# Value Opportunities

## *Value Equity Strategies*

**First Quarter 2025**

Value Opportunities is a concentrated portfolio of businesses that range in market capitalization. Companies are selected using a bottom-up, fundamental research process that seeks to identify individual businesses that are trading at substantial discounts to our estimate of intrinsic value and have near-term catalysts in which to unlock the value. The portfolio may have concentrations in both individual holdings and/or industries. It typically comprises 8-12 holdings and is expected to result in high annual turnover. The strategy is appropriate for clients seeking an aggressive approach to generating capital appreciation.

### 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.

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.

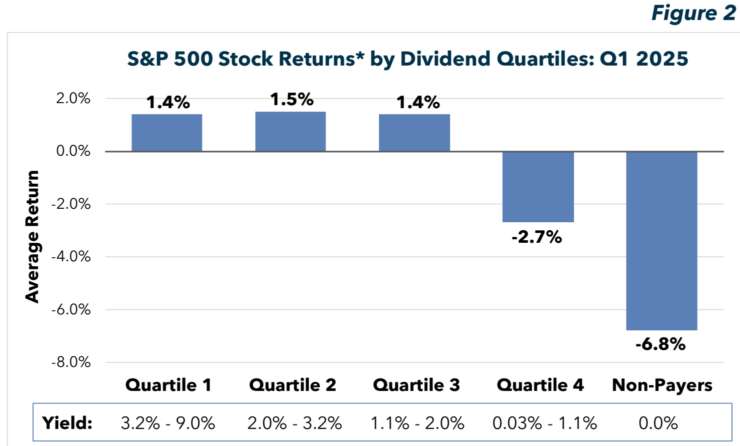
This shift resulted in value stocks outperforming growth stocks and yield/dividend-oriented businesses leading over non-payers and lower-yielding companies. Moreover, heightened uncertainty kept large cap stocks ahead of small caps, while tariff-related developments favored international markets over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

*Figure 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)*

*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% | |
| 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% | |
| 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% | |
| **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 | |

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



*See GIPS Report on pages 5-6.*

## 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*

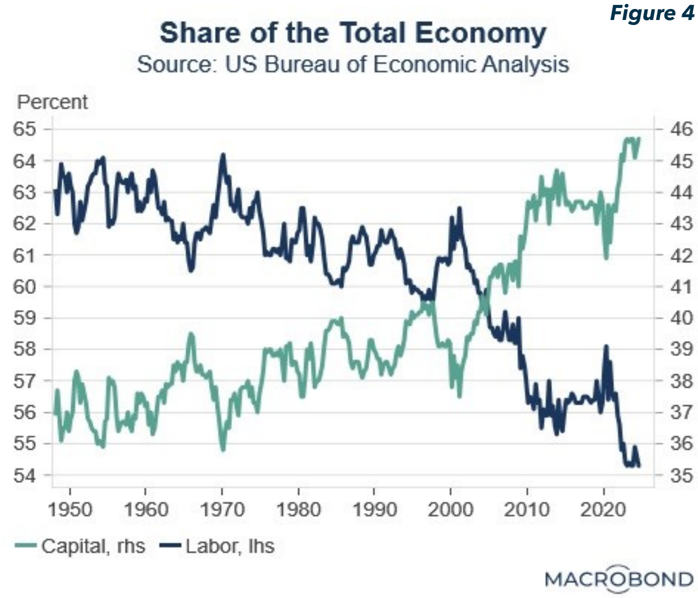



*Figure 5*

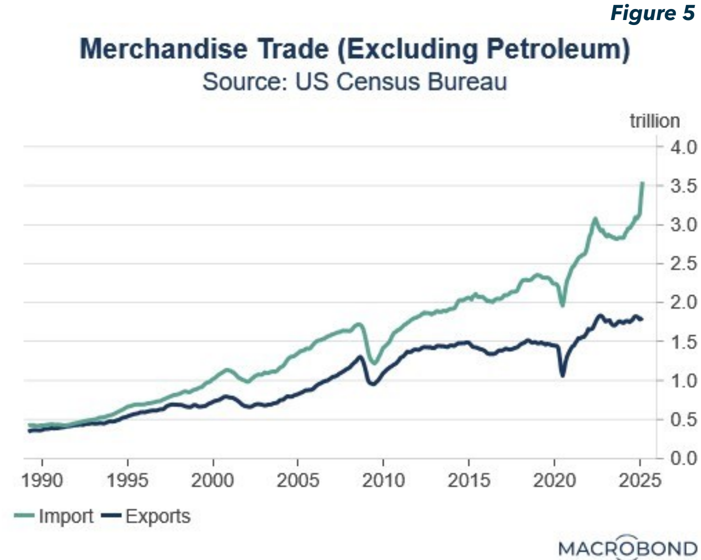
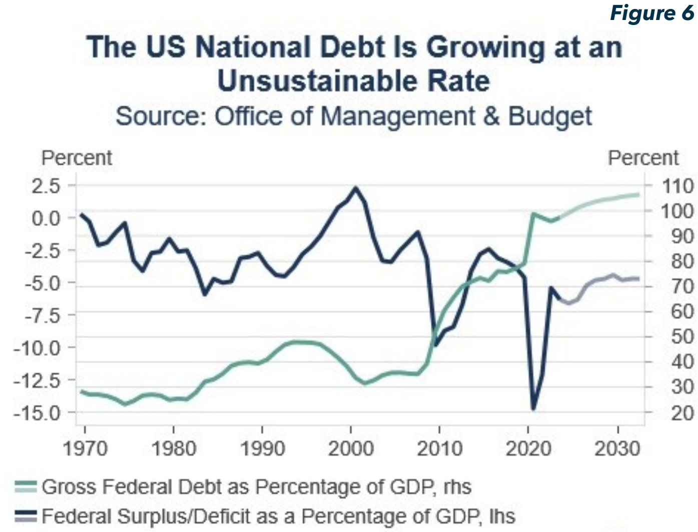



*Figure 6*




*(Sources: Confluence, Macrobond)*

## Strategy Commentary

The rotation from the Magnificent 7 (M7) mega-cap tech stocks to the other 490+ stocks in the S&P 500 resumed in the first quarter of this year. As discussed in our fourth quarter commentary, this rotation began in July 2024 but was partially reversed in December when the M7 came roaring back. At the time, we thought this was a flight to "safety" (ironically, in highly valued growth stocks) given the uncertainty around interest rates. However, as time goes by, it seems this may have been a waning surge in the M7/AI mania that we have been observing over the past few years…only time will tell.

With the emergence of DeepSeek in late January, investors have started to question the predetermined winners of the AI era. For more information on the ramifications of DeepSeek, you can Google it (or ask AI!), but the important thing to remember is that the very essence of the tech sector is innovation, so it is difficult to find the ***sustainable competitive advantages*** that our investment approach requires. When it comes to technology and innovation, better/faster/cheaper will eventually emerge and always win. We are not sure if DeepSeek is that much better/faster/cheaper when it comes to AI, but we are sure that those innovations are coming, and most likely from startups rather than the incumbents.

With the rotation re-engaged in the first quarter, the S&P 500 Index was down 4.3%, while the Russell 3000 Value Index was up 1.6% and the S&P 500 Equal Weight Index was nearly flat at -0.6%. By comparison, Confluence's Value Opportunities strategy was down 2.5% (gross of fees) in the first quarter. [*The strategy's net-of-fees return for the same period was -3.3% QTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

In the first quarter, Value Opportunities outperformed the S&P 500 primarily due to the Financials sector, with Progressive (PGR) continuing to produce solid underwriting profits while also gaining market share. Additionally, the strategy outperformed by not owning the M7, which heavily influence the Technology and Consumer Discretionary sectors. Lastly, our holdings in the Industrials sector outperformed, with Paycom Software (PAYC) and The Azek Company (AZEK) continuing to prosper.

The top contributors to Q1 performance were the aforementioned Progressive, auto insurance; Paycom, payroll processor; and Azek, composite decking. The weakest contributors during the quarter were Diageo (DEO), liquor; TripAdvisor (TRIP), online travel reviews/experiences; and Charles River Laboratories (CRL), drug development products and services.

During the first quarter, we added TripAdvisor to the portfolio as recent positive developments have emerged, yet the stock remains significantly undervalued relative to our estimate of intrinsic value. The first key catalyst is TRIP's agreement to acquire Liberty TripAdvisor, simplifying its ownership structure by eliminating the dual-share arrangement. This move not only reduces the outstanding share count by roughly 18% (which should be accretive to EPS and enhance intrinsic value), but it also creates strategic flexibility for management to focus on value-enhancing initiatives, particularly optimizing Viator, TRIP's crown jewel.

The second major catalyst is the emergence of a potential strategic buyout offer in the range of $18-$19 per share, underscoring TRIP's attractiveness as an asset. This news, disclosed ahead of the shareholder vote on the Liberty TripAdvisor acquisition, has renewed speculation around bidders, especially given prior interest from multiple financial sponsors and strategic buyers. TRIP's board rejected the initial offer, deeming it too low. Previously, bidders explored acquisition offers as high as $30 per share but withdrew due to the complexities tied to the Liberty TripAdvisor structure. With this structural overhang now removed, the company is in a stronger position to attract future suitors. These developments align with our investment thesis, making TRIP a compelling addition to our Value Opportunities portfolio.

In early February, Markel Group (MKL) was sold in the portfolio at an average price of around $1,875 per share. We were long-term holders of Markel as we first purchased the stock 25 years ago in our Small Cap Value portfolio and added it to the Value Opportunities portfolio in 2012 at around $415. Markel was a successful investment over the past 13 years as its 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 its specialty insurance peers (several of which we also own) in the past five years, 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 over 25% and approached our estimate of intrinsic value. 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.

## Strategy Commentary continued…

Additionally, we had two major catalysts come to fruition during the quarter at Azek and Dollar Tree (DLTR).

On March 23, James Hardie Industries announced a deal to acquire Azek in a cash and stock deal valued at $56.88 per share. This deal values Azek right in line with our intrinsic value estimate and is a solid return from our initial purchase in October 2022 at around $17.

A few days later, on March 26, Dollar Tree announced the long-awaited divestiture of Family Dollar to private equity for $1 billion. While this is a substantial loss from the $9 billion that the previous management paid for Family Dollar in 2015, this impairment has long been priced into the stock but a clean exit with net proceeds was not. With management and operations once again fully focused on the Dollar Tree concept, the spotlight should return to its long history of profitable growth driven by delivering real value to customers.

## Outlook

While there is always uncertainty in the stock market, it is particularly high today given all the initiatives underway from the second Trump administration (tariffs, DOGE, food and health oversight, tax cuts, geopolitical issues, etc.). Furthermore, market volatility has increased due to rising concerns about a recession following the tariff actions in early April.

Still, at Confluence, we remain focused on owning great businesses with capable management teams that are purchased with a margin of safety. This investment approach has historically provided solid downside protection and long-term outperformance as the stock prices of these high-quality companies tend to bounce coming out of a recession like a tennis ball, instead of going splat at the bottom like a tomato!

In fact, market downturns often present us with opportunities to add great companies, ones we have long admired, to the portfolio at a discount to our estimate of intrinsic value, which should help drive above-average returns in the future.

## 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** | | |
| Progressive Corp. | 11.95 | 2.11 |
| Paycom Software Inc. | 12.51 | 0.81 |
| Azek Co. Inc. | 8.83 | 0.43 |
| i3 Verticals Inc. | 5.23 | 0.31 |
| Markel Group Inc. | *Sold* | 0.13 |
| **Bottom 5** | | |
| Keysight Technologies Inc. | 7.17 | (0.47) |
| CONMED Corp. | 8.38 | (0.99) |
| Charles River Laboratories International Inc. | 6.72 | (1.36) |
| TripAdvisor Inc. | 7.37 | (1.49) |
| Diageo plc | 8.32 | (1.61) |

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

| | Since Inception** | 20-Year* | 15-Year* | 10-Year* | 5-Year* | 3-Year* | 1-Year | YTD | QTD |
|---|---|---|---|---|---|---|---|---|---|
| **Value Opportunities** *Pure Gross-of-Fees[3]* | 9.9% | 9.1% | 9.9% | 5.4% | 11.1% | 4.9% | (5.8%) | (2.5%) | (2.5%) |
| *Max Net-of-Fees[4]* | 6.7% | 5.9% | 6.6% | 2.3% | 7.8% | 1.8% | (8.6%) | (3.3%) | (3.3%) |
| **S&P 500** | 7.4% | 10.2% | 13.1% | 12.5% | 18.6% | 9.0% | 8.2% | (4.3%) | (4.3%) |
| **Russell 3000 Value** | 7.5% | 7.9% | 10.3% | 8.6% | 16.1% | 6.2% | 6.6% | 1.6% | 1.6% |

| Calendar Year | Pure Gross-of-Fees[3] | Max Net-of-Fees[4] | S&P 500 | R3000 Value | Difference (Gross-S&P500) | # of Portfolios | Composite Assets (000s) | Total Firm Assets (000s) | Composite 3yr Std Dev | S&P 500 3yr Std Dev | R3000V 3yr Std Dev | Composite Dispersion |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2005** | 4.4% | 1.6% | 4.9% | 6.9% | (0.5%) | 179 | $23,399 | | 11.7% | 9.0% | 9.7% | 0.8% |
| 2006 | 27.0% | 23.6% | 15.8% | 22.3% | 11.3% | 171 | $19,132 | | 7.6% | 6.8% | 7.0% | 1.7% |
| 2007 | 2.1% | (0.7%) | 5.5% | (1.0%) | (3.4%) | 197 | $20,510 | | 8.4% | 7.7% | 8.3% | 0.7% |
| 2008 | (22.3%) | (24.5%) | (37.0%) | (36.2%) | 14.7% | 29 | $8,299 | $291,644 | 18.6% | 15.1% | 15.5% | N/A |
| 2009 | 31.5% | 27.6% | 26.5% | 19.8% | 5.0% | 37 | $14,001 | $533,832 | 25.2% | 19.6% | 21.3% | 2.0% |
| 2010 | 6.9% | 3.7% | 15.1% | 16.3% | (8.2%) | 51 | $7,429 | $751,909 | 27.9% | 21.9% | 23.5% | 0.7% |
| 2011 | (1.7%) | (4.6%) | 2.1% | (0.1%) | (3.8%) | 53 | $7,694 | $937,487 | 23.7% | 18.7% | 21.0% | 0.6% |
| 2012 | 28.5% | 24.7% | 16.0% | 17.6% | 12.5% | 53 | $9,576 | $1,272,265 | 18.3% | 15.1% | 15.8% | 0.9% |
| 2013 | 32.3% | 28.3% | 32.4% | 32.7% | (0.1%) | 76 | $18,299 | $1,955,915 | 13.5% | 11.9% | 12.9% | 0.4% |
| 2014 | 31.6% | 27.7% | 13.7% | 12.7% | 17.9% | 110 | $31,040 | $2,589,024 | 11.4% | 9.0% | 9.4% | 0.9% |
| 2015 | 2.3% | (0.7%) | 1.4% | (4.1%) | 1.0% | 554 | $113,587 | $3,175,419 | 10.8% | 10.5% | 10.7% | 0.3% |
| 2016 | 15.4% | 12.0% | 12.0% | 18.4% | 3.4% | 959 | $207,565 | $4,413,659 | 10.9% | 10.6% | 11.0% | 0.5% |
| 2017 | 14.5% | 11.1% | 21.8% | 13.2% | (7.3%) | 1,737 | $359,636 | $5,944,479 | 9.8% | 9.9% | 10.3% | 0.8% |
| 2018 | (18.8%) | (21.2%) | (4.4%) | (8.6%) | (14.4%) | 1,494 | $236,097 | $5,486,737 | 11.9% | 10.8% | 11.1% | 0.8% |
| 2019 | 28.6% | 24.7% | 31.5% | 26.2% | (2.9%) | 1,129 | $230,991 | $7,044,708 | 13.6% | 11.9% | 12.0% | 0.7% |
| 2020 | 9.5% | 6.2% | 18.4% | 2.9% | (8.9%) | 745 | $165,389 | $6,889,798 | 20.0% | 18.5% | 20.0% | 1.3% |
| 2021 | 6.9% | 3.8% | 28.7% | 25.3% | (21.7%) | 532 | $132,656 | $7,761,687 | 18.3% | 17.2% | 19.3% | 1.2% |
| 2022 | (22.3%) | (24.6%) | (18.1%) | (8.0%) | (4.1%) | 331 | $61,497 | $6,931,635 | 21.1% | 20.9% | 21.5% | 0.9% |
| 2023 | 30.6% | 26.7% | 26.3% | 11.6% | 4.3% | 250 | $61,922 | $7,200,019 | 19.5% | 17.3% | 16.7% | 0.6% |
| 2024 | 8.8% | 5.6% | 25.0% | 14.0% | (16.2%) | 223 | $61,505 | $7,280,773 | 21.2% | 17.2% | 16.9% | 1.1% |

**Average annualized returns*   ***Inception is 4/1/2000. 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 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 | Tore Stole | Tom Dugan, CFA | Dustin Hausladen | Brett Mawhiney, CFA |
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*See Territory Map on the Confluence website for sales coverage.*

## 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 3000 Value are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only & do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

[1] **Contribution—**Contribution data shown from a sample account, based on individual stock performance and portfolio weighting. Table showing the top 5 contributors/detractors reflects the strategy's best and worst performers (net), based on each holding's contribution to the sample account for the period stated. Holdings identified do not represent all of the securities purchased, sold or recommended. Individual client portfolios in the strategy may differ, sometimes significantly, from these listings.

[2] **Performance Composite Returns—Confluence Investment Management LLC claims compliance with the Global investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Confluence Investment Management LLC has been independently verified for the periods August 1, 2008, through December 31, 2023. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards.**

Verification provides assurance on whether the firm's policies and procedures related to composite maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

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The Value Opportunities Strategy was incepted on April 1, 2000, and the current Value Opportunities 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: 1.00% on the first $500,000; 0.90% on the next $500,000; and 0.75% 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 Value Opportunities Composite contains fully discretionary Value Opportunities wrap accounts. Value Opportunities is a concentrated, value-based, bottom-up portfolio that utilizes stocks from all market capitalizations with a focus on near-term catalysts. Catalysts include reorganizations, turnarounds, and other unique situations that are anticipated to come to fruition in approximately 6-18 months. This short-term investment time frame often leads to high turnover. *Because of the concentrated positions, the portfolio is more susceptible to movements of any one holding.*

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