Emerging Markets • International Equity Strategies

Confluence Emerging Markets invests in large cap, growth-oriented companies in the more mature emerging markets around the world. The strategy's management team employs both top-down and bottom-up fundamental analysis to identify attractive emerging market countries and economic sectors as well as high-quality companies worthy of a long-term investment allocation. The portfolio's primary objective is long-term capital appreciation.

Market Commentary

Emerging markets moved lower during the second quarter of 2022 as the Russia/Ukraine war combined with a challenging macroeconomic environment, pushing global equity prices lower. This was the worst quarterly decline in emerging markets since the beginning of the COVID-19 pandemic in first quarter 2020. That said, emerging market equities outperformed the world's developed economies despite such headwinds as the strong U.S. dollar (USD), tighter monetary conditions in the United States, and the dilemma China faces by promoting economic growth while trying to maintain its "Zero-COVID" policy. The problems of high inflation, aggressive central bank tightening, and recessionary fears are global in nature. Year-to-date, the MSCI Emerging Markets Index has fallen nearly 18%, while the MSCI World Index has fallen by nearly 21%. Inflationary pressures will continue to weigh on emerging markets as food and energy generally comprise a significant portion of their consumption. These economies have a path forward that includes keeping inflation at bay, while simultaneously maintaining economic growth. Economies that export high-value commodities are generally better insulated from the harsh impact of high food and energy prices. The inflationary impact may be more profound on the world's developed markets as they raise interest rates to quell the inflationary pressures in their own economies. Slowing global growth would not be positive for most emerging market economies.

Most emerging markets have been actively working to blunt the impact of inflationary consequences for the past several decades. This process has resulted in correcting structural issues which has produced very different expectations moving forward. Countries such as Turkey and Argentina still suffer from legacy structural issues and inflation will have a more detrimental impact on these economies. Especially hard hit will be countries with relatively high U.S.-denominated debt. For most economies the decision becomes whether to keep inflation under control at the risk of slowing growth. Most emerging market central banks in Latin America and Europe have been ahead of the Fed in resisting inflation. More than four dozen countries have raised interest rates this year, resulting in the fastest rise in global interest rates in 30 years. More than 30 central banks have increased rates by 100 bps or more in a single move, with most of these large moves coming from the emerging markets. In these "rate-tightening" economies, growth is expected to slow, and inflation is expected to peak in the second half of 2022. The central banks in Asia, including China and Indonesia, have been relatively dovish this year as inflationary pressures in their countries remained more muted. This balance between economies is what will determine the pace of global growth.

On a positive note, China's growth trajectory is expected to show improvement in the second half of the year. Despite the country's Zero-COVID policy, it appears the oppressive lockdowns surrounding minor COVID outbreaks may be coming to an end. These lockdowns caused factory output to fall to its lowest level in more than two years in April 2022 and also lowered the official manufacturing PMI to 47.4 in April. The PMI has since recovered to 50.2 in the latest reading as of June. China is among a few countries attempting to stimulate economic growth as Chinese officials have targeted GDP growth at 5.5% and are cutting rates to jumpstart the struggling economy. Additionally, the Chinese government has unveiled more fiscal stimulus this year, including stepping up local bond issuance to fund infrastructure projects and cutting taxes for businesses. President Xi recently introduced an infrastructure spending package to provide jobs and help stabilize the housing market. It also appears that China has reined in its regulatory oversight of the internet and technology sectors. Top Chinese officials have voiced their support for these cutting-edge technology companies and promised to curtail further regulations. Finally, the 20th National Congress of the Chinese Communist Party will convene during the fourth quarter of 2022. President Xi would like to get the economy "back on track" prior to this meeting as Xi is expected to seek his third term in power. Earnings estimates have been rising and China's equity market has recovered more than 30% from the mid-March lows. Because the Chinese market has floundered for the past 15 months, attractive investment opportunities may be uncovered. Sharp drawdowns in Chinese equities have historically been good entry points with solid returns over the near to intermediate term.

Market Commentary continued…

Chinese authorities continue to work with the U.S. Securities and Exchange Commission (SEC) concerning Chinese equities listed on U.S. exchanges and their adherence to the 2020 Holding Foreign Companies Accountable Act (HFCAA). The HFCAA permits the SEC to ban companies from trading and order them to be delisted from U.S. exchanges if they are found to be in violation of foreign ownership laws or audit requirements. China is working to help companies maintain their listings, but the delistings will not occur until 2023 at the earliest.

Quarterly Trade Summary

The investment committee made one change to the Confluence Emerging Markets portfolio during the second quarter. Brazilian meat producer JBS S.A. (JBSAY) was added in April. JBS is the world's largest food company with a market cap of more than $18 billion and is the world's largest protein producer. It processes and trades animal protein worldwide, offering beef, pork, chicken, and lamb products and by-products, food products, pet food and concentrates, and bresaola. All parts of the animal are harvested, and other product lines include soap bases and bars, biodiesel, glycerin, fatty acid, collagen, and wrapper, as well as wet blue, semi-finished, and finished leather products. The company, formerly known as Friboi Ltda., was founded in 1953 and is headquartered in Sao Paulo, Brazil. It has a presence in 20 countries with over 500 facilities and offices, employs more than 250,000 people worldwide, and is the largest employer in Brazil with more than 150,000 team members. JBS has 275,000 customers and conducts sales in 190 countries. Its most prominent brands are Swift, Pilgrim's Pride, Primo, Friboi, and Serra. We like the company for its strong fundamentals, reasonable valuation, and improving macro trends such as increasing world populations, income growth, and the transition from plant-based diets to ones that include animal proteins. JBS also has the ability to pass on higher prices as consumers can trade down to other company products as prices increase.

Performance Review

The MSCI Emerging Markets Index returned -11.4% in USD terms, outperforming the return of developed international markets (MSCI EAFE, -14.5%) and the U.S. markets (S&P 500, -16.1%). Much of the weakness during the quarter can be attributed to a challenging and dramatic course of events including the Russian invasion of Ukraine, global monetary tightening intended to minimize the impact of accelerating inflation across the major economies, and the potential for widespread recession. COVID outbreaks are still challenging major Chinese cities and further pressuring global supply chains. Among the regions, EM Asia posted the best performance by a wide margin (-9.3%) following a resurgence in Chinese equities as EM Europe, Middle East, and Africa (EMEA) and EM Latin America were much weaker, falling 17.1% and 21.9%, respectively. The Latin American markets aggressively increased interest rates to offset strong inflationary forces. From a sector perspective, only Consumer Discretionary (+6.3%) posted a positive return, while Materials (-20.5%) and Information Technology (-20.9%) were the worst-performing sectors.

During the second quarter of 2022, the Confluence Emerging Markets strategy posted a return of -12.9% (gross of fees) versus -11.4% (gross of fees) for the benchmark over the same period. Year-over-year, Confluence Emerging Markets returned -31.4% (gross of fees) versus -25.3% for the benchmark. *[Net-of-fees returns for the same periods were -13.6% QTD and -33.5% year-over-year. See disclosures on last page for fee description; actual investment advisory fees may vary.]*

The two best-performing countries within our portfolio on an absolute basis were China (+6.6%) and Hong Kong (+6.2%), and the worst returns were recorded by Colombia (-28.0%) and Argentina (-28.1%). Utilities (+10.5%) and Communication Services (+4.5%) were the strongest sectors during the quarter, while Materials (-32.9%) and Energy (-22.7%) were the weakest.

It is important to note that we have seen a sharp style shift in the emerging markets since June 30, 2020, as they were surfacing from the COVID global shutdown. For most of the past decade, the MSCI EM Growth Index outpaced the MSCI EM Value Index as growth companies performed well in the emerging market economies. However, year-to-date, the MSCI EM Index fell 17.6% as MSCI EM Value returned -13.9% and MSCI EM Growth returned -21.1%. The Confluence Emerging Markets strategy is growth-oriented and tends to perform well in environments where growth companies are more competitive with their value counterparts.

The top contributors and detractors for the portfolio thus far in 2022 are shown in the accompanying table.[1]

Security	Avg Weight (%)	Contribution (%)
Top 5		
Gold Fields Limited	2.49	0.23
Vale S.A.	1.56	0.13
Ecopetrol S.A.	3.12	0.11
Localiza Rent a Car S.A.	2.83	0.07
Credicorp Ltd.	1.52	0.03
Bottom 5		
Pagseguro Digital Ltd.	1.10	(0.93)
Infosys Ltd.	3.98	(1.07)
Taiwan Semiconductor Manufacturing Co. I	4.94	(1.67)
MercadoLibre Inc.	3.15	(2.07)
Yandex N.V.	1.41	(4.26)

(Contribution data shown from a sample account, based on individual stock performance and portfolio weighting)

What We Are Watching

The outlook for global growth is fading as central banks are aggressively increasing interest rates to tackle inflation concerns. Recessionary fears have also negatively impacted commodity prices which have moderated, causing commodity-exporting nations to reevaluate their monetary and fiscal policies. Inflationary pressures also persist from the supply chain disruptions due to COVID-19, which have improved but are still causing production and shipping bottlenecks.

Chinese leaders are now rethinking lockdown and quarantine policies due to new COVID outbreaks. While the central government continues to affirm its Zero-COVID policy, major cities are adopting less disruptive containment measures rather than large-scale lockdowns, such as conducting rolling tests every 48 to 72 hours. New lockdowns in China are now less oppressive and thus Chinese GDP growth is expected to accelerate and supply chains should quickly rebuild.

Inflation rates have continued to spike higher. Inflation rates can negatively impact emerging market economies since lower income consumers are especially sensitive to higher food and energy prices. Rising inflation and interest rates heighten concerns about emerging market economic growth, financing costs, and debt sustainability. Developed markets, particularly the U.S. and Europe, have driven global growth since the depths of the global pandemic. Slower growth in these economies should ease supply chain stresses and bring down the inflationary pressures as global supply chains need to be reestablished. This will require that all factors of production are available, including sufficient levels of labor. The current COVID lockdowns in China are again stressing some of these supply chains, but the restoration of supply chains should help lessen global inflation pressures and fears.

U.S. dollar strength is important for international markets, in general, and emerging markets, in particular. During the second quarter, the dollar strengthened by an additional 6.5%, bringing the year-to-date appreciation to 9.4%. In general, a strong USD is a drag on international equity returns. If the Federal Reserve feels that it is too far behind the inflation curve, policymakers will likely raise rates and reduce the balance sheet at a faster rate than anticipated, potentially leading to a stronger dollar. Nevertheless, the Confluence macro team still feels that the U.S. dollar will not maintain its current strength indefinitely; however, the dollar will probably remain strong for the balance of this year and the macroeconomic environment supports this thesis moving forward. Historically, emerging market equities have tended to outperform developed international equities and U.S. equities during periods of dollar weakness.

We continue to identify countries and regions that have better adapted to the pandemic and subsequent recovery. Global supply chains are being restored in most emerging market economies, but bottlenecks persist. Emerging markets have weathered the recent weakness in global equities remarkably well. With inflation expectations accelerating, the key question is whether tighter monetary conditions will result in a "soft landing" or a global recession. Provided a significant global recession can be avoided, we believe emerging market equities are attractively priced. Emerging market equities with impressive growth characteristics are now trading at a 30% discount (P/E) to developed markets, while providing a higher dividend yield, a higher free cash flow yield, and a return on equity profile that has been improving since the end of 2020.

Risks to our positive outlook for emerging markets include:

- Excessive inflation causes emerging market and developed market central banks to sharply raise rates to combat inflationary pressures:
  - The need for massive fiscal and monetary stimulus packages has softened as inflation has surged
  - Tighter monetary and fiscal policies may cause a global recession
  - Emerging markets are particularly sensitive to inflationary pressures and may react in such a way that could severely damage any economic recovery
  - Weaker demand could push commodity prices lower, benefiting commodity importers at the expense of commodity-exporting nations, which could especially impact certain emerging market economies
- Prolonged U.S. dollar strength:
  - A strong USD weakens local currencies, exacerbating inflation in these economies
  - Debt service on USD-denominated emerging market sovereign debt is much more difficult to repay
- Prolonged slowdown in global economic activity caused by new COVID-related outbreaks and lockdowns: :
  - Persistent problems associated with new variants
  - China's back-peddling on its Zero-COVID policy could reduce the strain on supply chains
- Escalation in tensions within China:
  - Chinese regulatory actions on Chinese companies:
    - Onerous new regulations placed on many of China's most prolific and powerful companies and implemented under the objective of wealth re-distribution, or "common prosperity"
    - Excessive oversight seems to have been relaxed but further rules may be implemented following the 20th National Congress of the Chinese Communist Party
  - Tensions between China and Taiwan escalate

Portfolio Characteristics[2] (as of 6/30/2022)

10 Largest Holdings	Weight
ENN Energy Holdings Ltd.	4.3%
Wuxi Biologics Cayman Inc.	4.1%
Taiwan Semiconductor Manufacturing Co. Ltd.	4.1%
Huazhu Group Ltd.	3.9%
Wal-Mart de México S.A.B. de C.V.	3.8%
Infosys Ltd.	3.8%
ZTO Express Cayman Inc.	3.7%
Grupo Financiero Banorte S.A.B.	3.4%
Tencent Holdings Ltd.	3.4%
HDFC Bank Ltd.	3.3%

Sector Allocation	Weight
Consumer Discretionary	14.9%
Consumer Staples	11.2%
Energy	4.2%
Financials	18.6%
Health Care	6.9%
Industrials	9.3%
Information Technology	13.2%
Materials	7.2%
Communication Services	6.1%
Utilities	4.3%
Cash	4.1%

10 Largest Countries	Weight
China	35.3%
India	19.3%
Brazil	11.7%
Mexico	9.5%
South Korea	4.8%
Taiwan	4.1%
Hong Kong	2.8%
South Africa	2.5%
Argentina	2.4%
Colombia	2.0%

Performance Composite Returns[3] (For Periods Ending June 30, 2022)

	Since Inception**	10-year*	5-year*	3-year*	1-year	YTD	QTD
Emerging Markets *Pure Gross-of-Fees[4]*	3.3%	3.5%	(0.1%)	(2.2%)	(31.4%)	(17.3%)	(12.9%)
Net-of-Fees[5]	0.3%	0.4%	(3.1%)	(5.1%)	(33.5%)	(18.5%)	(13.6%)
MSCI Emerging Markets (Net)	3.1%	3.1%	2.2%	0.6%	(25.3%)	(17.6%)	(11.4%)

Calendar Year	Pure Gross-of-Fees[4]	Net-of-Fees[5]	MSCI EM	Difference (Gross-MSCI EM)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	MSCI EM 3yr Std Dev	Composite Dispersion
2009**	10.3%	9.5%	8.5%	1.8%	5	$1,030	-	N/A	N/A	N/A
2010	13.1%	9.8%	18.9%	(5.7%)	5	$1,462	-	N/A	N/A	0.1%
2011	(15.7%)	(18.2%)	(18.4%)	2.7%	7	$2,430	-	N/A	N/A	0.0%
2012	11.4%	8.1%	18.2%	(6.8%)	4	$2,346	-	18.3%	21.5%	0.8%
2013	13.5%	10.2%	(2.6%)	16.1%	1	$220	-	16.0%	19.0%	N/A
2014	(3.6%)	(6.5%)	(2.2%)	(1.4%)	4	$1,636	-	13.9%	15.0%	N/A
2015	(2.7%)	(5.6%)	(14.9%)	12.2%	6	$3,218	-	14.7%	14.1%	0.5%
2016	0.7%	(2.3%)	11.2%	(10.5%)	17	$6,265	-	15.5%	16.1%	0.2%
2017	42.7%	38.5%	37.3%	5.4%	16	$9,288	-	15.0%	15.4%	0.8%
2018	(19.7%)	(22.1%)	(14.6%)	(5.1%)	15	$8,643	$5,486,737	14.8%	14.6%	0.6%
2019	17.3%	13.9%	18.4%	(1.1%)	13	$9,604	$7,044,708	16.0%	14.2%	0.6%
2020	22.9%	19.2%	18.3%	4.6%	14	$11,350	$6,889,798	21.3%	19.6%	1.9%
2021	(11.4%)	(14.1%)	(2.5%)	(8.9%)	9	$8,357	$7,761,687	20.7%	18.3%	0.4%

*Average annualized returns

See performance disclosures on last page.

**Inception is 10/1/2009*

Portfolio Benchmarks

MSCI Emerging Markets (Net) Index *– Free float-adjusted market capitalization index designed to measure the equity market performance of emerging markets. Performance results are presented net of estimated foreign withholding taxes on dividends, interest, and capital gains. (Source: Bloomberg)*

(Prior to March 31, 2020, the S&P/BNY Emerging Market ADR Index was shown as a secondary benchmark. This index was removed to simplify the presentation, being less widely recognized and relevant than the primary benchmark.)

Disclosures

Market & Strategy Commentary—Information is presented as supplemental information to the disclosures required by GIPS® standards. 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. Holdings identified do not represent all of the securities purchased, sold or recommended. Sector and country allocations represent a portion currently or previously held in a representative (model) portfolio invested in accordance with the stated investment strategy.

Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable. It is important to review your investment objectives, risk tolerance, and liquidity needs before choosing an investment style or manager. All investments carry a certain degree of risk, including possible loss of principal, that investors should be prepared to bear. Equity securities are subject to market risk and 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 or that any investment will be profitable or avoid incurring losses.

Indices: The MSCI Emerging Markets Index is shown as additional information. This index is unmanaged. An investor cannot invest directly in an index. It is shown for illustrative purposes only & does 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—**Table showing the top 5 contributors/detractors reflects the strategy's best and worst performers, based on each holding's contribution to the sample account for the period stated. Individual client portfolios in the strategy may differ, sometimes significantly, from these listings. Contact Confluence for a complete list of holdings. 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.

[2] **Portfolio Characteristics—**The listing of "10 Largest Holdings" is not a complete list of all stocks in the portfolio or which Confluence may be currently recommending. Application of the investment strategy as of a later date will likely result in changes to the listing. Listings of countries and holdings do not represent all of the countries/stocks currently or previously owned in the portfolio or which Confluence may be currently recommending. Sector/country weightings and holdings of individual client portfolios in the program may differ, sometimes significantly, from these listings.

[3] **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, 2021. 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 Emerging Markets Strategy was incepted on October 1, 2009, and the current Emerging Markets Composite was created on May 1, 2018. Performance presented prior to May 1, 2018, occurred while the Portfolio Management Team was affiliated with a prior firm and was independently verified for the periods of 10/1/1999 through 12/31/2017. The Portfolio Management Team members were the primary individuals responsible for selecting securities to buy and sell. Composite performance is typically net of foreign withholding taxes on dividends, interest income and capital gains with some exceptions based on custodian treatment. 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.

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

[5] Net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly. This fee includes brokerage commissions, portfolio management, consulting services and custodial services. The Confluence fee schedule for this composite: 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. Subsequent to February 1, 2013, 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.

Performance prior to February 1, 2013, is based on the Emerging Markets–Direct Composite which was initially created on October 1, 2009. The Emerging Markets–Direct Composite includes accounts that pursue the Emerging Markets strategy, but do not have bundled fees. Gross returns from the Emerging Markets–Direct Composite include transaction costs and net-of-fee performance was calculated using the highest applicable annual bundled fee of 3.00% applied quarterly.

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. Prior to year-end 2018, the annual composite dispersion was an asset-weighted standard deviation calculated for 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 Emerging Markets Composite contains fully discretionary Emerging Markets wrap accounts. The Emerging Markets portfolio invests in U.S.-listed shares of companies from emerging markets.

**Results shown for the year 2009 represent partial period performance from October 1, 2009, through December 31, 2009. N/A-Composite Dispersion: Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year. N/A-3yr Std Dev: Composite does not have 3 years of monthly performance history.

About Confluence Investment Management LLC

Confluence Investment Management is an independent Registered Investment Advisor located in St. Louis, Missouri, that provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates evaluation of market cycles, macroeconomics and geopolitical analysis with the firm's value-driven, company-specific approach. The portfolio management philosophy begins by assessing risk and follows through by positioning clients to achieve their income and growth objectives.

Confluence International Equities Investment Committee

Mark Keller, CFA	Tore Stole	Matthew Sinkovitz	Blair Brumley, CFA
Bill O'Grady	Greg Tropf, CFA	Kaisa Stucke, CFA	Patrick Fearon-Hernandez, CFA

For more information contact a member of our sales team:

Wayne Knowles	Ron Pond, CFA | *West*	Jason Gantt | *East*	Michael Kelnosky | *North-Central*	Jim Taylor | *Mid-South*
National Sales Director	Sr. Regional Sales Director	Sr. Regional Sales Director	Regional Sales Director	Regional Sales Director
(314) 526-0914	(314) 526-0759	(314) 526-0364	(314) 526-0622	(314) 526-0469
wknowles@confluenceim.com	rpond@confluenceim.com	jgantt@confluenceim.com	mkelnosky@confluenceim.com	jtaylor@confluenceim.com

20 Allen Ave., Ste. 300, St. Louis, MO 63119 • (314) 743-5090 www.ConfluenceInvestment.com