

**OBJECTIVE**

Invests in municipal bond Exchange Traded Funds (ETFs), diversified across maturities and a wide variety of municipalities. These ETFs produce income generally exempt from federal income taxes. Strives to deliver the income and lower volatility traditionally available from a diversified municipal bond portfolio.

**INVESTMENT PHILOSOPHY & PROCESS**

Fixed Income Tax-Exempt invests in municipal bond ETFs with domestically oriented, investment-grade benchmarks. These ETFs produce income that is generally exempt from federal income taxes. The investment approach incorporates ETFs with a national, not state-specific, posture. It is constructed to have characteristics similar to a traditional, laddered bond portfolio. The Confluence Fixed Income Strategy Committee may adjust the portfolio duration and maturity to be longer, shorter, or in line with the benchmark. The investment committee incorporates its viewpoints regarding Fed policy, the shape of the yield curve, relative yields, credit spreads, default rates, and other market factors into the portfolio construction process.

The strategy invests in a range of maturity-date ETFs to construct a portfolio similar to a diversified bond ladder and complements these positions with traditional fixed income ETFs with more “static” maturity profiles, allowing for more precise exposures to maturities and sectors of the bond market. The Fixed Income Strategy Committee continuously monitors the portfolio, rebalancing at least annually, but may elect to rebalance over shorter time frames at its discretion. The investment committee may direct larger allocations to certain ETFs to alter the nature of maturity exposures in a portfolio.

Fixed Income Tax-Exempt is available as a standalone portfolio and may also be available as part of a Balanced account, which allows investors to combine this fixed income strategy with one of the firm’s equity strategies in one portfolio.

**OVERVIEW**

- ◆ Uses high-quality ETFs following investment-grade benchmarks with domestic orientation that provide income exempt from federal income tax
- ◆ Similar characteristics to traditional bond ladder or diversified bond index by combining use of maturity-date ETFs with traditional fixed income ETFs
- ◆ Allocations incorporate viewpoints on Fed policy, yield curve shape, relative yields, credit spreads, default rates, etc.
- ◆ Nationally diversified across maturities and municipalities; not managed on a state-specific basis
- ◆ Available as a standalone portfolio or in Confluence Balanced account combined with value equity strategy
- ◆ Strategy assets: \$3.9 million<sup>1</sup>

<sup>1</sup> Total strategy assets include assets under management (AUM) and assets under advisement (AUA). As of 12/31/23, AUM = \$0.6 million and AUA = \$3.3 million.

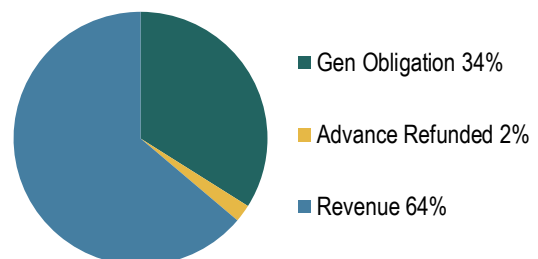
**CURRENT PORTFOLIO<sup>2</sup>**

CHARACTERISTICS	WEIGHTED AVERAGE
SEC Yield	3.3%
Tax-Equivalent SEC Distribution Yield Estimate*	5.1%
*Assumes Federal Income Tax Rate of 35%	
Duration	5.2
Maturity	11.0
ETF Expense Ratio	0.19%

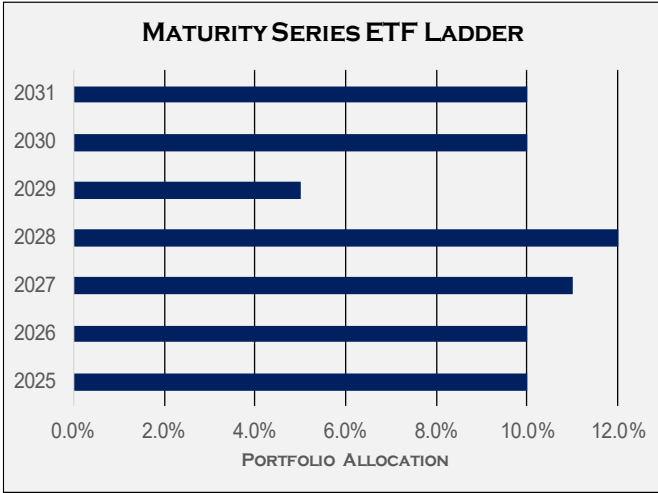
RATING CATEGORIES	WEIGHT
AAA	18.4%
AA	60.9%
A	18.7%
BBB	2.0%
BB or Below	0.1%

5 LARGEST HOLDINGS	WEIGHT
Dimensional National Municipal Bond ETF - DFNM	16.0%
Invesco National AMT-Free Municipal Bond ETF - PZA	15.0%
Invesco BulletShares 2028 Municipal Bond ETF - BSMS	12.0%
Invesco BulletShares 2027 Municipal Bond ETF - BSMR	11.0%
Invesco BulletShares 2031 Municipal Bond ETF - BSMV	10.0%

**SECTOR ALLOCATION**



See GIPS Report on page 3.



Fixed Income Tax-Exempt utilizes a portfolio structure similar to that of a “bond ladder,” a tactic often used when purchasing individual bonds. With our approach, we instead create a ladder of maturity-series ETFs. These ETFs hold large pools of bonds that mature near to, but always before, a specified end date. Accordingly, with the passage of time, the average maturity of this kind of ETF naturally shortens, thereby replicating some characteristics of an individual bond. It’s not exactly the same, particularly because it doesn’t mature at a par value. However, the maturity-series ETF has more credit risk diversification, while oftentimes also providing liquidity improvement, relative to an individual bond.

The strategy has ladder “rungs” from end dates ranging between 2025 and 2031. We believe this laddered approach positions investors to participate in a wider range of yields, while also providing a mechanism to help address the risk of rising interest rates. If rates were to rise, the shortest “rung” could be sold, or allowed to reach its end date. The proceeds could then be redeployed into a longer “rung,” one with a higher yield.

**JULY 2024 MARKET OBSERVATIONS & RECENT PORTFOLIO CHANGES<sup>3</sup>**

- ◆ Although the yield curve remains inverted, the economy continues to move forward with positive growth, indicating the Fed has successfully avoided a recession.
- ◆ The inverted municipal yield curve within 10 years of maturity presents an opportunity to take advantage of attractive yields, while avoiding interest risk from longer maturities. At the same time, we believe very short maturities create high levels of reinvestment risk.
- ◆ We prefer intermediate maturities with an overall portfolio duration of 5.2 years, which is shorter than the benchmark duration of 6.1 years.
- ◆ This quarter, we extended the municipal ladder through the liquidation of the 2024 rung and purchase of a 2031 rung.

The Confluence Fixed Income Tax-Exempt strategy’s gross return in the second quarter was 0.0%, which roughly matched the benchmark return. Similarly, the strategy’s year-to-date return of -0.4% (gross of fees) was identical to the benchmark return for the same period. [*The strategy’s net-of-fees returns for the same periods were -0.7% QTD and -1.9% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

While the strategy’s shorter duration posture modestly detracted from returns this quarter, the slight overweight to revenue bonds was additive.

Despite the inverted municipal yield curve within 10 years of maturity, the economy now appears to be heading toward growth instead of recession. Historically, during economic expansions, the yield curve has shifted to a “normal” shape, where long-term rates are well above short ones. We believe this normal curve may ultimately manifest as the economy grows, but current market technical factors indicate long-term rates may avoid cyclical upside pressure, at least until (and if) inflation shifts higher. Accordingly, we expect the curve to flatten as the Fed eases, but the inversion may persist for longer than what we’ve experienced in previous cycles.

Our view on the yield curve reflects a more constructive view toward longer maturity exposures. But because the curve remains inverted, incremental interest rate risk is not necessarily accompanied by incremental yield. At the same time, we believe very short maturities are exposed to elevated levels of reinvestment risk as the Fed eases. To us, the solution is pretty straightforward: focus on intermediate maturities. For this reason, we modestly extend the portfolio’s average maturity this quarter, increasing the allocation into intermediate maturities.

Our sector exposures include an advanced refunded allocation slightly lower than the benchmark, a continued modest underweight to general obligation bonds, and an overweight allocation to revenue bonds, particularly essential services. Portfolio duration is 5.2 years, which remains shorter than the benchmark duration of 6.1 years.

**Confluence Fixed Income Strategy Committee**

Mark Keller, CFA

Gregory Ellston

Patrick Fearon-Hernandez, CFA

David Miyazaki, CFA

William O’Grady

Kaisa Stucke, CFA

**FOR MORE INFORMATION CONTACT A MEMBER OF OUR SALES TEAM: (314) 530-6729 or sales@confluenceim.com**

See [Territory Map](#) on the Confluence website for sales coverage.

**PERFORMANCE COMPOSITE RETURNS<sup>4</sup>** (FOR PERIODS ENDING JUNE 30, 2024)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
<b>Fixed Income Tax-Exempt</b>							
<i>Pure Gross-of-Fees<sup>5</sup></i>	1.4%	1.2%	0.2%	(2.1%)	3.2%	(0.4%)	0.0%
<i>Max Net-of-Fees<sup>6</sup></i>	(1.7%)	(1.8%)	(2.7%)	(5.0%)	0.1%	(1.9%)	(0.7%)
<b>Benchmark (BB-Muni)</b>	2.9%	2.4%	1.2%	(0.9%)	3.2%	(0.4%)	(0.0%)

Calendar Year	Pure Gross-of-Fees <sup>5</sup>	Max Net-of-Fees <sup>6</sup>	Benchmark (BB-Muni)	Difference (Gross-Benchmark)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	Benchmark 3yr Std Dev	Composite Dispersion
2010**	(3.4%)	(4.1%)	(4.2%)	0.8%	1	\$48	\$751,909	N/A	N/A	N/A
2011	6.5%	3.3%	10.7%	(4.2%)	1	\$51	\$937,487	N/A	N/A	N/A
2012	2.0%	(1.0%)	6.8%	(4.8%)	1	\$52	\$1,272,265	N/A	N/A	N/A
2013	(1.1%)	(4.1%)	(2.6%)	1.4%	1	\$52	\$1,955,915	2.4%	4.0%	N/A
2014	4.0%	0.9%	9.1%	(5.1%)	3	\$600	\$2,589,024	2.2%	3.7%	N/A
2015	1.9%	(1.2%)	3.3%	(1.4%)	4	\$2,678	\$3,175,419	2.1%	3.4%	0.0%
2016	(0.8%)	(3.8%)	0.2%	(1.1%)	5	\$2,983	\$4,413,659	3.3%	3.4%	0.1%
2017	4.1%	1.0%	5.4%	(1.3%)	5	\$3,073	\$5,944,479	3.4%	3.3%	0.0%
2018	0.8%	(2.2%)	1.3%	(0.4%)	4	\$2,961	\$5,486,737	3.5%	3.4%	0.0%
2019	5.5%	2.4%	7.5%	(2.0%)	3	\$2,931	\$7,044,708	2.2%	2.4%	0.0%
2020	5.4%	2.3%	5.2%	0.2%	3	\$3,210	\$6,889,798	3.9%	4.0%	0.0%
2021	0.8%	(2.2%)	1.5%	(0.7%)	3	\$3,274	\$7,761,687	4.0%	3.9%	0.0%
2022	(10.6%)	(13.2%)	(8.5%)	(2.0%)	2	\$513	\$6,931,635	6.3%	6.4%	0.0%
2023	5.4%	2.2%	6.4%	(1.0%)	2	\$536	\$7,200,019	6.3%	7.4%	0.0%

\*Average annualized returns

\*\*Inception is 10/1/2010

**Portfolio Benchmark:**

**BB-Muni** – Bloomberg Municipal Bond Index (Source: Bloomberg)

**DISCLOSURES**

<sup>2</sup> **Current Portfolio**—Sector allocations shown represent the model portfolio as of 7/23/24 and do not represent the precise allocation in an actual client account. Allocations in client accounts may vary based on individual client considerations and market fluctuations. Investments are not guaranteed and do carry a risk of loss of principal. Each asset class has specific risks associated with it and no specific asset class can prevent a loss of capital in market downturns. Individual client portfolios may differ, sometimes significantly, from these listings. Yield data source: Morningstar; 30-day SEC yield of the model portfolio as of 7/23/24. Duration and maturity figures shown are based on all holdings in the model portfolio as of the rebalance date. ETF expense ratio is in addition to Confluence management fees. Rating categories reflect S&P ratings; source: Morningstar.

<sup>3</sup> **Market Observations & Recent Portfolio Changes**—The investment or strategy discussed may not be suitable for all investors. Investors must make their own decisions based on their specific investment objectives and financial circumstances. Opinions expressed are current as of the date shown and are subject to change.

<sup>4</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, 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 Fixed Income Tax-Exempt strategy was inception on October 1, 2010, and the current Fixed Income Tax-Exempt Composite was created on May 1, 2014. 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.

<sup>5</sup> Pure gross returns are shown as supplemental information to the disclosures required by the GIPS® standards.

<sup>6</sup> Net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly. This fee includes brokerage commissions, portfolio management, consulting services and custodial services. The Confluence fee schedule for this composite is as follows: 0.40% on the first \$500,000; 0.35% on the next \$500,000; and 0.30% 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. Subsequent to May 1, 2014, 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.

Performance prior to May 1, 2014, is based on the Fixed Income Tax-Exempt-Direct Composite which was created on October 1, 2010. The Fixed Income Tax-Exempt-Direct Composite includes accounts that pursue the Fixed Income Tax-Exempt strategy, but do not have bundled fees. Gross returns from the Fixed Income Tax-Exempt-Direct Composite include transaction costs and net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly. 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 Fixed Income Tax-Exempt Composite contains fully discretionary Fixed Income Tax-Exempt wrap accounts. The Fixed Income Tax-Exempt portfolio utilizes bond ETFs to earn tax-exempt income.

The benchmark was changed retroactively on 1/1/24 due to wider market adoption and transparency of the underlying constituents. The benchmark prior to 1/1/24 was the ICE BofA Municipal Index.

\*\*Results shown for the year 2010 represent partial period performance from October 1, 2010, through December 31, 2010. 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.