends for quite some time. To stay abreast of these developments, we encourage readers to [subscribe to our newsletters]().

As always, we remain focused on fundamentals and steadfast on the protection of capital by concentrating on competitively advantaged businesses that have historically displayed an ability to maintain margins and returns on capital — attributes which are important given the concerns of inflation.

Figure 3



(Source: J.P. Morgan Asset Management; Guide to the Markets®, US 4Q 2024, as of September 30, 2024)

Strategy Commentary

In the third quarter, the S&P 500 Index was up a solid 5.9%, but the undercurrents were noteworthy as a significant rotation began on July 11 away from the Magnificent 7 (M7) mega-cap, tech-oriented stocks and into the other 493 stocks in the index. As a result, the NYSE FANG+ Index was up only 1.0% in the third quarter, while the S&P 500 Equal Weight Index was up 9.6% and the Russell 3000 Value Index was up 9.5%. Confluence All Cap Value was up 9.3% (gross of fees) in the quarter as our holdings tend to be among the 493 companies that are not included in the M7. [*The strategy's net-of-fees return for the same period was 8.5% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

While this rotation was dramatic, one quarter does not make a trend. The AI-driven M7 could still bounce back and extend their 5+-year dominance over the other stocks in the S&P 500. But, either way, the third quarter was a glimpse at a "great rotation" that could occur if or when the mega-cap growth tech party comes to an end.

Year-to-date, All Cap Value posted a strong return of 15.4% (gross of fees), in-line with both the Russell 3000 Value, up 16.2%, and the S&P 500 Equal Weight Index, up 15.2%, but the strategy has trailed the S&P 500 return of 22.1% almost entirely due to the outperformance of the M7 in the first half of 2024. [*The strategy's net-of-fees return for the same period was 12.8% YTD.*]

All Cap Value outperformed the S&P 500 in the third quarter with continued strong performance from our insurance holdings (Progressive (PGR) and Brown & Brown (BRO), in particular) and our Consumer Discretionary holdings. Our Consumer Staples holdings have trailed, primarily due to Dollar Tree (DLTR), which is in temporary limbo as low-income consumers are pulling back on spending but middle- and upper-income consumers are not hurting enough to trade down. Still, Dollar Tree continues to excel at providing value to its customers through low-priced items. With a successful divestiture of Family Dollar, we expect DLTR will be even more focused on outperformance at its legacy Dollar Tree format.

The top contributors to performance year-to-date were Progressive (auto insurance), Brown & Brown (insurance broker), Oracle (ORCL, business software), Berkshire Hathaway (BRK-B, insurance conglomerate), and Lowe's (LOW, home improvement retailer). The weakest contributors year-to-date were Dollar Tree (low-price retail), Charles River Laboratories (CRL, drug research services), Keysight Technologies (KEYS, electronics testing equipment), Vontier (VNT, convenience store technology), and Nordson (NDSN, industrial fluid handling equipment).

During the quarter, we finished buying a new position in Baldwin Insurance Group (BWIN). We also sold DuPont (DD) in order to buy Paycom (PAYC), and CarMax (KMX) was sold to purchase another retailer — a buy that is still in progress but we look forward to discussing once complete.

Baldwin Insurance Group is a commercial insurance broker based in the Southeastern US that was founded in 2011 and went public in October 2019. Commercial insurance brokerage is a good business that we know well from our years of investing in insurance. While BWIN was founded in 2011, management has a long track record of success dating back to 1981 when Chair Lowry Baldwin entered the insurance brokerage business. BWIN's model is keenly focused on high-growth segments and niches, and the company is driven by a culture that attracts successful team members. From late 2020 through early 2022, BWIN took on debt to aggressively acquire other insurance brokers in order to expand its footprint and capabilities. As a result, the stock traded sideways until early 2024 when it was disclosed that those acquisitions were performing at or above expectations. It then became clear to us that continued strong growth should bring leverage down to manageable levels within the next year, and strong free cash flow will likely follow the final earnout payments in early 2025. Having followed the company for many years, this gave us an opportunity to add BWIN to the All Cap Value portfolio at an attractive valuation given its growth prospects. Overall, BWIN has a good business, capable management team, and strong culture, and it is building a track record of solid capital allocation. These attributes, along with a reasonable valuation at purchase, should drive favorable long-term investment results.

Paycom is a cloud-based Human Resource Management (HRM) platform. Its software helps companies fulfill payroll and HR functions more efficiently. This is a founder-led business that has grown profitably for over two decades. Just a few years ago, Paycom traded for exorbitant valuation multiples, in our assessment. However, the company recently introduced a new service offering that was not well-received by the investment community. Why? Because although it was popular among clients, and improved customer retention, it reduced the revenue growth rate of Paycom. This disappointed the growth/ momentum-oriented shareholder base, and the stock sold off. We viewed this as an opportunity to add an attractive business at a fair price. Further, it's a prime example of a management team making decisions through a long-term lens.

Outlook

Following the Fed's highly anticipated first interest rate cut of 50 bps in September, the market now assumes another 150 bps of cuts through 2025 despite market expectations for strong earnings growth next year. Historically, meaningful interest rate cuts have coincided with a weak economy and stock market, so the current expectations, along with global geopolitical risks, suggest much uncertainty. Still, in our many decades of experience we find there is often market uncertainty, so as always we continue to stay focused on owning great businesses with capable management teams that are bought at a discount to intrinsic value.

Contribution[1]

The top contributors and detractors for the portfolio in Q3 2024 and year-to-date are shown in the following tables:

(QTD as of 9/30/2024)

Security	Avg Weight (%)	Contribution (%)
Top 5		
Lowe's Cos. Inc.	4.44	0.98
Progressive Corp.	4.63	0.97
Baldwin Insurance Group Inc.	2.15	0.76
Lockheed Martin Corp.	3.14	0.74
Oracle Corp.	3.14	0.66
Bottom 5		
Charles River Laboratories Intl Inc.	2.56	(0.13)
Vontier Corp.	2.77	(0.36)
Alphabet Inc.	3.30	(0.37)
NXP Semiconductors N.V.	3.54	(0.41)
Dollar Tree Inc.	1.57	(0.62)

(YTD as of 9/30/2024)

Security	Avg Weight (%)	Contribution (%)
Top 5		
Progressive Corp.	4.50	2.35
Brown & Brown Inc.	3.95	1.60
Oracle Corp.	2.86	1.57
Berkshire Hathaway Inc. (Class B)	4.51	1.23
Lowe's Cos. Inc.	4.42	1.02
Bottom 5		
Nordson Corp.	2.80	(0.00)
Vontier Corp.	3.08	(0.03)
Keysight Technologies Inc.	2.95	(0.04)
Charles River Laboratories Intl Inc.	2.85	(0.55)
Dollar Tree Inc.	1.92	(1.26)

Performance Composite Returns[2] (For Periods Ending September 30, 2024)

	Since Inception**	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
All Cap Value *Pure Gross-of-Fees*[3]	10.1%	12.8%	11.7%	12.2%	8.6%	28.0%	15.4%	9.3%
Max Net-of-Fees[4]	6.9%	9.5%	8.4%	8.9%	5.4%	24.2%	12.8%	8.5%
S&P 500	10.4%	14.1%	13.4%	16.0%	11.9%	36.3%	22.1%	5.9%
Russell 3000 Value	8.0%	11.1%	9.2%	10.6%	8.7%	27.6%	16.2%	9.5%

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
2005**	2.4%	(0.4%)	4.9%	6.9%	(2.5%)	242	$27,603		N/A	N/A	N/A	0.5%
2006	14.4%	11.3%	15.8%	22.3%	(1.4%)	224	$26,916		N/A	N/A	N/A	0.6%
2007	4.6%	1.8%	5.5%	(1.0%)	(0.9%)	220	$27,835		6.9%	7.7%	8.3%	0.7%
2008	(26.9%)	(28.9%)	(37.0%)	(36.2%)	10.1%	19	$1,778	$291,644	13.9%	15.1%	15.5%	N/A
2009	26.8%	23.0%	26.5%	19.8%	0.3%	33	$11,558	$533,832	18.6%	19.6%	21.3%	2.8%
2010	9.7%	6.4%	15.1%	16.3%	(5.4%)	41	$13,980	$751,909	21.0%	21.9%	23.5%	0.5%
2011	3.6%	0.5%	2.1%	(0.1%)	1.5%	40	$14,294	$937,487	18.4%	18.7%	21.0%	0.6%
2012	18.0%	14.5%	16.0%	17.6%	2.0%	40	$11,654	$1,272,265	14.6%	15.1%	15.8%	0.3%
2013	35.3%	31.3%	32.4%	32.7%	2.9%	73	$22,893	$1,955,915	11.2%	11.9%	12.9%	0.7%
2014	14.7%	11.3%	13.7%	12.7%	1.0%	119	$34,036	$2,589,024	8.8%	9.0%	9.4%	0.4%
2015	0.1%	(2.9%)	1.4%	(4.1%)	(1.3%)	207	$50,568	$3,175,419	10.0%	10.5%	10.7%	0.6%
2016	14.2%	10.8%	12.0%	18.4%	2.2%	345	$91,109	$4,413,659	9.7%	10.6%	11.0%	0.6%
2017	15.7%	12.3%	21.8%	13.2%	(6.1%)	649	$167,342	$5,944,479	8.7%	9.9%	10.3%	1.1%
2018	(5.2%)	(8.0%)	(4.4%)	(8.6%)	(0.8%)	689	$168,742	$5,486,737	10.1%	10.8%	11.1%	0.6%
2019	35.6%	31.6%	31.5%	26.2%	4.2%	818	$262,167	$7,044,708	11.7%	11.9%	12.0%	1.1%
2020	17.3%	13.8%	18.4%	2.9%	(1.1%)	953	$333,804	$6,889,798	18.5%	18.5%	20.0%	0.9%
2021	23.4%	19.7%	28.7%	25.3%	(5.3%)	1,084	$422,786	$7,761,687	17.5%	17.2%	19.3%	0.6%
2022	(16.2%)	(18.7%)	(18.1%)	(8.0%)	2.0%	1,065	$342,473	$6,931,635	20.5%	20.9%	21.5%	0.7%
2023	18.8%	15.3%	26.3%	11.6%	(7.5%)	1,046	$385,449	$7,200,019	16.9%	17.3%	16.7%	0.7%

**Average annualized returns* ***Inception is 1/1/2005* *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	Blair Brumley, CFA	Ben Kim, CFA

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See Territory Map on the Confluence website for sales coverage.

Disclosures

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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—**Contribution data shown from a sample account, based on individual stock performance and portfolio weighting. 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, 2023. 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 All Cap Strategy was incepted on January 1, 2005, and the current All Cap Value 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: 0.60% on the first $500,000; 0.55% on the next $500,000; and 0.50% 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 All Cap Value Composite contains fully discretionary All Cap Value wrap accounts. All Cap Value is a value-based, bottom-up portfolio that utilizes stocks from all market capitalizations.

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.