Value Opportunities

Value Equity Strategies

Third Quarter 2024

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

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 9.0% gain for the quarter. While one quarter does not make a trend, and growth is still leading value for the year (Russell 1000 Growth 24.6% versus Russell 1000 Value 16.7%), the broadening of the market into new highs provides for a much healthier environment. In turn, we find it is also a more favorable environment for stock pickers and value-oriented strategies.

Notably, the quarter saw a healthy rotation into previously underperforming sectors. Ten of 11 large cap sectors finished higher in the third quarter, with Utilities (19.4%), REITs (+17.0%), Industrials (11.5%), and Financials (10.7%) leading the market. These sectors have a heavier weight in the value benchmarks and benefited from the decline in interest rates as the 10-year Treasury yield declined from 4.36% to 3.81% during the quarter (see *Figure 1*, sector returns table).

Figure 1 **Returns and Valuations by Sector**

	Energy	Materials	Financials	Industrials	Cons. Disc.	Tech.	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index
S&P weight	**3.3%**	**2.3%**	**12.9%**	**8.5%**	**10.2%**	**31.7%**	**8.8%**	**2.3%**	**11.6%**	**5.9%**	**2.5%**	**100.0%**
Russell Growth weight	0.4%	0.7%	6.4%	4.6%	14.3%	48.7%	12.8%	0.6%	7.8%	3.7%	0.2%	100.0%
Russell Value weight	6.7%	4.7%	21.1%	14.7%	6.3%	9.1%	4.2%	4.9%	15.5%	8.0%	4.8%	100.0%
Russell 2000 weight	5.3%	4.5%	17.9%	17.0%	10.1%	12.9%	2.7%	6.5%	17.4%	2.8%	2.8%	100.0%
QTD	-2.3	9.7	10.7	11.5	7.8	1.6	1.7	17.0	6.1	9.0	19.4	5.9
YTD	7.5	14.8	21.5	19.6	14.2	29.6	27.8	14.8	13.7	18.6	30.1	21.6

(Source: J.P. Morgan Asset Management; Guide to the Markets®, US 4Q 2024, as of September 30, 2024)

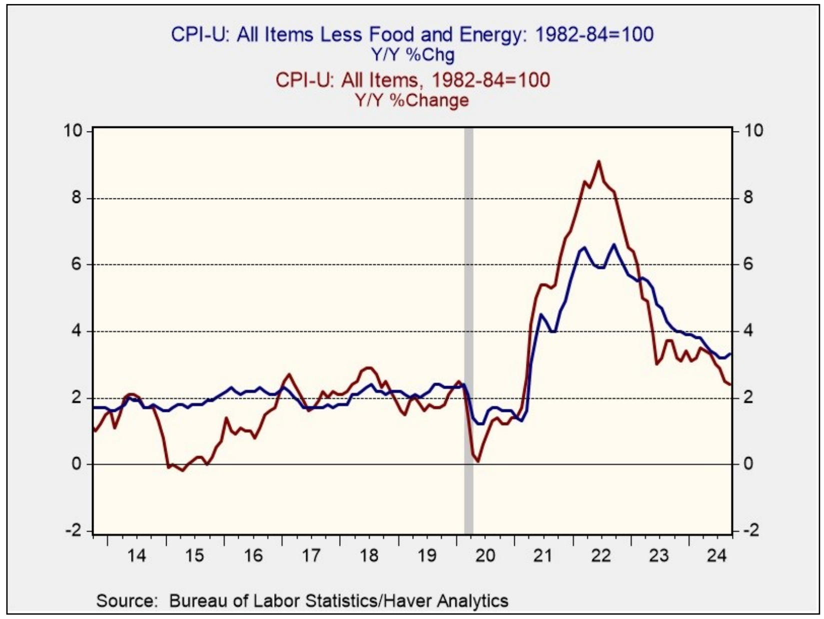
Small and mid-cap stocks, often overlooked during periods of mega-cap dominance, also performed well. The Russell 2000 Index and Russell Midcap Index outperformed the broader market, returning 9.3% and 9.2%, respectively, for the quarter. Small cap businesses, which are more levered than large cap businesses, benefited from the decline in short-term interest rates which should provide some earnings relief for floating rate debt as well as the perceived reduced probability of a recession. Despite the marginal outperformance of small caps, we believe they still offer an attractive valuation relative to large caps.

See GIPS Report on pages 5-6

Market Commentary continued...

The continued improvement in inflation levels also allowed the Federal Reserve to alter course and make its first interest rate cut this year. On September 18, 2024, 420 days after the last rate hike, the FOMC cut rates by an aggressive 50 bps. This followed the rapid increase in rates that started in March 2022 at 0% and lasted until July 2023, the last increase of which brought the fed funds rate to 5.25%. Of course, this action was needed to stem the rapid ascent of inflation following the liquidity infusion induced by the pandemic (see *Figure 2* from the Confluence macroeconomic team).

Figure 2



The equity markets have been rallying following the rate cut as the fixed income markets have been selling off (i.e., yields migrating upward). This indicates that equity investors are more optimistic that the Fed can tame inflation and avoid a recession, while fixed income investors are becoming more concerned about inflation. The aggressiveness of the 50 bps rate cut seems to have sent a mixed message regarding the strength of the economy and inflationary pressures over the near term.

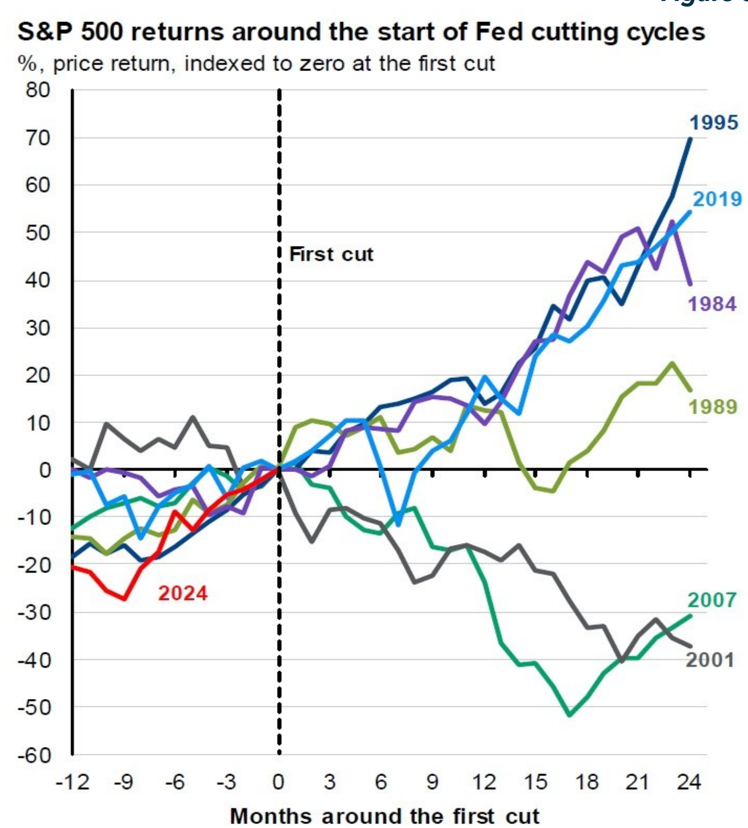
Moreover, there has been much discussion surrounding the historical impact on the equity markets following the first rate cut by the Fed. Many seem to focus on the positive implications for equities that lower rates offer. The reality is more nuanced as each period must consider the economic backdrop, employment, inflationary trends, valuation, and geopolitical events. The next chart (*Figure 3*) reflects the last six cycles dating back to 1984. Looking at this chart, the verdict is mixed six months after the first cut, with half posting positive returns and half posting negative returns. The current environment is unique given the low levels of unemployment, higher valuations, and recent experience with inflation.

We remain concerned about the longer-term pressure on structural inflation given the fracturing of global trade. Deglobalization elevates trade barriers, supply chains become less efficient, and production costs increase, which lead to higher prices for goods and services. In essence, these changes would reverse the disinflationary effects previously afforded by globalization over the past few decades, which would likely result in inflation running above the Fed's current 2% target and pressure longer-term rates. For investors, it elevates the importance of protecting purchasing power.

The Confluence macroeconomic team has been writing about these trends for quite some time. To stay abreast of these developments, we encourage readers to [subscribe to our newsletters]().

As always, we remain focused on fundamentals and steadfast on the protection of capital by concentrating on competitively advantaged businesses that have historically displayed an ability to maintain margins and returns on capital — attributes which are important given the concerns of inflation.

Figure 3



(Source: J.P. Morgan Asset Management; Guide to the Markets®, US 4Q 2024, as of September 30, 2024)

Strategy Commentary

Given the concentrated nature of the Value Opportunities portfolio, short-term performance can swing dramatically. Following a strong start to 2024 when the strategy was up 12.6% (gross of fees) in Q1, with the S&P 500 up 10.6% and the Russell 3000 Value up 8.6%, Value Opportunities is now trailing at the end of Q3 with a year-to-date return of 4.4% (gross of fees). This compares to the benchmarks' year-to-date performance of 22.1% and 16.2%, respectively. [*The strategy's net-of-fees returns for the same periods were 11.7% Q1 2024 and 2.1% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

This wide swing in performance is primarily due to four holdings: Vontier (VNT) and Lamb Weston (LW), which were sold during the quarter, and Charles River Laboratories (CRL) and Dollar Tree (DLTR), which are still held in the portfolio.

Charles River Labs, a provider of products and services for drug development, has traded off from its highs in March as the pharma industry continues to work through post-pandemic normalization of drug research budgets. Still, once demand recovers, we believe Charles River Labs is well-positioned to benefit from secular growth in this industry over the long term.

Dollar Tree has been the largest lag on performance as it is down almost 50% since the end of March. Dollar Tree (and its primary competitor, Dollar General) is in temporary limbo as low-income consumers are pulling back on spending, but middle- and upper-income consumers are not hurting enough to trade down. Still, Dollar Tree continues to excel at providing value to its customers through low-priced items (now at $1.25, $3, or $5). With a successful divestiture of Family Dollar, we expect the company will be even more focused on outperformance at its legacy Dollar Tree format. At the current valuation, Dollar Tree has significant upside if any of these three catalysts occur under the stewardship of a highly skilled and incentivized management team.

Underperformance from the four holdings listed above has been partially offset by strong performance from Progressive (PGR, auto insurance), which has doubled from our initial purchase a year ago, and Azek (AZEK, composite decking). Both companies are established leaders in growing industries.

We made several changes to the portfolio in the third quarter, and we therefore believe it is well-positioned with high-quality, lower leveraged businesses that should be resilient throughout the economic cycle and compound over the long term. During the quarter, Lamb Weston was sold to buy CONMED, we completed a new position in Paycom (PAYC), and Vontier was sold in order to purchase Diageo (DEO).

Lamb Weston Holdings was added to the portfolio earlier this year following a disappointing first quarter earnings report related to ERP integration issues, which are common and usually short term in nature. On July 24, the stock took another leg down following the second quarter earnings report as management's updated assessment of market conditions revealed that ongoing ERP implementation issues, weak QSR traffic, and greater-than-expected industry capacity meant Lamb Weston's turnaround will now be a much longer, drawn out process dependent on multiple industry dynamics rather than a single self-inflicted short-term issue. Given these factors, in late August, we decided it was best to sell and move on rather than wait for a turnaround that could be a multi-year process.

Lamb Weston was replaced in the portfolio with CONMED Corporation, a medical technology company that provides devices and equipment for surgical procedures. CONMED's origins are in products that are used by surgeons and often offer a solution for an unmet need. The company gets many of its product ideas from the surgeons themselves, which creates a very sticky relationship with surgeons who become accustomed to the solutions that CONMED offers. These solutions are often single-use or carry a disposable component, allowing the company to generate a sustainable stream of cash flow. While this is a great model, it is only as good as management's ability to reinvest this cash flow.

CONMED has been around for years, but we became interested in the company in 2014 when an ex-Stryker veteran took the helm. We have long admired Stryker's business model and felt that CONMED provided a compelling platform to emulate that model — it just needed the right management team. Under the new leadership, the company has undertaken several changes and has drastically improved the growth profile of the company. Management's successful reinvestment of the cash flow, both internally through R&D and externally through M&A, has transformed a steady recurring revenue stream into a growing recurring revenue stream. Recent competitive concerns have pressured the shares and created an attractive entry point for what we feel is an established business model that offers above-average, top-line growth and margin expansion opportunities.

Strategy Commentary continued...

During the quarter, we also finished building our position in Paycom, a cloud-based Human Resource Management (HRM) platform. Its software helps companies fulfill payroll and HR functions more efficiently. This is a founder-led business that has grown profitably for over two decades. Just a few years ago, Paycom traded for exorbitant valuation multiples, in our assessment. However, the company recently introduced a new service offering that was not well-received by the investment community. Why? Because although it was popular among clients, and improved customer retention, it reduced the revenue growth rate of Paycom. This disappointed the growth/momentum-oriented shareholder base, and the stock sold off. We viewed this as an opportunity to add an attractive business at a fair price. Further, it's a prime example of a management team making decisions through a long-term lens.

Lastly, during the third quarter we had an opportunity to buy Diageo at a very attractive discount to our estimate of intrinsic value. Additionally, the business is less economically sensitive than Vontier, which was sold to fund the purchase of Diageo. Diageo is one of the world's largest distributors of alcoholic beverages and spirits, with premium brands such as Johnnie Walker, Guinness, Crown Royal, and Bailey's holding dominant share in their respective categories. The company's broad portfolio allows it to respond nimbly to changing consumer demands, while also providing diversification across categories. Diageo's premium brands, reputation for quality, and strong distributor relationships have historically afforded the company substantial pricing power which has resulted in attractive returns on capital. The company has been able to deploy its free cash flow toward M&A opportunities in emerging categories.

Greater-than-average consumer spending levels during the COVID era have led to overstock in consumers' pantries, which is being felt across the industry as distributors have lowered their inventory levels in response. For Diageo, this trend has been particularly acute in Latin America. Concurrent with these events, Diageo was thrust into a CEO transition after long-time CEO Ivan Menezes passed away suddenly in June of last year. As a result, the stock was trading at its most attractive valuation in a decade, outside of the March 2020 lows. Underlying long-term trends for spirit consumption remain strong, however, and Diageo is well-positioned to benefit from the eventual normalization in the distribution channel and consumer spending. The company is well-managed, and its brands continue to command premium pricing and market leadership. For a patient investor, we believe these shorter-term issues have provided an attractive opportunity to own this high-quality business.

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 quality businesses with capable management teams and opportunistically purchased at a discount to intrinsic value.

Contribution[1]

The top contributors and detractors for the portfolio in Q3 2024 and year-to-date are shown in the following tables:

(QTD as of 9/30/2024)

Security	Avg Weight (%)	Contribution (%)
Top 5		
Progressive Corp.	17.79	3.61
Azek Co. Inc.	9.67	1.06
Paycom Software Inc.	6.91	1.04
Keysight Technologies Inc.	6.41	1.04
Diageo plc	2.20	1.01
Bottom 5		
i3 Verticals Inc.	4.84	(0.20)
Charles River Laboratories Intl Inc.	8.63	(0.49)
Vontier Corp.	*Sold*	(1.81)
Dollar Tree Inc.	5.25	(2.05)
Lamb Weston Holdings Inc.	*Sold*	(2.69)

(YTD as of 9/30/2024)

Security	Avg Weight (%)	Contribution (%)
Top 5		
Progressive Corp.	15.85	7.68
Azek Co. Inc.	9.78	2.02
Gates Industrial Corp. plc	*Sold*	1.64
Spectrum Brands Holdings Inc.	*Sold*	1.60
Markel Corp. Inc.	10.62	1.14
Bottom 5		
J & J Snack Foods Corp.	*Sold*	(1.58)
Charles River Laboratories Intl Inc.	9.13	(1.73)
Clarivate plc	*Sold*	(1.79)
Lamb Weston Holdings Inc.	*Sold*	(2.21)
Dollar Tree Inc.	6.21	(3.96)

Performance Composite Returns[2] (For Periods Ending September 30, 2024)

	Since Inception**	20-Year*	15-Year*	10-Year*	5-Year*	3-Year*	1-Year	YTD	QTD
Value Opportunities *Pure Gross-of-Fees[3]*	10.0%	9.8%	10.5%	6.5%	5.3%	3.3%	19.6%	4.4%	0.8%
Max Net-of-Fees[4]	6.8%	6.6%	7.2%	3.4%	2.2%	0.3%	16.0%	2.1%	0.0%
S&P 500	7.7%	10.7%	14.1%	13.4%	16.0%	11.9%	36.3%	22.1%	5.9%
Russell 3000 Value	7.7%	8.5%	11.1%	9.2%	10.6%	8.7%	27.6%	16.2%	9.5%

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
2004**	4.8%	2.0%	10.9%	16.9%	(6.1%)	189	$25,252		20.1%	14.9%	14.8%	1.0%
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%

**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	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—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.

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] **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 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.

[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.