Increasing Dividend Equity Account (IDEA)

Value Equity Strategies

Confluence INVESTMENT MANAGEMENT

Third Quarter 2024

Increasing Dividend Equity Account (IDEA) is focused on high-quality companies with long track records of distributing earnings to shareholders through dividends. These companies tend to be established companies that generate free cash flow and have management teams committed to growing the dividend. The portfolio is selected from a universe of stocks meeting initial minimum criteria of paying and increasing dividends over the last 10 years. The portfolio typically has approximately 49 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)

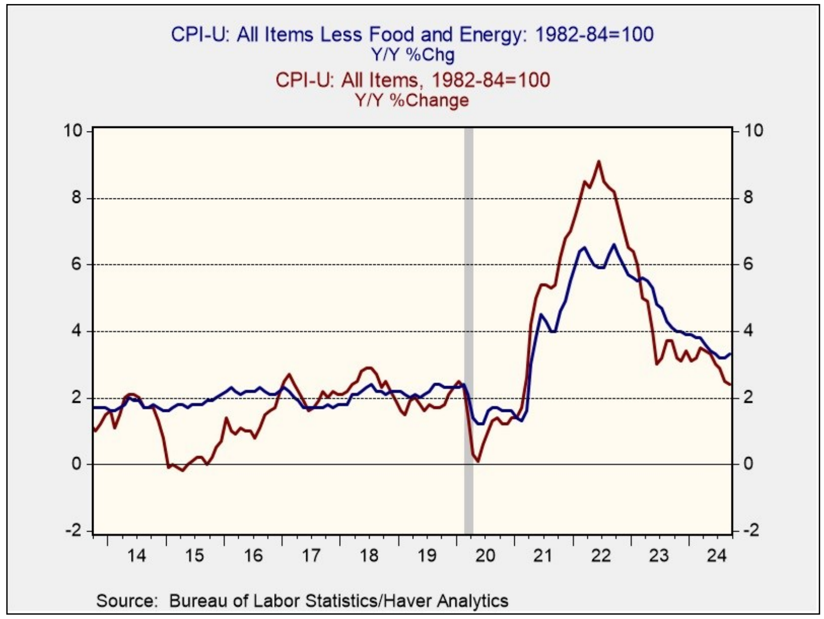
Small and mid-cap stocks, often overlooked during periods of mega-cap dominance, also performed well. The Russell 2000 Index and Russell Midcap Index outperformed the broader market, returning 9.3% and 9.2%, respectively, for the quarter. Small cap businesses, which are more levered than large cap businesses, 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 6-7

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.

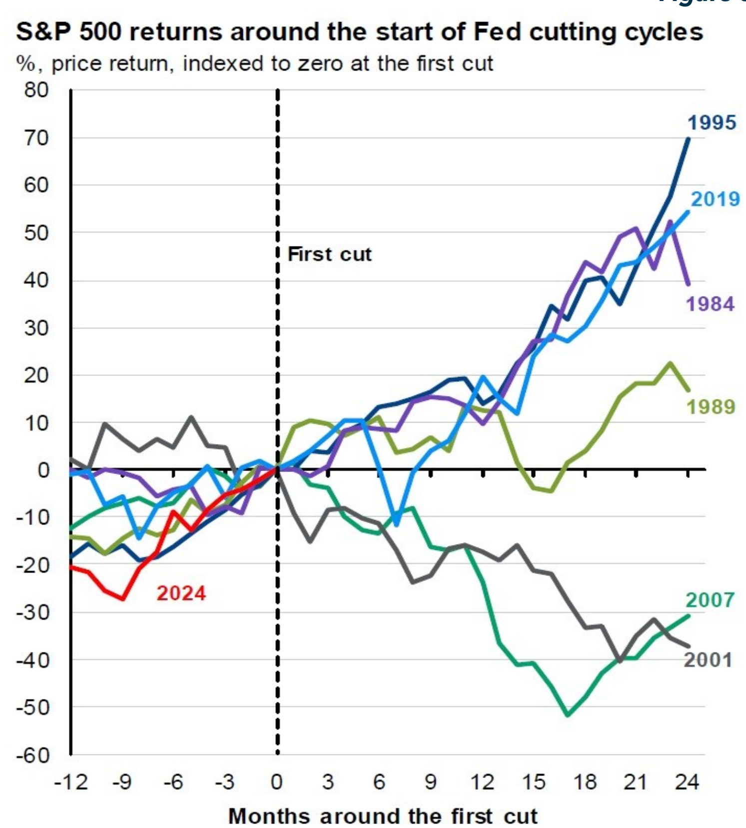
Moreover, there has been much discussion surrounding the historical impact on the equity markets following the first rate cut by the Fed. Many seem to focus on the positive implications for equities that lower rates offer. The reality is more nuanced as each period must consider the economic backdrop, 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 S&P 500. 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%. The Confluence Increasing Dividend Equity Account (IDEA) strategy was up 10.9% (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 10.1% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

While this rotation was dramatic, especially for dividend-focused defensive stocks, 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.

In addition to the strong performance during the quarter, the companies held in the IDEA strategy continued to pay and grow their dividends. As seen in the table below (*Figure 4*), 32 of the 49 companies in the current portfolio raised their dividends year-to-date, with an average announced growth rate of 8.4%.

Figure 4 **Annual Dividend Statistics for IDEA 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***
2009	49	2.9%	39	10	0	5.6%
2010	49	2.9%	45	4	0	9.3%
2011	49	2.9%	46	3	0	9.6%
2012	48	3.3%	46	2	0	9.3%
2013	49	2.4%	47	2	0	10.6%
2014	49	2.5%	47	2	0	9.3%
2015	49	2.8%	46	3	0	8.9%
2016	50	2.4%	46	4	0	6.9%
2017	48	2.1%	44	4	0	7.4%
2018	49	2.5%	47	2	0	11.2%
2019	49	2.1%	48	1	0	9.4%
2020*	49	2.1%	42	7	0	6.4%
2021	49	1.9%	46	3	0	8.3%
2022	49	2.1%	47	2	0	9.5%
2023	48	2.2%	47	1	0	7.4%
Average-15 yrs (2009-2023)		2.5%	46	3	0	8.6%
YTD (9/30/24)	49	1.9%	32	-	0	8.4%

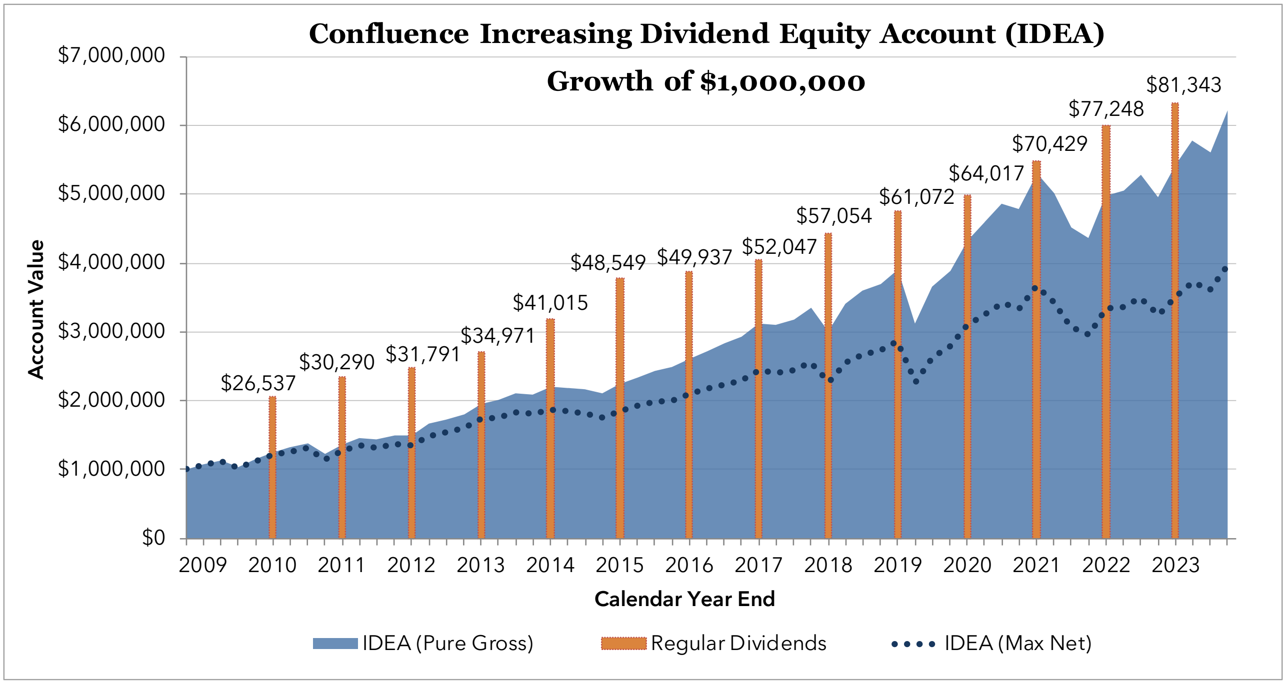
* 2020 excludes impact of temporary dividend suspensions during the pandemic of 2020. ** Dividend Change from Prior Year excludes impact of special dividends and spin-offs.
*** For YTD statistics, the average growth rate is calculated using only those holdings for which an increase or decrease in the 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 dividends plus any special dividends paid during the year.
Avg. Yield as of 9/30/2024 calculated using Indicated Annual Dividend (IAD) from FactSet.

Furthermore, as depicted in the chart on the following page (*Figure 5*), the IDEA strategy has produced consistent dividend growth over the past 15 years, resulting in annual dividend income more than tripling since the strategy's inception, in addition to delivering strong capital appreciation.

Year-to-date, the IDEA strategy posted a strong return of 15.1% (gross of fees), in-line with dividend growers (per Ned Davis Research, see *Figure 7* on page 5), up 16.4%, and the Russell 3000 Value, up 16.2%, 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 12.5% YTD.*] Additionally, IDEA underperformed the S&P 500 (and the Russell 3000 Value) in the Industrials sector as cyclical industrials outperformed the steady dividend growers that we look to own in the IDEA strategy. In the third quarter, however, IDEA outperformed the S&P 500 across almost all sectors as investors rotated away from the mega-cap tech stocks and into dividend-paying stocks, in particular.

Strategy Commentary continued...

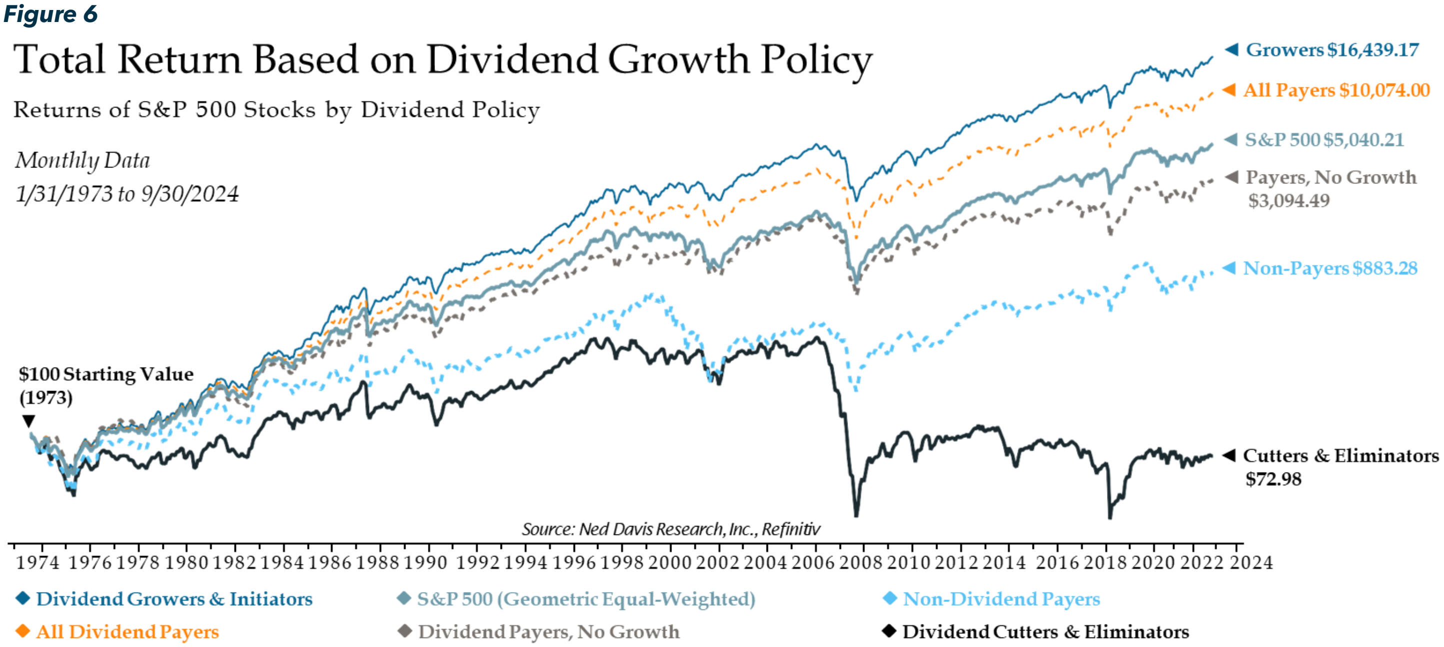
Figure 5 **Growth of Investment & Dividends** [2]



(Annual dividend data as of 12/31/2023)

Historically, dividend growers (like the companies owned in the IDEA portfolio) have substantially outperformed companies whose dividends remained flat, companies that have cut their dividends, and companies that do not pay dividends. As shown in the following chart from Ned Davis Research (*Figure 6*), $100 invested in dividend growers in 1973 has now grown to $16,439, while $100 invested in non-dividend payers is now worth $883, and $100 invested in dividend cutters is only worth $73 today.

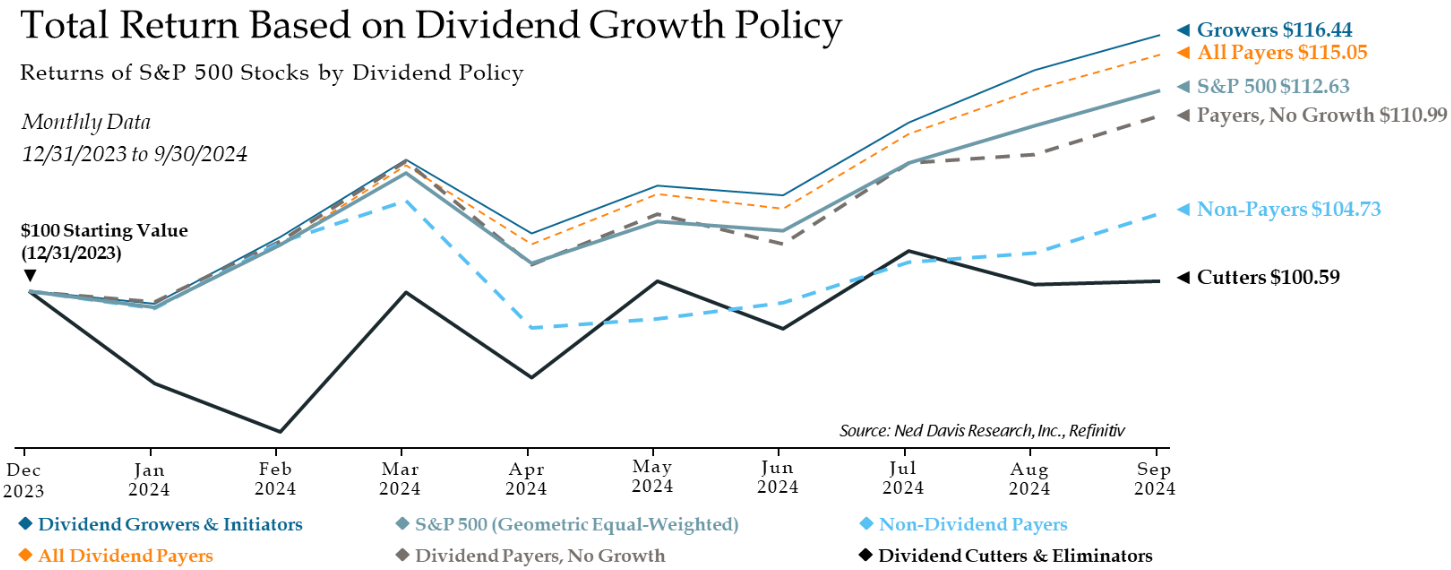
Figure 6



(Source: Ned Davis Research, Inc.; © Copyright 2024)

Strategy Commentary continued...

Figure 7



(Source: Ned Davis Research, Inc.; © Copyright 2024)

During the third quarter, we sold Nestlé (NSRGY) in order to purchase Brown-Forman (BF-B). Ironically, we sold Brown-Forman 10 years ago around $38 (split-adjusted) because it was selling well above our estimate of intrinsic value (near 30x earnings) and we bought Nestlé in its place. Over the past 10 years, Nestlé's stock outperformed as Brown-Forman's valuation declined, giving us a chance to repurchase this great business in the mid-$40s, now at a discount to our estimate of intrinsic value.

Brown-Forman is a leader in spirits production and is one of the longest-tenured North American whiskey distillers. The company's flagship brand, Jack Daniel's, holds a top-10 spot in global whiskey sales and is ranked as the most valuable spirits brand worldwide by Interbrand. Brown-Forman's decades of marketing and brand building have created a very loyal customer base and significant cultural relevance as Jack Daniel's is routinely referenced in pop music and film and has become a symbol of rugged American independence. This brand equity has even extended outside of the US, with Jack Daniel's comfortably holding the spot as the most exported US spirits brand.

The Brown family has maintained control of the company since its founding 154 years ago. As a result, Brown-Forman is unique among publicly traded consumer goods companies in its conservative mindset and focus on long-term sustainable growth; management is more likely to speak of the business in terms of decades than quarters. The company has weathered Prohibition, two World Wars, and multiple economic cycles while growing its brands and delivering consistent returns to shareholders. Brown-Forman has paid quarterly dividends for 80 consecutive years and has increased its regular dividend each year for the past 40 years.

Brown-Forman has been negatively impacted by weak consumer trends and the hangover impact of above-trend spending habits during COVID, which have left consumers with a surplus of spirits on their shelves. As a result, the company's stock has experienced a 30% decline over the past year and is nearly 45% off its COVID-era highs. We believe the market's short-term focus has created an attractive entry point for the stock. The company's strong brand equity, conservative management, significant competitive moats, and steadily growing dividend should reward investors over the long term.

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 a diversified portfolio of quality, dividend-growing businesses purchased at reasonable valuations.

Contribution[3]

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		
Lockheed Martin Corp.	2.90	0.69
Masco Corp.	2.71	0.67
Sherwin-Williams Co.	2.43	0.63
ResMed Inc.	2.45	0.62
Oracle Corp.	2.22	0.47
Bottom 5		
T. Rowe Price Group Inc.	1.11	(0.06)
Amphenol Corp.	2.02	(0.06)
Microsoft Corp.	2.02	(0.08)
Chevron Corp.	1.75	(0.10)
Toro Co.	1.75	(0.13)

(YTD as of 9/30/2024)

Security	Avg Weight (%)	Contribution (%)
Top 5		
Oracle Corp.	2.02	1.10
Brown & Brown Inc.	2.38	0.96
ResMed Inc.	1.84	0.85
Lockheed Martin Corp.	2.67	0.82
Chubb Ltd.	2.87	0.76
Bottom 5		
Nestle S.A.	1.38	(0.08)
Rockwell Automation Inc.	0.36	(0.13)
Toro Co.	1.80	(0.17)
Polaris Inc.	1.53	(0.19)
NIKE Inc.	1.08	(0.26)

Performance Composite Returns[4] (For Periods Ending September 30, 2024)

	Since Inception**	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
IDEA *Pure Gross-of-Fees[5]*	13.0%	11.5%	11.0%	9.1%	25.5%	15.1%	10.9%
Max Net-of-Fees[6]	9.6%	8.2%	7.7%	5.9%	21.7%	12.5%	10.1%
S&P 500	14.1%	13.4%	16.0%	11.9%	36.3%	22.1%	5.9%
Russell 3000 Value	11.1%	9.2%	10.6%	8.7%	27.6%	16.2%	9.5%

Calendar Year	Pure Gross-of-Fees[5]	Max Net-of-Fees[6]	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
2009**	7.5%	6.7%	6.0%	4.2%	1.4%	40	$7,190	$533,832	N/A	N/A	N/A	N/A
2010	16.8%	13.3%	15.1%	16.3%	1.7%	138	$33,407	$751,909	N/A	N/A	N/A	0.4%
2011	8.9%	5.7%	2.1%	(0.1%)	6.8%	325	$68,562	$937,487	N/A	N/A	N/A	0.5%
2012	9.2%	6.0%	16.0%	17.6%	(6.8%)	414	$91,822	$1,272,265	12.7%	15.1%	15.8%	0.2%
2013	31.4%	27.5%	32.4%	32.7%	(1.0%)	536	$153,123	$1,955,915	10.3%	11.9%	12.9%	0.4%
2014	12.0%	8.7%	13.7%	12.7%	(1.7%)	942	$257,782	$2,589,024	8.1%	9.0%	9.4%	0.2%
2015	1.6%	(1.4%)	1.4%	(4.1%)	0.3%	1,265	$311,651	$3,175,419	9.5%	10.5%	10.7%	0.3%
2016	17.0%	13.5%	12.0%	18.4%	5.1%	1,714	$470,340	$4,413,659	9.2%	10.6%	11.0%	0.3%
2017	19.8%	16.2%	21.8%	13.2%	(2.0%)	2,254	$698,440	$5,944,479	8.5%	9.9%	10.3%	0.4%
2018	(3.8%)	(6.6%)	(4.4%)	(8.6%)	0.6%	2,539	$699,689	$5,486,737	9.8%	10.8%	11.1%	0.3%
2019	29.9%	26.0%	31.5%	26.2%	(1.6%)	3,193	$1,079,861	$7,044,708	10.9%	11.9%	12.0%	0.4%
2020	10.7%	7.4%	18.4%	2.9%	(7.7%)	3,269	$1,159,219	$6,889,798	16.5%	18.5%	20.0%	0.8%
2021	22.6%	19.0%	28.7%	25.3%	(6.1%)	2,083	$891,288	$7,761,687	16.0%	17.2%	19.3%	0.5%
2022	(6.2%)	(9.0%)	(18.1%)	(8.0%)	11.9%	2,105	$810,480	$6,931,635	18.7%	20.9%	21.5%	0.8%
2023	8.7%	5.5%	26.3%	11.6%	(17.5%)	2,158	$855,063	$7,200,019	16.0%	17.3%	16.7%	0.5%

**Average annualized returns* ***Inception is 10/1/2009* *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

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.

Disclosures

Market & Strategy Commentary—*Figures 6 and 7:* Charts from Ned Davis Research show the S&P 500 Index split by each constituents' dividend policy. Returns are based on monthly equal-weighted geometric average of total returns of S&P 500 component stocks, with components reconstituted monthly. Dividends are assumed to be reinvested. Dividend rates are not guaranteed payments, nor can they guarantee a rate of return. *Dividend Paying* and *Non-Paying* stocks are defined by each stock's dividend policy determined on a rolling 12-month basis. The dividend figure used to categorize the stock is the company's indicated annual dividend, which may be different from the actual dividends paid. *Dividend Growers/Initiators* is a subset of dividend-paying stocks and include stocks that increased their dividend any time in the last 12 months. Once an increase occurs, it remains classified as a grower for 12 months or until another change in dividend policy. For illustrative purposes only & not representative of any specific investment.

Individual holding performance and contribution methodology 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. Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable. It is important to review your investment objectives, risk tolerance, and liquidity needs before choosing an investment style or manager. 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] **Growth of Investment/Dividends—***Figure 5:* Account value based on $1,000,000 invested in IDEA strategy on 10/1/2009 with dividends reinvested. Annual dividend income is annualized estimate based on representative, fee-paying accounts & includes regular dividends. In Dec. 2012, 10 portfolio holdings pulled forward their 2013 regular dividend payments into 2012 for tax purposes; those Dec. 2012 dividends are allocated to 2013 in this illustration to reflect the companies' regular dividend payment schedules. Additional information is available upon request.

[3] **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.

[4] **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 Increasing Dividend Equity Account (IDEA) strategy was incepted on October 1, 2009, and the Increasing Dividend Equity Account (IDEA) Composite was created on October 1, 2009. 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.

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

[6] 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: 0.60% 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 IDEA Composite contains fully discretionary IDEA wrap accounts. The IDEA portfolio is selected from a universe of stocks, from all market capitalizations, meeting minimum criteria of paying & increasing dividends over the last 10 years.

**Results shown for the year 2009 represent partial period performance from October 1, 2009, through December 31, 2009. 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.