



## **ADV Part 2A**

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March 10, 2017

This Brochure provides information about the qualifications and business practices of Confluence Investment Management LLC ("Confluence"). If you have any questions about the contents of this brochure, please contact us at 314-743-5090 and/or [compliance@confluenceim.com](mailto:compliance@confluenceim.com). The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

Confluence is a registered investment adviser. Registration of an investment adviser does not imply any level of skill or training. The oral and written communications of an adviser provide you with information about which you determine to hire or retain an adviser. Additional information about Confluence also is available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). Clients can search this website by using our name or by using a unique identification number known as a CRD number. The CRD number for Confluence is 146019.

## Annual Update

This annual update discusses only specific material changes that are made to the brochure and provides clients with a summary of such changes. It also references the date of our last annual update of our brochure.

In the past we have offered or delivered information about our qualifications and business practices to clients on at least an annual basis. Pursuant to SEC Rules, we will ensure that you receive a summary of any material changes to this and subsequent brochures. We may further provide other ongoing disclosure information about material changes as necessary. We further provide a new brochure as necessary based on changes or new information, at any time, without charge.

Currently, our brochure may be requested by contacting Joe Hanzlik at 314-743-5096 or [jhanzlik@confluenceim.com](mailto:jhanzlik@confluenceim.com). Our brochure is also available on our website at [www.confluenceinvestment.com](http://www.confluenceinvestment.com), also free of charge.

Additional information about Confluence is available via the SEC's web site at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The SEC's website also provides information about any persons affiliated with Confluence who are registered, or are required to be registered, as investment adviser representatives of Confluence.

## Summary of Material Changes

Since filing our last annual update amendment on March 11, 2016, Confluence has had no material changes to the business.

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## Advisory Business

Confluence was formed in December 2007 and registered with the Securities and Exchange Commission in January 2008. Confluence is primarily comprised of former investment management and investment banking professionals from A.G. Edwards & Sons and its investment management subsidiary, Gallatin Asset Management, Inc. (“Gallatin”). The firm is 100% employee owned with Mark Keller and Brian Hansen as the principal owners.

Confluence is an investment money manager that manages investments primarily in separately managed accounts (SMAs). Separately managed accounts are where the client opens an account and custodies the assets at a brokerage firm and then utilizes an investment manager to manage a particular portfolio strategy. Confluence does not take possession of client assets as all securities and monies are held by the client’s choice of custodian.

Confluence negotiates and enters into agreements to provide discretionary portfolio management and investment advisory services to individuals, institutions and investment companies sponsored by unaffiliated parties. Confluence also provides investment advice and management services as a non-discretionary investment adviser to certain clients, including other investment advisers. This non-discretionary investment advice can take the form of model portfolios, Unified Managed Accounts (UMAs) or portfolio construction and monitoring of Unit Investment Trusts (UITs). Confluence may also provide investment advisory services to investment vehicles it would sponsor.

Confluence sub-advises a closed-end fund, First Trust Specialty Finance and Financial Opportunities Fund (NYSE: FGB), and an open-end mutual fund, First Trust Confluence Small Cap Value Fund (FOVIX, FOVAX, FOVCX, FOVRX). Confluence has been serving as FGB’s investment sub-advisor since July 29, 2008, following the prior investment sub-advisor’s resignation. Confluence investment professionals previously sub-advised FGB while at Gallatin. Confluence has a sub-advisor agreement with First Trust Advisors L.P., the advisor to both funds, with fees to be paid to Confluence based on a percentage of assets under management in the funds.

As of December 31, 2016, Confluence managed or had investment discretion for \$4.4 billion of assets and supervised \$1.8 billion of assets on a non-discretionary basis.

Confluence participates as an adviser providing investment management services to clients of wrap fee programs sponsored by Wells Fargo Advisors, a subsidiary of Wells Fargo & Company (NYSE: WFC), Stifel, Nicolaus & Company, Incorporated, a subsidiary of Stifel Financial Corp (NYSE: SF), Robert W. Baird & Co. Inc., Benjamin F. Edwards & Company and D.A. Davidson & Co. Confluence’s services to the wrap fee clients are similar to its regular services provided to its other clients. The firm receives a portion of the wrap fee for its services based on a percentage of assets under management. Confluence also manages investments for clients at other brokerage firms, such as Charles Schwab, Fidelity Investments, Merrill Lynch, Morgan Stanley Smith Barney LLC, Raymond James, RBC Wealth Management, TD Ameritrade and UBS. Client portfolios are managed in a similar fashion.

With respect to the assets we manage for clients of these advisers that are employee benefit plans covered under Rule 408(b)(2) of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), Confluence provides services as an ERISA “fiduciary” (as defined in Section 3(21) of ERISA) and is a registered investment adviser under the Investment Advisers Act of 1940.

Non-Discretionary Advisory Services

Confluence occasionally provides non-discretionary investment advisory services to certain clients, including other investment advisers, broker-dealers, account managers and fiduciaries. Such non-discretionary advice may take the form of model portfolios, which represent Confluence recommendations as to the composition of a portfolio of securities that would be reasonably appropriate to meet a stated investment objective, based on criteria provided by the client, research reports or UMAs.

Unified Managed Accounts are similar to model accounts, but there are important differences that investors should take the time to understand. A UMA typically combines all of a client's assets into a single account. While a model account holds the securities associated with a single investment manager in a unique custodial account at the sponsor firm, a UMA typically holds multiple investment strategies in the same custodial account, as well as other investment products such as mutual funds, individual stocks, or bonds. In a UMA or model account, the investment manager delivers an investment model to the sponsor firm and often does not have trading discretion over the account. Clients should speak to their Financial Advisor about the similarities and differences associated with SMAs, UMAs and model accounts so they fully understand their specific account structure.

While Confluence SMA, UMA and model accounts utilizing the same investment solutions may perform similarly, there are expected to be performance differences between them. There will be performance dispersion between UMAs and model accounts as compared to SMAs because Confluence does not have trading discretion over the UMAs and model accounts. For example, in an effort to accommodate the sponsor and minimize trades, target investment percentages for each holding may differ slightly between an SMA and a UMA.

Model Portfolios

Confluence serves as a non-discretionary model portfolio provider to Benjamin F. Edwards & Company ("BFEC") in its asset allocation strategies program, and Stifel, Nicolaus & Co.'s Unified Managed Account (UMA) program. Under these programs, Confluence provides non-discretionary recommendations to assist in the development of a portfolio of investments in industry and sector basket exchange-traded funds ("ETFs"), which are passively managed securities designed to track the performance of a specific industry, security type or country benchmark index that the sponsor determines to be suitable for its clients using the sponsor's program. The Stifel UMA program also includes strategies with equity securities. The firm's asset allocation strategies are also available at Adhesion Wealth Advisor Solutions Inc. for its UMA program, Envestnet Placemark for its UMA program and Wedbush Securities Inc. for its model program.

Confluence provides non-discretionary models to Wells Fargo Advisors, LLC for its Diversified Managed Allocations (DMA) program, to Morgan Stanley Smith Barney LLC for its Select UMA program, to Envestnet Placemark for its UMA program, to Adhesion Wealth Advisor Solutions Inc. for its UMA program, Oppenheimer Asset Management Inc. for its UMA program and Wedbush Securities Inc. for its model program. Under normal circumstances, Confluence has discretion over generating trades for a DMA account. Confluence's role is solely to provide research and portfolio recommendations to the program sponsors. The sponsors retain full discretion to accept, modify or reject Confluence's recommendations. The sponsors' clients are clients of each sponsor, not Confluence clients. Confluence's fees for non-discretionary management services are negotiable and Confluence does not maintain any standard fee schedule with respect to such services. Confluence does not operationally distinguish between model and UMA accounts.

## Fees and Compensation

Subject to applicable laws and regulations, Confluence retains complete discretion over the fees it charges to its clients, excluding supervisory services for Unit Investment Trusts, model portfolios and Unified Managed Accounts (UMAs) administered by broker-dealer clients. Upon entering into investment advisory or supervisory agreements, fees may be negotiated or modified based upon the size of the account and the nature and level of services provided by Confluence. Confluence may agree to offer certain clients a fee schedule that is lower than that of any other comparable client. Confluence fees are generally payable quarterly in advance and typically clients authorize fees to be deducted from their accounts by the custodian. The following fee schedules represent fees for investment services only, and do not include transaction or execution costs that may be incurred by the client. Confluence's fees are exclusive of brokerage commissions, transaction fees, and other related costs and expenses which shall be incurred by the client. Clients may incur certain charges imposed by custodians, brokers, third-party investment and other third parties such as fees charged by managers, custodial fees, deferred sales charges, odd-lot differentials, exchange fees, SEC fees, transfer taxes, wire transfer and electronic fund fees, and other fees and taxes on brokerage accounts and securities transactions. Mutual funds and exchange-traded funds also charge internal management fees, which are disclosed in a fund's prospectus. Such charges, fees and commissions are exclusive of and in addition to Confluence's fee, and Confluence shall not receive any portion of these commissions, fees and costs. In addition, there can be brokerage commissions, including step-out costs, which are described in brokerage practices.

Strategy					
Asset Allocation		All Cap Value, Balanced, Equity Income, Global Hard Assets, Increasing Dividend Equity Account (IDEA), Large Cap Value, REIT and Utility		BDC, Global Macro, IDEA Plus, Small Cap Value and Value Opportunities	
Advisor Based					
<u>Account Assets</u>		<u>Annual Fee</u>	<u>Account Assets</u>		<u>Annual Fee</u>
First	\$500,000	0.40%	First	\$500,000	0.60%
Next	\$500,000	0.35%	Next	\$500,000	0.55%
Over	\$1,000,000	0.30%	Over	\$1,000,000	0.50%
Private Wealth					
<u>Account Assets</u>		<u>Annual Fee</u>	<u>Account Assets</u>		<u>Annual Fee</u>
First	\$2,500,000	0.90%	First	\$2,500,000	1.00%
Next	\$2,500,000	0.80%	Next	\$2,500,000	0.90%
Over	\$5,000,000	0.70%	Over	\$5,000,000	0.80%
Institutional					
<u>Account Assets</u>		<u>Annual Fee</u>	<u>Account Assets</u>		<u>Annual Fee</u>
First	\$10,000,000	0.80%	First	\$10,000,000	0.75%
Next	\$40,000,000	0.50%	Next	\$40,000,000	0.40%
Over	\$50,000,000	0.40%	Over	\$50,000,000	0.30%

Confluence advisory agreements generally may be terminated at any time by either party by giving thirty (30) days written notice of such termination to the other party. Since clients generally pay fees in advance, upon termination the fee amount is prorated through the termination date and the difference is refunded to the client.

The brokerage practices section further describes the factors that Confluence considers in selecting or recommending broker-dealers for client transactions and determining the reasonableness of their compensation (e.g., commissions).

Confluence is not affiliated with any broker-dealer. Clients have the option to purchase investment products directly through Confluence or broker-dealers for which we provide services.

Confluence sub-advises a closed-end fund for which it receives fees from the fund for managing the investments. This closed-end fund invests in business development companies that, in turn, receive management fees for managing investments. As such, the closed-end fund's direct fees and expenses, including the applicable management fee to the advisor and sub-advisor, coupled with the compensation of the underlying managers, results in two levels of fees and greater expense than would be associated with direct investment. The closed-end fund's expenses constitute a higher percentage of net assets than expenses associated with other types of investment entities, such as mutual funds.

Confluence sales personnel may receive a portion of the fees paid to Confluence for investment management services, creating a potential conflict in that they may be incented to recommend higher fee-generating products.

### **Performance-Based Fees and Side-By-Side Management**

Confluence does not charge any performance-based fees (fees based on a share of capital gains on or capital appreciation of the assets of a client).

### **Types of Clients**

Confluence provides portfolio management services to individuals, high net worth individuals, corporate pension and profit-sharing plans, Taft-Hartley plans, charitable institutions, foundations, endowments, municipalities, registered open-end mutual funds and closed-end funds. Confluence generally requires Advisor Based, Private Wealth and Institutional accounts to have minimum account values of \$100,000, \$500,000 and \$5 million, respectively. Balanced equity strategies typically have a \$200,000 minimum account value. Confluence does not have the ability to impose minimums on UMA or model accounts.

### **Methods of Analysis, Investment Strategies and Risk of Loss**

#### Methods of Analysis

Confluence employs fundamental, technical and cyclical security analysis methods, which vary by the type of portfolio strategy provided. Confluence's equity strategies, which are comprised of specific company securities, utilize a bottom-up, fundamental approach whereas Confluence's asset allocation and fixed income strategies, which are implemented using ETFs, utilize a top-down, technical and cyclical approach. ETFs are an individual security that represents a basket of securities that are designed to mirror targeted indices, sectors or asset classes (e.g., XLP: Consumer Staples Select Sector SPDR). The firm's Global Hard Assets strategy, which is primarily comprised of common stock securities with a small portion of ETFs, is a combination of the above two approaches. Confluence's Global Macro strategy is comprised solely of ETFs and is analyzed and managed similarly to the asset allocation strategies. Confluence also manages sector specific strategies (e.g., Business Development Companies (BDCs), Real Estate Investment Trusts (REITs) and Utilities) that utilize both top-down and bottom-up approaches.

Most research is generated in-house. Confluence utilizes external sources, such as Bloomberg, Haver Analytics, Ned Davis, FactSet and various governmental banking and agency data. Confluence may also utilize analytics from other private market research institutions.

For the Increasing Dividend Equity Account (IDEA) Plus strategy, which is an equity strategy combined with a covered call option strategy on the S&P 500 Index, the firm analyzes option securities for their strike price, premium, volatility and term. Seventy-five percent of the portfolio is the IDEA portfolio in which the stock selection utilizes qualitative analyses in an attempt to identify high-quality companies with long track records of distributing earnings to shareholders through dividends. The remaining twenty-five percent consists of an ETF position in the S&P 500 Index with a corresponding covered call position, although this allocation can range at times from 15% to 40% of the portfolio.

### Investment Strategies

#### *Asset Allocation*

Asset allocation is the process of developing a diversified investment portfolio by combining different assets in varying proportions. A portfolio's long-term performance is determined primarily by the distribution of dollars among asset classes.

Confluence's investment philosophy is based upon independent, fundamental research that integrates evaluation of market cycles, macroeconomics and geopolitical analysis with a value-driven approach. Confluence's portfolio management philosophy begins by assessing risk and follows through by positioning clients to achieve income and growth objectives. Confluence's approach to asset allocation is more dynamic than many traditional strategic allocation strategies. Confluence extends the traditional approach by incorporating forward-looking analytics that address changing opportunities and risks as it moves through economic and market cycles.

Investment objectives vary between growth and income, or may include a combination of the two, subject to limitations of overall portfolio volatility and risk. Equity allocations are typically the primary means to pursue growth objectives and may include domestic large, mid and small caps, while foreign equities may include foreign developed country stocks or emerging market stocks. Foreign allocations may involve a focus or avoidance of certain countries or regions. Sector specific work may be involved in certain equity asset classes, particularly in large cap equities. Growth and value style biases may also be included in allocation decisions.

Fixed income allocations usually form the foundation to pursue income objectives. Allocations are actively managed to target specific duration or credit quality profiles, and may include speculative grade allocations. Real estate and commodity allocations may be included for income, capital appreciation or diversification opportunities. The asset allocation portfolios are principally formed from passive ETFs, along with a usually smaller proportion of passive exchange-traded notes (ETNs).

This process draws upon Confluence's extensive experience of investing, on behalf of its clients, in a wide range of equity and fixed income securities during various market cycles in an attempt to provide attractive, risk-adjusted returns to its clients. Asset allocations are modified generally once a quarter with the portfolios typically rebalanced mid-way through the first month of the quarter.



*Equity Strategies*

The firm's equity strategies include All Cap Value, Equity Income, Increasing Dividend Equity Account (IDEA), Large Cap Value, Small Cap Value and Value Opportunities. Confluence utilizes a team-based approach in which all equity investment committee members are fundamental analysts first and foremost. Each analyst is responsible for specific industries and brings ideas to the investment committee for vetting existing ideas and disseminating news to ensure each name has many of the attributes Confluence looks for (e.g., sustainable competitive advantage, free cash flow, capable management, trading at a discount to intrinsic value, etc.)

Confluence analysts begin by compiling data on individual securities including independent and Wall Street research. Data gathering includes reviews of specific company documents, SEC documents, company visits, management interviews, newspaper and other media stories, industry publications, competitors' information and Wall Street research among others. Much of the analyst's time is spent qualitatively analyzing this information to determine if a company possesses a sustainable competitive advantage that allows for pricing flexibility. The remainder of the time is spent on a quantitative cash flow analysis to determine estimates of fair value.

Typically, the process begins with an equity analyst or portfolio manager analyzing and writing up a proposed name in their respective industry coverage. The information is disseminated to the equity investment committee and subsequently vetted by the committee. The vetting process is thorough, often requiring additional information or analysis. If approved, the portfolio management committee decides placement into a portfolio based on weighting/contribution. Each portfolio has an established target number of holdings. The portfolio will become fully invested over the following months as targeted investments become available within the stated pricing discipline.

Before investing in any security, Confluence conducts a rigorous investment review:

- Determine if the business has a sustainable competitive advantage. This advantage usually protects its business or allows it to maintain market share leadership over time.
- Examine a company's free cash flow. Free cash flow is the amount of cash available after paying expenses and making necessary expenditures. Free cash flow can be used to build shareholder value through such things as dividends, stock buybacks and/or acquisitions. Confluence analyzes each business and forecasts future free cash to approximate the intrinsic value. Confluence then invests in those companies whose stocks trade below their estimates of fair value.
- Review a company's return on invested capital. Well-managed companies should be able to reinvest capital to improve or grow their company's business. A firm with high or increasing return on capital meets Confluence's criteria.
- Analyze a company's management team. Focused, passionate management teams are likely to make decisions in the best interest of shareholders with the goal of capital appreciation. The firm looks for corporate managers with large personal investments in their companies' stocks.

*Buy Discipline*

Confluence generally invests in companies whose stocks trade below our estimates of intrinsic or fair value, which is determined by analyzing historical and forecasted free cash flow in an attempt to estimate what a knowledgeable buyer would pay to purchase 100% of the company in an all-cash transaction. Buy limits generally are set at a 25% - 50% discount to Confluence's estimate of intrinsic value.

### Sell Discipline

To help preserve capital, portfolio positions are continually reviewed. A company's stock may be sold if any of the following occurs:

- The share price reaches estimates of full valuation.
- The business underperforms relative to its peer group/better idea.
- The company's fundamentals deteriorate.

There are circumstances that may cause all or part of a stock position to be sold. Such instances may include a stock's value in the portfolio becoming disproportionate or a more attractive opportunity presenting itself.

### *Balanced Strategies*

The firm's balanced strategies allow investors to combine the firm's equity strategies with fixed income allocations in a single account. The equity portion of the account is managed in an identical manner to the non-balanced equity strategies whereas the fixed income portion is managed in a similar fashion to the fixed income portion of the asset allocation strategies. That is, rather than utilizing individual bonds, Confluence utilizes fixed income ETFs that trade in a similar fashion to stocks. A principal difference relative to the asset allocation strategies is that balanced strategies generally do not include speculative grade fixed income ETFs.

### *Alternative and Sector Strategies*

Management of these strategies begins with top-down evaluations of the geopolitical environment, fundamental macroeconomic trends and technical patterns in the target markets.

The Global Hard Assets portfolio is focused on investments in hard assets which Confluence defines as tangible commodities, such as a gold bar, a barrel of oil or a ton of potash. The portfolio is comprised of the common stocks of companies in the hard assets sector or various hard asset ETFs or ETNs, thus giving the portfolio exposure to actual commodities. The companies in the hard assets sector are directly responsible for mining, extracting or producing the hard assets. The firm's investment process utilizes a top-down approach to identify investable sectors, coupled with bottom-up, security selection. Confluence's geopolitical and global macro analyses define the sector weights along with acceptable geographic locations of reserves. Overall allocation is decided once this process is complete. Next, investments are screened based upon our view of commodities compared to equities. Once a universe of securities is identified utilizing the macro-analysis, our investment philosophy seeks to identify companies that have the ability to increase production and grow reserves over time, thus appreciating capital.

The Global Macro portfolio seeks to take advantage of major macroeconomic trends in four primary markets: equities (domestic and international), debt, commodities and currencies. Its objective is to maximize total return (as opposed to a risk-dampening non-correlated alternative asset) by investing in market categories using Confluence's evaluation of the geopolitical environment, fundamental macroeconomic trends and technical patterns. The firm's investment process utilizes a top-down, macro-based approach driven by proprietary research. The investable universe includes exchange-traded products (ETFs and ETNs), tradable open-end mutual funds, closed-end funds and, in limited cases, individual equity securities (with no more than 10% in any single stock). The portfolio can employ leveraged exchanged traded products ("ETPs") and has the ability to invest in inverse ETPs; however, margin and shorting are not used in the management of the portfolio. The portfolio may at times be concentrated. However, no mutual fund

or ETF can exceed 40% of the portfolio's value (at cost) and no single market category can make up more than 50% of the portfolio.

Confluence manages sector-specific strategies, such as BDCs, REITs and Utilities, that are by nature concentrated by industry or asset class. The Specialty Finance BDC portfolio is focused on a niche of the financial sector in which companies lend and invest in the private debt and equity markets. The REIT and Utilities strategies invest in their respective industries.

#### Risk of Loss

Past performance is not a guarantee of future returns. Investing in securities involves the risk of loss that clients should be prepared to bear.

#### *Asset Allocation*

Confluence's asset allocation strategies are implemented using ETFs, which own a basket of stocks that track a particular stock market index. Changes in the price of an ETF, before deducting expenses, track the movement of the associated index relatively closely. ETFs charge their own management fee and other expenses that come directly out of the ETF returns. In addition, a commission on each purchase or sale may be charged by the executing broker-dealer. The principal risks associated with ETFs include the risk that the equity securities in an ETF will decline in value due to factors affecting the issuing companies, their industries or the equity markets generally. ETFs sometimes may not perfectly correlate with the targeted indices or sector performance. ETFs are subject to various risks, including management's ability to meet the fund's investment objective, and to manage the fund's portfolio when the underlying securities are redeemed or sold, during periods of market turmoil and as investors' perceptions regarding ETFs or their underlying investments change. Unlike open-end funds, which can be purchased or redeemed at prices based on a daily determination of the fund's net asset value, ETFs frequently trade at a premium or discount from their net asset value in the secondary market and can have limited trading liquidity. Industry specific ETFs by design provide concentrated risks in industries. For example, a Real Estate Investment Trust (REIT) ETF has investments in companies that are subject to changes in the real estate market, vacancy rates and competition, volatile interest rates and economic recession. Also, asset allocation strategies can include commodity ETFs. Buying commodities allows for a source of diversification for those persons who wish to add this asset class to their portfolios and who are prepared to assume the risks inherent in the commodities market. Any commodity purchase represents a transaction in a non-income-producing asset and is highly speculative.

Certain fixed income ETFs invest in investment grade and, at times, speculative securities. Investment grade securities are subject to numerous risks including higher interest rates, economic recession, deterioration of the investment grade market or investors' perceptions thereof, possible downgrades and defaults of interest and/or principal. Changes in interest rates could affect the value of a client's investment. Rising interest rates tend to cause the prices of debt securities (especially those with longer maturities) to fall. The credit rating of financial condition of an issuer may affect the value of the debt security. Generally, the lower the quality rating of a security, the greater the risk that issuer will fail to pay interest fully and return principal in a timely manner. Credit ratings are not an absolute standard of quality, but rather general indicators that reflect only the view of the originating rating agencies from which an explanation of the significance of such ratings may be obtained. If an issuer defaults or becomes unable to honor its financial obligations, the security may lose some or all of its value. Speculative securities are usually issued by smaller, less credit worthy and/or highly leveraged (indebted) companies. Compared with investment-grade bonds, speculative bonds carry a greater degree of risk that are less likely to make payments of interest and principal.

Regarding the fixed income portion of asset allocation strategies and balanced strategies, there are risks associated with the use of ETFs and ETNs. Fixed income ETFs and ETNs are not bonds. During market disruptions, there may be times when they can trade at discounts or premiums, which can directly affect an investor's performance. Liquidity can also vary depending on market conditions. A fixed income ETF does not mature like an individual bond. These and other various differences highlight the fact that fixed income ETFs may vary in performance relative to direct investments in bonds.

### *Equity Strategies*

Confluence's equity strategies are value-oriented strategies in which Confluence believes the portfolio securities are undervalued or inexpensive relative to other investments. These types of securities may present risks in addition to the general risks associated with investing in them. These securities generally are selected on the basis of an issuer's business and economic fundamentals or the securities' current and projected credit and profit profiles, relative to current market price. Such securities are subject to the risk of misestimating certain fundamental factors. Disciplined adherence to a value investment mandate during periods in which that style is out of favor can result in significant underperformance relative to overall market indices and other managed investment vehicles that pursue growth style investments and/or flexible style mandates.

Confluence equity strategies sometimes utilize American Depositary Receipts (ADRs), which are typically issued by a U.S. bank or trust company and represent ownership of underlying foreign securities. ADRs have risks along with other equity securities but are vulnerable to currency risks. If the value of the company's home currency falls too much relative to the U.S. Dollar, the effect will eventually trickle down to the ADR.

The Small Cap Value, Equity Income and All Cap Value strategies can be comprised of smaller capitalization companies that, due to their size, generally are more vulnerable to adverse general market or economic developments than larger, more established companies. These small companies' securities often have abrupt and greater price volatility and may be less liquid because of limited financial resources, management inexperience and less publicly available information, among other factors. The firm's Value Opportunities strategy has a shorter investment horizon and is comprised of 10 to 12 positions. This strategy typically has greater portfolio turnover and more concentrated positions than other equity strategies that typically have 25 to 33 securities in each portfolio.

The IDEA Plus strategy includes options, which present option risk. Confluence may write (sell) covered call options on all or a portion of the equity securities held in the IDEA Plus portfolio as determined to be appropriate, consistent with the strategy's investment objective. The ability to successfully implement this investment strategy depends on Confluence's ability to predict pertinent market movements, which cannot be assured. Thus, the use of options may require the investor to sell portfolio securities at inopportune times or for prices other than current market values, limit the amount of appreciation the investor can realize on an investment, or cause Confluence to hold an equity security that it might otherwise sell. There can be no assurance that a liquid market for the options will exist when Confluence seeks to close out an option position. Additionally, to the extent that Confluence purchases options pursuant to a hedging strategy, the investor will be subject to additional risks.

### *Balanced Strategies*

The firm's balanced strategies combine a specific equity strategy with the fixed income strategy. The fixed income portion risks are listed in the above Asset Allocation section and the equity portion are outlined in the Equity Strategies section.

*Alternative and Sector Strategies*

Confluence's sector-specific strategies are concentrated by design and thus the portfolios do not provide investors with broad diversification.

Confluence's alternative strategies, such as Global Hard Assets, include securities and asset classes that typically have greater price volatility than the firm's asset allocation and equity strategies. Due to the specialized nature and more specific investment objectives, these portfolio strategies generally only comprise a small portion of an investor's assets as they have specific commodity, currency, basic material, foreign and diversification risks associated with them. The Global Hard Assets strategy specifically has significant commodity risk, which is disclosed in the asset allocation section above.

**Disciplinary Information**

Registered investment advisers are required to disclose all material facts regarding any legal or disciplinary events that have occurred in the last ten years that would be material to your evaluation of Confluence or the integrity of Confluence's management. Confluence has no information applicable to this item to disclose.

**Other Financial Industry Activities and Affiliations**

Mark Keller, CEO and Chief Investment Officer, is a member of the board of directors of Benjamin Edwards, Inc. ("BEI"), the holding company of BFEC, and has a private investment in the equity securities of BEI. Although he has no day-to-day decision making responsibilities for BEI, as a member of their board of directors he is involved in the development of strategy, policy and other important matters affecting the firm. As part of his professional responsibilities with Confluence, he is involved in making investment decisions concerning portfolios of individual clients of BFEC. See disclosure of advisory services.

BFEC and its representatives do not receive any additional or different sales compensation in connection with recommendations to clients concerning Confluence versus any other money manager under comparable circumstances. Confluence and Mr. Keller do not receive any additional or different compensation in connection with client investments placed with Confluence through BFEC versus those of any other investment firm similarly situated. Mr. Keller is compensated for his service as a board member of BEI on the same terms as other independent board members.

Confluence professionals may from time to time assist other financial services organizations through providing advisory services for which they may be remunerated. These outside business activities are vetted by management prior to an employee's involvement and routinely reviewed to ensure Confluence clients are not disadvantaged.

Brian Hansen, President and Chief Operating Officer, is the sole owner of Hansen Investment Partners LLC ("HIP"). HIP provides non-investment advisory services to corporate clients for which it receives fixed fees. HIP and Confluence have a mutual client: First Trust, a financial distribution firm for which Confluence provides traditional investment advisory services by acting as a sub-advisor to an open-end mutual fund and a closed-end fund.

On November 1, 2012, Brian Hansen joined the board of directors of Franklin Street Properties Corp (NYSE: FSP), a publicly-traded Real Estate Investment Trust (REIT). Mr. Hansen has personal, long-term investments in securities issued by FSP and expects to make additional investments in FSP for his own account from time to time.

Confluence evaluates each investment idea on its own merits and has established policies and procedures that address conflicts of interest that are or may be raised by Mr. Hansen's relationship with FSP. Mr. Hansen is not a member of Confluence's investment committee and neither participates in the investment committee's decision-making nor provides Confluence or the committee with information relating to FSP.

Mr. Hansen's transactions in FSP securities must be effected in accordance with Confluence's policies and procedures relating to personal securities transactions as well as in accordance with applicable legal requirements.

Prior to several Confluence principals joining the firm, they previously managed investments at Gallatin for its affiliated brokerage firm, Wachovia Securities, LLC (n.k.a. "Wells Fargo Advisors"). On July 1, 2008, Confluence and Evergreen Investment Management Company, LLC ("Evergreen"), Gallatin's parent, entered into an agreement whereby in exchange for allowing Confluence principals to continue managing legacy accounts at Wells Fargo Advisors and gaining access to the books and records solely for validating its performance track record, the firm shares a portion of these legacy account revenues with Evergreen. Evergreen subsequently assigned its contractual rights to an affiliate, Wells Fargo Bank, N.A.

## **Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

Pursuant to SEC Rule 204A-1, Confluence has adopted a Code of Ethics for all supervised persons of the firm describing its high standards of business conduct, potential conflicts of interest and fiduciary duties to its clients. This Code of Ethics includes provisions relating to the confidentiality of client information, a prohibition on insider trading and pay-to-play and restrictions on the acceptance of significant gifts, among other things. All supervised persons at Confluence must acknowledge the terms of the Code of Ethics annually and compliance with the Code is a condition of employment for all personnel. A serious violation of the Code or related policies may result in dismissal. A copy of the Code of Ethics will be provided to any client or prospective client upon request.

### Participation or Interest in Client Transactions

Confluence permits its employees to engage in personal securities transactions. Personal securities transactions by an employee may raise a potential conflict of interest if an employee trades in a security that is considered for purchase or sale by a client. Confluence's Code of Ethics is designed to ensure that those persons at the firm who are responsible for developing or implementing the firm's investment advice or who provide the investment advice to clients are not able to act thereon to the disadvantage of clients. Client trading is required to be completed prior to an employee conducting any personal trading. The Code further prohibits Confluence's personnel from using any material non-public information in securities trading.

It is Confluence's policy that the firm will not affect any principal or agency cross securities transactions for client accounts. Cross trades between client accounts are allowed in limited circumstances when in the best interest of the client and properly documented with all parties.



### Offering Participation

From time to time, Confluence is presented with an opportunity to participate in public offerings. Retail clients are typically prohibited from participating through a separately managed account by their respective broker/dealer. Since Confluence services retail clients across a wide group of custodians, certain retail clients would not have access to purchase shares if their broker/dealer did not participate in the offering. Accordingly, Confluence's policy is to not purchase shares in offerings for its retail SMA clients. In contrast, the First Trust Specialty Finance and Financial Opportunities Fund, the First Trust Confluence Small Cap Value Fund and institutional SMA clients are not restricted and thus, they are allowed to participate in public offerings.

### **Brokerage Practices**

#### Factors Used to Select Broker-Dealers

Confluence recommends that clients choose their own financial advisor and broker/dealer. Under certain circumstances when requested by the client, Confluence may provide a broker/dealer recommendation. For clients that choose not to utilize a traditional financial advisor, Confluence may recommend that clients establish brokerage accounts with a preferred custodian to maintain custody of clients' assets and to effect trades for their accounts. Confluence does not custody client assets. The custodian sends statements directly to the clients. Confluence is independently owned and operated and not affiliated with any preferred custodian. The services provided by the preferred custodians are not contingent upon Confluence committing to the preferred custodian any specific amount of business (assets in custody or trading). The preferred custodian's services include brokerage, custody, research and access to mutual funds and other investments that are otherwise generally available only to institutional investors or would require a significantly higher minimum initial investment. For Confluence's client accounts maintained in its custody, a preferred custodian generally does not charge separately for custody but is compensated by account holders through commissions or other transaction-related fees for securities trades that are executed through the preferred custodian or that settle into preferred custodian accounts.

Confluence may be able to include the order of a directed brokerage account with orders of other accounts with the objective of obtaining a better execution for the directed brokerage account if the executing broker-dealer will transfer the billing and settlement of the order to the directed broker (generally known as a "step-out"). Reconciliation of the portion of the trade given to a directed broker is done through the clearing process between the two broker-dealers. Under such circumstances the client may incur both a transaction cost for the execution of the trade and a transaction cost for the billing and settlement of the trade. Confluence bunches the trades of directed brokerage accounts only under circumstances in which executing the order in this manner is deemed to be in the best interest of the directed brokerage account. Confluence investment advisory agreements include acknowledgements regarding these issues.

As a participating manager in various broker-dealer investment advisory programs, Confluence generally is free to place orders in these accounts through broker-dealers of its own choosing. However, since investment advisory clients' fee arrangements generally cover transaction costs only when Confluence places orders in these accounts through the broker-dealer investment advisory program sponsor, in most cases Confluence will place orders for broker-dealer accounts through the sponsor since to do otherwise would likely increase the cost of investment services to the broker-dealer investment advisory clients. When Confluence places orders for investment advisory clients through the sponsoring program broker-dealer, the firm typically does so in a rotational manner. Clients

involved in wrap programs or similarly directed brokerage arrangements should understand that client transactions generally are expected to be executed only with the broker-dealer providing custodial and other services, generally the sponsor. No assurance can be provided that transactions executed through the broker-dealer providing custodial and other services will result in the best execution available to the client. Transactions executed for these accounts may be less favorable in some respects than those accounts whose trades are not executed through the broker-dealer providing custodial services. This is because Confluence has no ability to negotiate price or take advantage of combined orders or volume discounts. Depending on a variety of factors, including the amount of the combined fee, the trading activity and the value of custodial and other services, the combined fee may or may not exceed the total cost of such services if obtained separately. Under certain circumstances, Confluence may direct client securities transactions to a broker-dealer or intermediary other than the designated broker-dealer or custodian if, in our opinion, the firm believes that such direction is in the client's best interest.

#### Research and Other Soft Dollar Benefits

Confluence sub-advises a closed-end fund (NYSE: FGB), manages institutional accounts and sub-advises an open-end mutual fund with a small cap value strategy in which it can direct trades through various broker-dealers based on execution, costs and other services provided. In accordance with Section 28(e) of the Securities Exchange Act of 1934, as amended, broker-dealers are selected on the basis of their ability to execute transactions at the most favorable prices and lowest overall execution costs, taking into consideration other relevant factors, such as the reliability, integrity and financial condition of the broker-dealer, the size of and difficulty in executing the order, the quality of execution and custodial services and the provision of valuable research services that can be reasonably expected to enhance the investment return of the clients' portfolios. These services may be useful for all client accounts, and not all research may be useful for the account for which the particular transaction was effected. When broker-dealers are selected on the basis of their research services, Confluence may negotiate commissions that may be higher than for "execution only" transactions, but are nevertheless deemed reasonable in light of the value of such services provided, viewed in terms of either a particular transaction or the overall responsibilities of Confluence as to the accounts over which it exercises investment discretion.

Confluence generally uses between five and twenty brokers. Commissions generally are \$0.04 per share and Confluence estimates that approximately \$0.015 per share is attributable to soft dollars through commission sharing agreements (CSAs). Products and services may either be provided by a broker-dealer, or paid for by a broker-dealer (either by direct or reimbursement payments – in whatever form – or by commissions, mark-ups, mark-downs or credits or by any other means) to be provided by others. The availability of such products and services may create a conflict between the interests of the client in obtaining the lowest cost of execution and our interest in obtaining such services. In addition, several brokers through whom we execute orders provide proprietary research on general economic trends or particular companies. This firm benefits by obtaining research or other products and services without having to produce or pay for research, products or services.

In recommending broker-dealers to clients, we need not solicit competitive bids and do not have an obligation to seek the lowest available transaction cost (e.g., commission cost). It is generally not our practice to negotiate "execution only" transaction costs (e.g., commission rates); thus, our clients may be deemed to be paying for products and services provided by the broker-dealer which are included in the transaction charges. When we determine that more than one broker-dealer can offer the brokerage and execution services needed to obtain the best available price and most favorable execution, consideration may be given to recommending those broker-dealers which also supply products and services that assist us in fulfilling our investment advisory responsibilities. Products and services may be



used by us in servicing some or all of our clients. These services include company and industry research as well as attendance at sponsored industry conferences.

In some instances, we may receive products and services that may be used for both research/brokerage and non-research/brokerage purposes. In such instances, we will make a good faith effort to determine the relative proportion of the products and services used for research/brokerage purposes and the relative proportion used for non-research/brokerage purposes. The proportion of the products and services attributable to research/brokerage purposes will be paid through brokerage commissions generated by client transactions; the proportion attributable to non-research/brokerage purposes will be paid for or reimbursed by us from our own resources. The receipt of “mixed-use” products and services and the determination of an appropriate allocation between research/brokerage and non-research/brokerage purposes create a potential conflict of interest between Confluence and its clients. These arrangements are periodically reviewed in relation to Section 28(e) of the Securities Exchange Act of 1934, as amended. The firm utilizes soft dollar credits to pay for financial data services and trading platforms. In no event are soft dollar credits used to offset losses from trading errors.

It is Confluence's policy to allocate trades in a fair and equitable manner. Shares can be pro-ratably allocated for the firm's retail SMA clients but not typically for institutional SMA clients. For client relationships that are not part of a sponsor program or direct relationships that are unaffiliated with a broker/dealer, these clients are treated as separate entities in the firm's trade rotation policy. Through a systematic rotation policy, Confluence rotates the trading order of each brokerage firm. If an order is not fully completed during the rotation process, then the broker/dealer with the partial fill is either randomly or pro-rata allocated.

## **Review of Accounts**

Investment personnel review each investment portfolio on a regular basis to ensure that investments are made in conformity with clients' stated objectives. Reviews are made in light of the client's stated investment objective, applicable economic or monetary developments, overall conditions in various markets and specific market and related developments affecting individual securities.

On a monthly or quarterly basis (as directed by each client), the client's custodian sends reports to clients showing transactions for the period, portfolio holdings, performance reporting and appropriate commentary. For dual contract clients, Confluence sends quarterly portfolio appraisals that can be compared to the client statements provided by the custodian. Investment commentary letters and additional information are periodically provided to clients as agreed to by Confluence and the client. A dual contract is when a client signs two contracts: an investment advisory agreement with Confluence and a second contract with a brokerage firm/custodian to custody the assets managed by Confluence.

## **Client Referrals and Other Compensation**

From time to time, Confluence utilizes solicitors. Confluence previously had a solicitation agreement with First Trust Advisors L.P., a solicitor that is not affiliated with Confluence. This agreement has been terminated and First Trust no longer solicits new clients on Confluence's behalf. There is no increase in the advisory fees payable to Confluence

by the solicited persons as a result of the compensation paid to the solicitor, under this solicitation agreement. Confluence may engage other independent contractors for client referrals. For such referrals, Confluence would compensate the independent contractor with a percentage of fees relating to such referrals based on the level of services performed. Any such compensation would be paid pursuant to a written agreement that is in compliance with the federal regulations as set forth in 17 CFR Section 275.206(4)-3, and in each state where state law requires. Each prospective client so solicited is given a copy of Confluence's written disclosure statement and a separate written disclosure statement of the solicitor as required by 17 CFR Section 275.206(4)-3 prior to or at the time of entering into any advisory contract.

## **Custody**

Other than obtaining authorization for deducting investment management fees, Confluence does not custody assets as it is a registered investment adviser only. Clients should receive statements at least quarterly from the broker-dealer, bank or other qualified custodian that holds and maintains the client's investment assets. Confluence reconciles accounts with custodial records and urges clients to carefully review such statements and compare such official custodial records to the account statements that Confluence may provide to the client. Our statements may vary from custodial statements based on accounting procedures, reporting dates, or valuation methodologies of certain securities.

## **Investment Discretion**

Confluence usually receives discretionary authority from the client at the outset of an advisory relationship to select the identity and amount of securities to be bought or sold. In all cases, however, such discretion is to be exercised in a manner consistent with the stated investment objectives for the particular client account.

When selecting securities and determining amounts, Confluence observes the investment policies, limitations and restrictions of the clients for which it advises. Clients are able to restrict certain types of securities for social responsibility investing purposes or specific securities for other reasons. For registered investment companies, Confluence's authority to trade securities may also be limited by certain federal securities and tax laws that require diversification of investments.

Investment guidelines and restrictions must be provided to Confluence in writing. Confluence does not have trading discretion over UMA and model accounts.

## **Voting Client Securities**

Confluence is generally responsible for voting all proxies with respect to securities held in the portfolios managed by it and keeps such records as may be required in connection with such activity. Confluence utilizes Broadridge Financial Solutions, Inc., an outsourcing provider to the global financial industry, to coordinate, process, manage and maintain electronic records of Confluence's proxy votes. Upon a client's request, Confluence will provide to the client a copy of its Proxy Voting Policy as well as information concerning the voting of shares in the managed portfolios.

**Financial Information**

Confluence does not require prepayment of more than \$1,200 in fees per client, six months or more in advance; therefore, a balance sheet is not required to be disclosed with this brochure. Confluence does not currently believe nor foresee any financial condition that is reasonably likely to impair its ability to meet its contractual commitments to clients. Confluence has not been the subject of a bankruptcy petition.