Large Cap Value

Value Equity Strategies

First Quarter 2025

Large Cap Value is focused on seasoned companies that generally have capitalizations above $10 billion. 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 our estimate of intrinsic value. The portfolio typically comprises 23-25 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

Financial markets exhibited signs of anxiety during the first quarter of 2025 as concerns began to surface around artificial intelligence (AI) financial models as well as uncertainty surrounding the new administration's economic agenda. The release of the DeepSeek chatbot by its Chinese developer in early January garnered praise for its innovative and, more importantly, cost-effective approach to model development. This prompted investors to reconsider their assumptions regarding AI's capital intensity. In February, tariff discussions began to gain traction, culminating in an announcement of an official release date in early April. This uncertainty triggered a sell-off in broad equity markets, with the S&P 500 declining by approximately 4.3% for the quarter, while the Treasury market rallied as the yield on the 10-year Treasury fell by 33 basis points to 4.24%, reflecting a flight to safety.

Figure 1

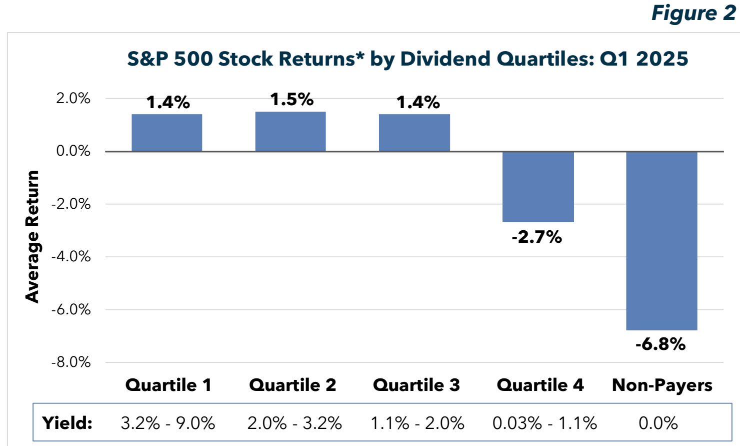
Index	*Q1 2025*	*Index*	*Q1 2025*
Russell 1000	(4.5%)	Russell 2000	(9.5%)
Russell 1000 Growth	(10.0%)	Russell 2000 Growth	(11.1%)
Russell 1000 Value	2.1%	Russell 2000 Value	(7.7%)
S&P 500	(4.3%)	MSCI World ex-US (net)	6.2%

(Sources: Confluence, FTSE Russell, S&P Dow Jones Indices, MSCI)

The most significant event of the quarter was the DeepSeek release, which introduced a novel approach that could challenge existing AI capital investment requirements and impact returns on prior investments. Since late 2022, equity markets have been heavily influenced by AI developments and the associated capital expenditures required to support them, producing outsized returns in select market segments. Consequently, any downward revision of these lofty expectations could disproportionately affect broader markets. DeepSeek's introduction spurred a market rotation away from the leading technology-oriented Magnificent 7 (M7) stocks toward less expensive areas of the market. A rotation should be viewed as healthy, and overdue for value investors, given the large concentration in the M7.

This shift resulted in value stocks outperforming growth stocks and yield/dividend-oriented businesses leading over non-payers and lower-yielding companies. Moreover, heightened uncertainty kept large cap stocks ahead of small caps, while tariff-related developments favored international markets over domestic ones. (See *Figures 1* and *2*.)

Figure 2



*Actual Historical Constituents. *Returns through 3/31/2025. (Sources: Confluence, Ned Davis Research)*

The rotation also influenced sector performance, with the three sectors that hold the M7 stocks – Communication Services (Alphabet and Meta), Consumer Discretionary (Amazon and Tesla), and Information Technology (Microsoft, NVIDIA, and Apple) – emerging as the worst performers during the quarter (see *Figure 3*, sector returns table).

***Figure 3* – Returns 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	**3.7%**	**2.0%**	**14.7%**	**8.5%**	**10.3%**	**29.6%**	**9.2%**	**2.3%**	**11.2%**	**6.1%**	**2.5%**	**100.0%**	Weight
Russell Growth weight	0.5%	0.7%	7.7%	4.9%	14.9%	46.2%	12.7%	0.6%	7.8%	3.9%	0.2%	100.0%	Weight
Russell Value weight	7.1%	4.2%	23.2%	14.1%	5.8%	8.7%	4.5%	4.7%	14.8%	8.2%	4.8%	100.0%	Weight
Russell 2000 weight	5.1%	3.9%	19.8%	17.6%	9.1%	12.3%	2.6%	6.4%	16.7%	3.2%	3.2%	100.0%	Weight
QTD	10.2	2.8	3.5	-0.2	-13.8	-12.7	-6.2	3.5	6.5	5.2	4.9	-4.3	Return (%)
YTD	10.2	2.8	3.5	-0.2	-13.8	-12.7	-6.2	3.5	6.5	5.2	4.9	-4.3	Return (%)

(Source: J.P. Morgan Asset Management; Guide to the Markets®, US 2Q 2025, as of March 31, 2025)

Administration's Impact on Investor Sentiment

While AI dominated attention early in Q1, investor anxiety was heightened when the new administration unveiled its agenda. As this commentary is being written, financial markets remain highly volatile following the end of the quarter — a topic worthy of brief discussion here. For more detailed insights, we encourage readers to follow the regular updates published by our macroeconomic team.

The tariff agenda was revealed in early April and is an attempt to restructure the global order. But why such an aggressive policy when the economy and financial markets appeared to be in good shape? The shift reflects the populist movement that has been gaining momentum for years as global trade has disproportionately benefited capital at labor's expense. *Figure 4* illustrates this trend: Labor's share of total economic output (blue line) remained stable at around 60% from World War II until China joined the World Trade Organization (WTO) in 2001, after which it declined significantly while capital thrived. This imbalance fueled populist movements globally, including the rise of both Bernie Sanders and Donald Trump in 2015 and Brexit across the Atlantic.

The initial step toward benefiting Main Street is a tariff policy designed to rebalance US trade by supporting re-industrialization and thereby creating "good jobs." It also aims to reduce US reliance on critical imports (an issue highlighted during COVID-19), while generating revenue to help address fiscal deficits. Essentially, tariffs act as a consumption tax and production subsidy that should reduce imports, while incentivizing domestic production. *Figure 5* highlights America's persistent trade imbalance, currently over $1.2 trillion.

Fiscal Challenges

The agenda also addresses fiscal deficits and national debt levels that have become unsustainable under existing policies. *Figure 6* shows US national debt approaching 100% of GDP alongside fiscal deficits exceeding 5% — a rarity outside wartime or severe crises. The situation must be addressed at some point, or the burden of servicing the debt will undermine our ability to provide the social safety nets of Medicare, Medicaid, and/or Social Security.

The first part of the agenda has shaken markets given the bold attempt to address the above issues. Future steps on the agenda will entail deregulation and tax policy reforms aimed at addressing inflation and boosting economic growth through measures such as tariffs to support domestic industries, inflation control to lower yields and ease the debt burden, spending cuts, and restoring fiscal discipline.

Market Outlook

The administration's audacious attempts to tackle these issues challenge the framework developed over generations by leveraging geopolitics to reshape America's global position. While risky, this approach seeks to rebuild American manufacturing sectors harmed by unfair trade practices — especially those involving China — and reset post-World War II global economic structures. Resistance and potential missteps are inevitable; however, we believe long-term investors should view volatility as an opportunity, a principle central to our investment philosophy.

Figure 4

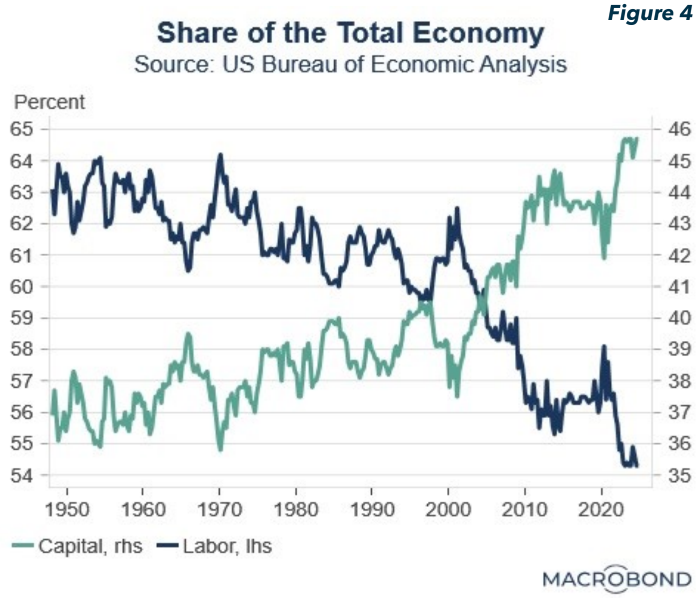


Figure 5

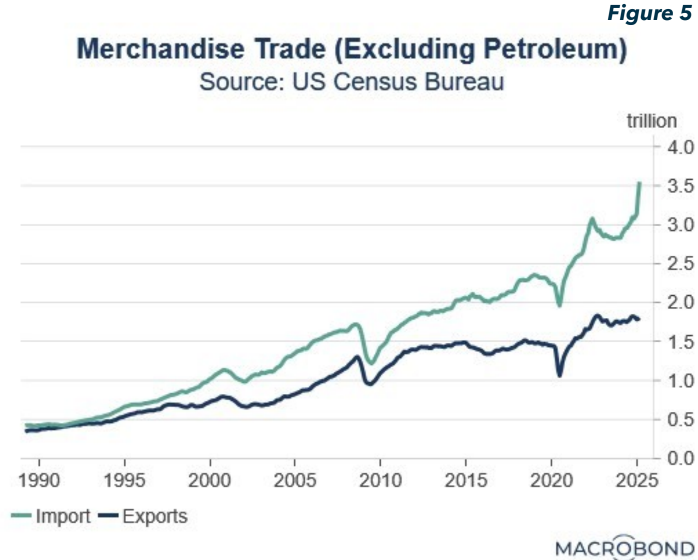
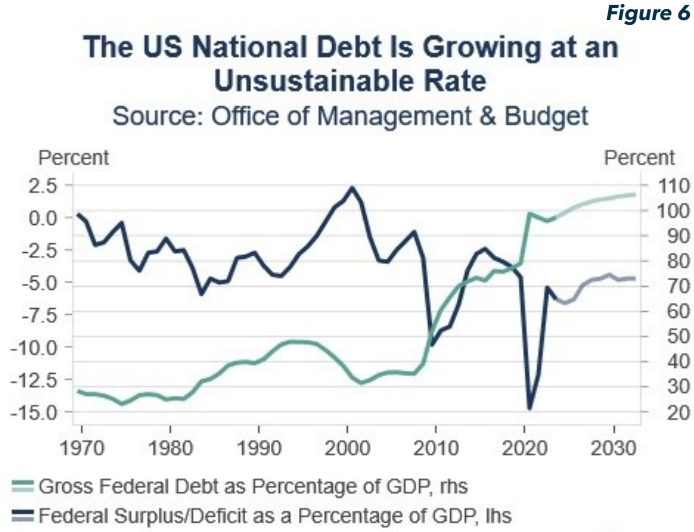


Figure 6



(Sources: Confluence, Macrobond)

Strategy Commentary

Uncertainty, velocity, and flux would all be appropriate labels for the first three months of 2025. Markets entered the year with exuberance, riding enthusiasm from consumers and businesses. About midway through the first quarter, however, positive sentiment was replaced by trepidation as markets began digesting the uncertainty that comes with significant policy changes. Historically, the start of a new administration does bring a flurry of activity, although the current pace and magnitude appear to be more elevated than in recent memory. The topics of tariffs and geopolitical realignments, both real and perceived, have dominated market psychology during the first quarter. Markets are forecasting mechanisms, and therefore volatility is to be expected when significant economic policy changes are underway.

During the first quarter, the S&P 500 Index declined 4.3%, while the Russell 1000 Value Index grew 2.1%. Confluence's Large Cap Value strategy declined 1.2% (gross of fees). [*The strategy's net-of-fees return for the same period was –2.0% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Like the third quarter of last year, the market experienced a broadening of performance. The Magnificent 7 technology behemoths that had fueled most of the S&P 500's returns over the last few years are now being derided as the "Lag 7." When bullish sentiment wanes and worries begin to creep into the prevailing narrative, valuations begin to matter again. Higher-yielding stocks, which typically skew toward commodity-oriented and highly regulated industries, were much better performers in Q1. Those areas are not the focus of our investment strategy, because they generally tend to lack the competitive advantages and pricing power we seek.

Primary contributors to performance in the quarter included W. R. Berkley (WRB), Berkshire Hathaway (BRK.B), and Starbucks (SBUX). Property and casualty insurer W. R. Berkley saw its stock rise upon an announcement that a large Japanese insurance company agreed to acquire 15% of WRB's shares over time. Encouragingly, members of the Berkley family (including the chairman and CEO) are not selling any stock associated with this transaction. This is viewed as a supportive endorsement of the company. Additionally, like many other insurers, W. R. Berkley has benefited from a favorable environment of late, buoyed by strong pricing, favorable development, and higher interest rates.

Berkshire Hathaway was another good performer during the first quarter. In addition to the fundamental tailwinds aiding the insurance business, Berkshire benefited from the risk-off rotation that occurred midway through the quarter. With approximately $350 billion of cash, there is a lot of dry powder available in Omaha waiting for good investment opportunities to emerge. With a fortress balance sheet, Berkshire often represents a "port in the storm" and was a beneficiary of the growing unease that dominated market sentiment.

Starbucks' strong performance was largely attributed to the timely sale of the position midway through the quarter when the shares were elevated. The company is undergoing a transformation led by new CEO Brian Niccol, who joined Starbucks following a successful turnaround at Chipotle (CMG). The pandemic fueled strong mobile order and drive-thru business, but this volume placed a strain on service levels and the cafe experience. We believe the new CEO represents a major upgrade in leadership and is the right person to improve operational efficiency and store atmosphere. During the quarter, the market appeared to agree with this assessment, and Starbucks shares appreciated toward our estimate of intrinsic value. Accordingly, we exited the position to make room for better alternatives.

Primary detractors included Oracle (ORCL), Dun & Bradstreet (DNB), and Alphabet (GOOG). Oracle has been discussed in recent commentaries as it has frequently been one of the better contributors to the strategy. However, this was not the case in the first quarter of this year. The market selloff in late February was especially punishing to stocks that carry relatively high multiples. The market was also disappointed with Oracle's most recent guidance. Nevertheless, our focus is on the overall trajectory of a business and whether its competitive moats are expanding or contracting, rather than how the near-term results compare with consensus expectations, which are often fickle. Oracle's expanding valuation over the last few years is a recognition of the improving quality of the business, largely related to a growing and credible cloud-based offering.

Dun & Bradstreet has been an underperforming investment throughout our ownership period, and Q1 was no exception. It is a data aggregation business that serves as a central repository for current and accurate information about companies, which is used to monitor creditworthiness and financial relationships, allowing businesses to extend or receive credit. We have maintained the view that the favorable attributes of the business should command a higher valuation over time. However, such a valuation has not materialized despite the company shopping itself for several months to prospective bidders. Ultimately, this process culminated in the board agreeing to sell to private equity for a little over $9/share. There is no doubt that this is a disappointing outcome. Investing is a batting average business, and we swung and missed at what we believed was a good pitch. We aim to emulate good hitters by learning from our mistakes, putting them behind us, and focusing on the next pitch. In time, we will replace Dun & Bradstreet with a new position.

Strategy Commentary continued…

Lastly, Alphabet (Google) was also a detractor from performance in Q1. The market was unimpressed with its cloud business *only* growing 30% in the most recent quarter. Additionally, the company announced it would invest a whopping $75 billion toward capital expenditures this year (much of it into AI-related infrastructure), which was more than expected and not well-received. There are legitimate concerns about underwriting AI investment given the lack of clarity on how these investments will be monetized. However, Google must also confront the narrative that generative AI is a threat to search engines (asking AI questions instead of "Googling"). The benefit of generating substantial free cash flow is that Google has significant resources at its disposal to maintain and deepen its competitive moats. Given the multitude of ways that AI may impact its business in the future, this is an area where it may be more prudent to overinvest rather than underinvest. We also continue to believe that Google's sum-of-the-parts is worth more than the current market value.

We made a few changes to the portfolio during the first quarter. As noted earlier, we sold our position in Starbucks (SBUX) along with longtime holding, Markel (MKL). New positions include Air Products and Chemicals (APD) and Arch Capital Group (ACGL).

Markel, a very successful long-term holding for the strategy, was sold to make room for a better opportunity. Over many years, Markel's specialty insurance business grew with solid underwriting profits along with a public equity investment portfolio that outperformed. However, the company shifted its focus from insurance toward being a holding company of private equity investments in non-insurance-related businesses. As a result, Markel's insurance business has underperformed at a time when many other insurance peers have seen strong results, which we found concerning given the favorable insurance market. Recently, an activist investor got involved to re-focus the company on specialty insurance, and management has been responsive. Consequently, the stock traded up toward our estimate of intrinsic value, and we decided to sell. It is always difficult to sell a stock that has returned many-fold, but we believe it is the prudent thing to do when better opportunities are available.

Accordingly, we were excited to add Air Products and Chemicals, a global leader in the production and sale of industrial gases (oxygen, nitrogen, hydrogen, helium, carbon dioxide, and many others). Such gases are used in a wide array of industrial applications and are routinely critical to the performance characteristics of many end-products. Despite being crucial to many manufacturing processes, these gases generally represent a small fraction of a customer's production costs – a favorable trait that results in pricing power. Safe distribution of these gases requires expertise and specialization, and, in many cases, APD builds facilities on-site with its customers. We made the investment in APD after the company replaced its CEO who was enamored with highly speculative, large-scale, clean energy projects that depended on massive government subsidies. New management is bringing a renewed focus to the attractive core business of industrial gas production and delivery.

Specialty insurer Arch Capital Group is a new addition to the strategy. Specialty insurance covers unique exposures that don't fit standard insurance policies. The nature of custom-tailored policies lends itself to niche markets with less competition, high-switching costs, and long-term client relationships. For these reasons, we find the specialty insurance business to be very attractive. Arch Capital has compounded book value at impressive rates over the past two decades, which is indicative of a strong culture and rigorous internal processes. We believe Arch Capital is a world-class specialty insurer, but the market is not currently valuing it as such.

Outlook

If you were to poll management teams of companies, you would likely observe a diverse range of opinions on preferred policy options. We suspect that one area of broad agreement would be a preference for stability and clarity. Running a business is hard enough. It is even more difficult when leaders lack visibility on the rules of the game. The market is currently digesting a rapid arrival of extremely significant rule changes. However, some degree of uncertainty is a fact of life and investing in companies for the long-term requires navigating unpredictable environments. To perform well through these periods, businesses must be prepared to endure and thrive against this reality. This is why we are adherents to an investment philosophy centered on competitively advantaged businesses that generate cash, are prudently financed, and are run by experienced individuals with an ownership mindset. We believe these are the types of businesses that are best equipped to maintain or widen their competitive moats during periods of uncertainty, which is a recipe for long-term compounding.

Contribution[1]

The top contributors and detractors for the portfolio in Q1 2025 are shown in the following table:

(YTD as of 3/31/2025)

Security	Avg Weight (%)	Contribution (%)
Top 5		
W. R. Berkley Corp.	4.37	0.92
Berkshire Hathaway Inc. (Class B)	4.85	0.80
Starbucks Corp.	*Sold*	0.73
Markel Group Inc.	*Sold*	0.43
Progressive Corp.	2.23	0.41
Bottom 5		
Constellation Brands	2.62	(0.53)
Diageo plc	3.25	(0.65)
Alphabet Inc.	3.95	(0.72)
Dun & Bradstreet Holdings Inc.	2.35	(0.78)
Oracle Corp.	5.60	(0.91)

Performance Composite Returns[2] (For Periods Ending March 31, 2025)

	Since Inception**	30-Year*	25-Year*	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Large Cap Value *Pure Gross-of-Fees[3]*	11.1%	10.9%	9.6%	9.9%	12.0%	9.9%	15.5%	5.9%	4.8%	(1.2%)	(1.2%)
Max Net-of-Fees[4]	8.0%	7.7%	6.5%	6.7%	8.6%	6.6%	12.1%	2.7%	1.6%	(2.0%)	(2.0%)
S&P 500	10.6%	10.4%	7.4%	10.2%	13.1%	12.5%	18.6%	9.0%	8.2%	(4.3%)	(4.3%)
Russell 1000 Value	9.7%	9.6%	7.4%	8.0%	10.4%	8.8%	16.1%	6.6%	7.2%	2.1%	2.1%

Calendar Year	Pure Gross-of-Fees[3]	Max Net-of-Fees[4]	S&P 500	R1000 Value	Difference (Gross-S&P500)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	S&P 500 3yr Std Dev	R1000V 3yr Std Dev	Composite Dispersion
2005**	(1.6%)	(4.3%)	4.9%	7.1%	(6.5%)	1,064	$188,332		8.7%	9.0%	9.5%	0.6%
2006	17.8%	14.5%	15.8%	22.2%	2.0%	957	$198,952		5.8%	6.8%	6.7%	0.6%
2007	5.9%	3.0%	5.5%	(0.2%)	0.4%	834	$174,711		6.7%	7.7%	8.1%	0.6%
2008	(27.0%)	(29.1%)	(37.0%)	(36.8%)	9.9%	119	$25,562	$291,644	13.2%	15.1%	15.4%	N/A
2009	28.6%	24.8%	26.5%	19.7%	2.2%	149	$53,387	$533,832	17.7%	19.6%	21.1%	1.4%
2010	12.1%	8.8%	15.1%	15.5%	(3.0%)	192	$76,040	$751,909	19.7%	21.9%	23.2%	0.4%
2011	6.4%	3.2%	2.1%	0.4%	4.3%	228	$89,145	$937,487	17.1%	18.7%	20.7%	0.3%
2012	19.0%	15.4%	16.0%	17.5%	3.0%	249	$143,568	$1,272,265	13.5%	15.1%	15.5%	0.4%
2013	37.6%	33.6%	32.4%	32.6%	5.2%	373	$208,844	$1,955,915	10.6%	11.9%	12.7%	0.9%
2014	10.7%	7.5%	13.7%	13.4%	(2.9%)	618	$278,339	$2,589,024	8.6%	9.0%	9.2%	0.5%
2015	1.6%	(1.4%)	1.4%	(3.8%)	0.2%	858	$352,556	$3,175,419	10.1%	10.5%	10.7%	0.5%
2016	8.6%	5.4%	12.0%	17.3%	(3.4%)	1,003	$396,038	$4,413,659	10.0%	10.6%	10.8%	0.4%
2017	16.1%	12.6%	21.8%	13.6%	(5.7%)	1,049	$380,737	$5,944,479	9.0%	9.9%	10.2%	0.6%
2018	(4.6%)	(7.4%)	(4.4%)	(8.3%)	(0.2%)	1,029	$364,805	$5,486,737	10.4%	10.8%	10.8%	0.6%
2019	34.5%	30.5%	31.5%	26.5%	3.0%	1,118	$525,944	$7,044,708	11.8%	11.9%	11.8%	0.6%
2020	13.0%	9.7%	18.4%	2.8%	(5.4%)	1,229	$647,076	$6,889,798	18.8%	18.5%	19.6%	0.9%
2021	26.8%	23.0%	28.7%	25.1%	(1.9%)	1,251	$738,402	$7,761,687	18.2%	17.2%	19.1%	0.6%
2022	(15.5%)	(18.0%)	(18.1%)	(7.6%)	2.7%	1,274	$609,865	$6,931,635	21.0%	20.9%	21.3%	0.6%
2023	16.9%	13.4%	26.3%	11.4%	(9.4%)	1,281	$611,018	$7,200,019	17.8%	17.3%	16.5%	0.7%
2024	14.5%	11.1%	25.0%	14.3%	(10.5%)	1,192	$609,515	$7,280,773	17.3%	17.2%	16.7%	0.7%

**Average annualized returns   **Inception is 10/1/1994. Additional years of performance available on our website.* *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 1000® Value Index – A capitalization-weighted index designed to measure performance of those Russell 1000® Index companies with lower price-to-book ratios and lower forecasted growth values. *(Source: Bloomberg)*

Confluence Value Equities Investment Committee

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Disclosures

Market & Strategy Commentary—Individual holding performance and contribution methodology as well as a list of every holding's contribution to the strategy 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.

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Indexes: The S&P 500 and Russell 1000 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 Large Cap Value Strategy was incepted on October 1, 1994, and the current Large 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 US 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 Large Cap Value Composite contains fully discretionary Large Cap Value wrap accounts. Large Cap Value is a value-based, bottom-up portfolio that utilizes stocks with market capitalizations typically exceeding $10 billion.
**Results shown for the year 1994 represent partial period performance from October 1, 1994, through December 31, 1994. 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 and/or performance was calculated quarterly prior to January 2001.

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