Equity Income

Value Equity Strategies

Third Quarter 2024

Equity Income is focused on businesses across a broad range of market capitalizations that collectively generate an above-average stream of dividend income, while also providing for capital appreciation potential. The businesses are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that have the ability to either pay a high level of dividend income or grow the dividend stream over time. The portfolio typically comprises 30-35 holdings and is expected to result in low to moderate turnover. The strategy is appropriate for clients seeking total return from dividend income and capital appreciation.

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 9.6% 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)

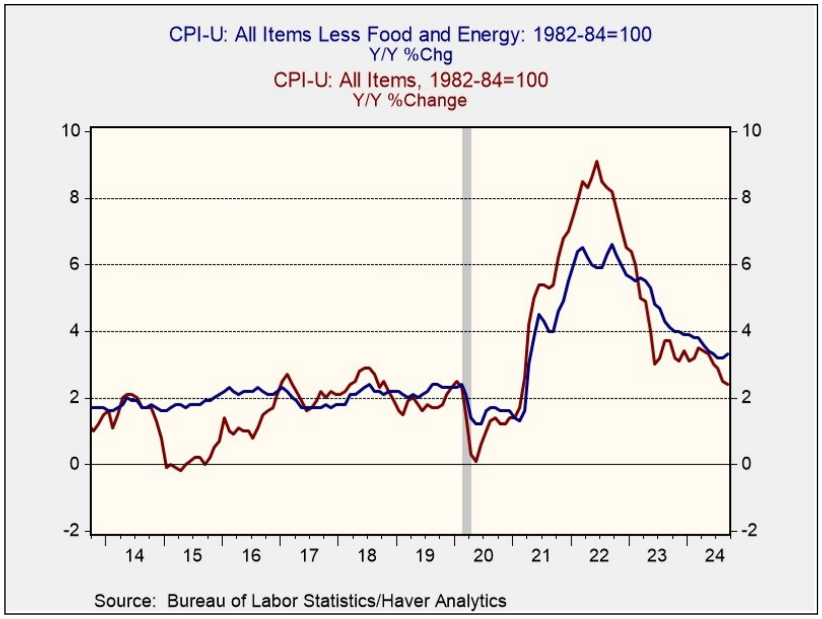
Small and mid-cap stocks, often overlooked during periods of mega-cap dominance, also performed well. The Russell 2000 Index and Russell Midcap Index outperformed the broader market, returning 9.3% and 9.2%, respectively, for the quarter. Small cap businesses, which are more levered than large cap businesses, 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 5-6

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.

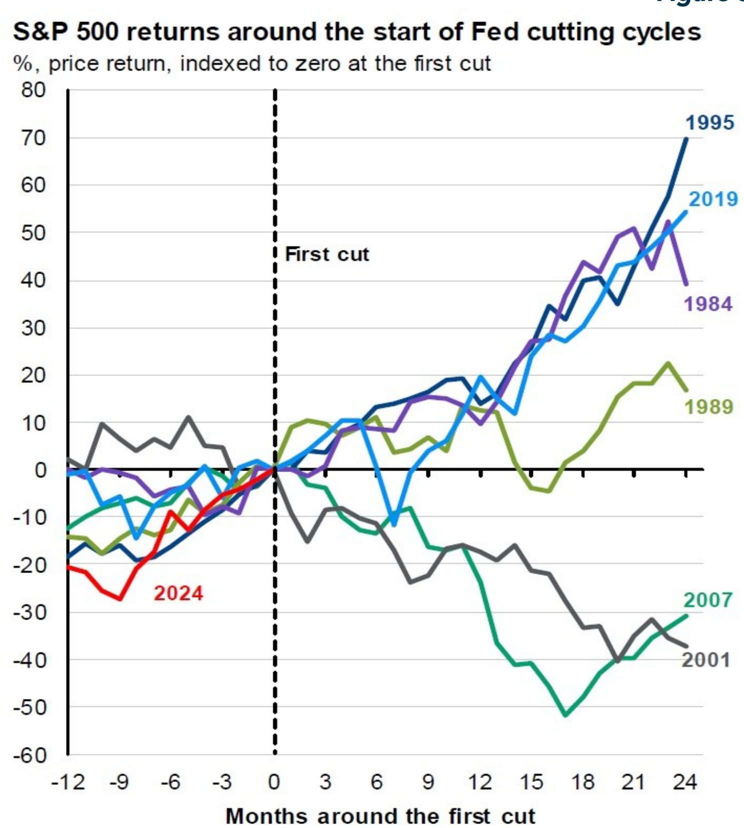
Moreover, there has been much discussion surrounding the historical impact on the equity markets following the first rate cut by the Fed. Many seem to focus on the positive implications for equities that lower rates offer. The reality is more nuanced as each period must consider the economic backdrop, 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

The Confluence Equity Income strategy's objective is to provide an above-average stream of income balanced with capital appreciation, while delivering reasonable dividend growth to protect purchasing power. As the table below shows, the strategy continues to generate a high level of growing income.

More specifically, the companies held in the Equity Income portfolio continued to pay and grow their dividends. As stated in the table (*Figure 4*), 24 of the 34 companies in the current Equity Income portfolio have increased their dividends, with an average announced growth rate of 5.8%. As of September 30, 2024, the average dividend yield for the Equity Income portfolio is 3.1% *(source: FactSet)*.

Figure 4 **Annual Dividend Statistics for Equity Income Portfolio at 12/31 *(Dividend Growth Using Announcement Date)*[1]**

			Dividend Change from Prior Year**			
			# of companies with			
Year	**Holdings**	**Avg. Yield+**	Increase	Flat	Decrease	Avg. Growth***
2014	33	3.4%	29	4	0	13.0%
2015	34	3.9%	27	7	0	8.4%
2016	33	3.4%	25	6	2	2.2%
2017	33	3.1%	25	6	1	10.1%
2018	34	3.5%	30	4	0	13.8%
2019	34	3.0%	32	2	0	9.4%
2020*	36	3.4%	26	10	0	4.4%
2021	36	2.8%	30	6	0	5.4%
2022	34	3.3%	31	2	1	6.5%
2023	34	3.4%	28	6	0	5.2%
Average-10 yrs (2014-2023)		3.3%	28	5	0	7.8%
YTD (9/30/2024)	34	3.1%	24		0	5.8%

** 2020 excludes impact of temporary dividend suspensions during the pandemic of 2020. ** Dividend Change from Prior Year excludes impact of special dividends and spin-offs.*
**** For monthly/YTD data, the average growth rate is calculated using only those holdings for which an increase or decrease in the indicated annual dividend amount has been announced. Full-year statistics are calculated as the average of all holdings, including those which did not announce a change to their indicated annual dividend during the year.*
+ Avg. Yield column is the equal-weighted average dividend yield of portfolio holdings at 12/31, calculated based on annualized current dividend plus any special dividend paid during the year. Avg. Yield as of 9/30/2024 calculated using Indicated Annual Dividend (IAD) from FactSet.

(Table shows past 10 years of dividend history; the Equity Income strategy was incepted 10/1/2000.)

The broadening of the equity markets as well as the downward drift of interest rates benefited higher-yielding equities. As mentioned in the Market Commentary, this was evident in the outperformance of a few of the higher-yielding sectors, Utilities (19.4%), Real Estate (17.0%), Financials (10.7%), and Consumer Staples (9.0%), compared to the broad-based S&P 500 (5.9%). The Energy sector is a higher-yielding sector but was the only one to produce negative results (-2.3%). Energy has historically been an uncorrelated sector as it is impacted by commodity-specific factors and influenced by geopolitical conditions.

Furthermore, as previously discussed, the mega-cap, technology-oriented stocks lagged as the Magnificent 7 had mixed results: Alphabet (-8.8%), Amazon (-3.6%), Apple (10.8%), Meta (13.6%), Microsoft (-3.6%), NVIDIA (-1.7%), and Tesla (32.2%). This rotation in the market is a healthy indicator, especially with the equity markets hitting new highs. The broadening and bias toward yield can also be seen in data from Ned Davis Research in their breakdown of the S&P 500 returns ranked by quartiles of dividend yield (*Figure 5*), where Quartile 1 shows the highest yielding, Quartile 4 shows the lowest yielding, and Quartile 0 represents non-payers.

Equity Income was a clear beneficiary of the rotation in which investor focus shifted toward high-yielding equities as the strategy posted a robust return of 12.0% for the third quarter, bringing its year-to-date gain to 14.7% (both gross of fees). [*The strategy's net-of-fees returns for the same periods were 11.1% QTD and 12.1% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Figure 5
S&P 500 Stock Constituents* Ranked by Quartiles (Dividend Yield)

*Actual Historical Constituents. *Returns through 9/30/2024 (Source: Ned Davis Research, Inc.; © Copyright 2024)*

Strategy Commentary continued...

As inflation and inflation expectations have become more of a focus for the FOMC and investors, we have also witnessed a return of real rates (nominal rates minus inflation rate > 0%), which is causing businesses and investors to refocus on risk. With negative real rates lingering for most of the period following the Global Financial Crisis, businesses and investors were encouraged to take risk as cash or short-term securities were losing value in real terms. With liquidity flush and the cost of capital extremely low, businesses were encouraged to focus on growth. Now that the cost of capital has risen, and cash and short-term investments are earning real returns, businesses and investors are refocusing on risk and the importance of fundamentals – requiring returns on capital now that capital has a real cost.

For the quarter, the Equity Income portfolio benefited from the underlying strength in Progressive (PGR) and Fidelity National Financial (FNF), which operate in the Financials sector. Progressive is primarily an auto insurer performing well due to solid underwriting of policies and a firm pricing environment. Fidelity National is a title insurer that will benefit from declining interest rates, which should provide a tailwind for refinancing and home purchases. The laggards were Microsoft (MSFT) and T. Rowe Price (TROW). Microsoft had been leading the market and is taking a much-needed breather. T. Rowe Price is a fundamental-based asset manager with a core growth bias which concerned some investors during the rotation. The shares appear to have overly discounted such concerns as we believe the valuation remains compelling and the dividend secure.

There were no wholesale changes during the quarter, although we did finally complete the sale of the stub position of DuPont that was received from the spin-off from Dow.

Outlook

As the Fed has embarked on its rate-cutting cycle, we remain watchful of inflation and inflationary expectations. While lower rates should aid the economy, inflation, albeit trending downward, still remains above-target and employment levels appear healthy, thus leading to concerns of reaccelerating inflation. As consumers and investors have witnessed over the past few years, inflation is a horrible stealth tax that disproportionately affects lower-income households and erodes purchasing power. At Confluence, we remain committed to a disciplined approach of seeking competitively advantaged businesses — ones that have pricing power to protect against inflation — trading at attractive valuations with a focus on solid dividend payors that have the ability to grow their dividends to protect investors' income stream.

Equity Income • *Value Equity Strategies*

Contribution[2]

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		
Progressive Corp.	4.72	1.00
Fidelity National Financial Inc.	3.56	0.88
Lockheed Martin Corp.	3.27	0.78
WEC Energy Group Inc.	3.24	0.72
Brookfield Infrastructure Corp.	2.57	0.71
Bottom 5		
United Parcel Service Inc.	2.28	0.01
DuPont de Nemours Inc.	*Sold*	(0.00)
Chevron Corp.	1.97	(0.11)
Microsoft Corp.	2.83	(0.11)
T. Rowe Price Group Inc.	2.63	(0.13)

(YTD as of 9/30/2024)

Security	Avg Weight (%)	Contribution (%)
Top 5		
Progressive Corp.	4.52	2.29
Lockheed Martin Corp.	3.01	0.92
Chubb Ltd.	3.39	0.91
Fidelity National Financial Inc.	3.42	0.85
Southern Co.	2.73	0.84
Bottom 5		
Weyerhaeuser Co.	1.77	(0.03)
Diageo plc	2.68	(0.04)
Polaris Inc.	1.94	(0.24)
United Parcel Service Inc.	2.48	(0.34)
Nestle S.A.	1.09	(0.35)

Performance Composite Returns[3] (For Periods Ending September 30, 2024)

	Since Inception**	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Equity Income *Pure Gross-of-Fees[4]*	10.6%	9.8%	12.3%	10.5%	10.7%	9.6%	25.6%	14.7%	12.0%
Max Net-of-Fees[5]	7.4%	6.6%	8.9%	7.2%	7.4%	6.3%	21.9%	12.1%	11.1%
Russell 3000 Value	7.7%	8.5%	11.1%	9.2%	10.6%	8.7%	27.6%	16.2%	9.5%
S&P 500	8.0%	10.7%	14.1%	13.4%	16.0%	11.9%	36.3%	22.1%	5.9%

Calendar Year	Pure Gross-of-Fees[4]	Max Net-of-Fees[5]	R3000 Value	S&P 500	Difference (Gross-R3000V)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	R3000V 3yr Std Dev	S&P 500 3yr Std Dev	Composite Dispersion
2004**	12.1%	9.1%	16.9%	10.9%	(4.8%)	2,811	$425,234		10.2%	14.8%	14.9%	1.1%
2005	0.4%	(2.3%)	6.9%	4.9%	(6.4%)	3,775	$536,505		8.4%	9.7%	9.0%	0.6%
2006	15.3%	12.1%	22.3%	15.8%	(7.1%)	3,122	$489,578		5.7%	7.0%	6.8%	0.8%
2007	1.5%	(1.3%)	(1.0%)	5.5%	2.5%	2,490	$381,383		6.2%	8.3%	7.7%	0.8%
2008	(18.9%)	(21.2%)	(36.2%)	(37.0%)	17.4%	346	$44,339	$291,644	12.0%	15.5%	15.1%	N/A
2009	18.8%	15.3%	19.8%	26.5%	(1.0%)	459	$85,079	$533,832	18.1%	21.3%	19.6%	0.8%
2010	16.1%	12.7%	16.3%	15.1%	(0.1%)	555	$128,855	$751,909	20.2%	23.5%	21.9%	0.8%
2011	5.1%	2.0%	(0.1%)	2.1%	5.2%	918	$225,088	$937,487	18.6%	21.0%	18.7%	1.0%
2012	17.8%	14.3%	17.6%	16.0%	0.2%	1,200	$337,610	$1,272,265	13.5%	15.8%	15.1%	0.6%
2013	26.1%	22.4%	32.7%	32.4%	(6.6%)	1,947	$606,780	$1,955,915	10.5%	12.9%	11.9%	1.3%
2014	11.4%	8.1%	12.7%	13.7%	(1.3%)	2,834	$858,027	$2,589,024	8.4%	9.4%	9.0%	0.4%
2015	0.1%	(2.9%)	(4.1%)	1.4%	4.3%	3,528	$939,550	$3,175,419	9.4%	10.7%	10.5%	0.4%
2016	18.0%	14.5%	18.4%	12.0%	(0.4%)	5,272	$1,549,506	$4,413,659	9.4%	11.0%	10.6%	0.4%
2017	17.5%	14.0%	13.2%	21.8%	4.3%	7,423	$2,177,984	$5,944,479	8.4%	10.3%	9.9%	1.1%
2018	(8.9%)	(11.6%)	(8.6%)	(4.4%)	(0.3%)	7,772	$1,945,646	$5,486,737	9.7%	11.1%	10.8%	0.5%
2019	31.0%	27.1%	26.2%	31.5%	4.7%	8,249	$2,725,466	$7,044,708	10.8%	12.0%	11.9%	0.8%
2020	4.6%	1.5%	2.9%	18.4%	1.8%	7,557	$2,440,128	$6,889,798	17.1%	20.0%	18.5%	0.8%
2021	27.2%	23.5%	25.3%	28.7%	1.9%	7,508	$3,048,035	$7,761,687	16.6%	19.3%	17.2%	0.5%
2022	(7.9%)	(10.6%)	(8.0%)	(18.1%)	0.2%	7,457	$2,609,193	$6,931,635	19.1%	21.5%	20.9%	0.4%
2023	10.8%	7.5%	11.6%	26.3%	(0.8%)	7,462	$2,743,018	$7,200,019	15.6%	16.7%	17.3%	0.7%

**Average annualized returns **Inception is 10/1/2000. Additional years of performance available on our website. See performance disclosures on last page.*

Portfolio Benchmarks

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.

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. *(Source: Bloomberg)*

Confluence Value Equities Investment Committee

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Disclosures

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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] **Annual Dividend Statistics—***Figure 4:* Annual dividend income history is available upon request. Current portfolio statistics exclude companies that have been sold and include companies that have been purchased year-to-date.

[2] **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.

[3] **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 Equity Income strategy was incepted on October 1, 2000, and the current Equity Income 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.

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

[5] 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 Equity Income Composite contains fully discretionary Equity Income wrap accounts. Equity Income is a value-based, bottom-up portfolio that invests in stocks from all market capitalizations based on their ability to generate an above-average stream of dividend income, while also providing capital appreciation potential.

**Results shown for the year 2000 represent partial period performance from October 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.