Emerging Markets • International Equity Strategies

Confluence Emerging Markets invests primarily in large cap, growth-oriented companies in the emerging markets around the world. The strategy's management team employs both top-down and bottom-up fundamental analysis to identify attractive 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: Mid-Year Update

Emerging market indexes moved higher during the second quarter of 2023, building on the advances of the prior two quarters. The renewed strength in the Information Technology sector (the second largest sector in the MSCI Emerging Markets Index) has driven returns for the first half of the year. Lower interest rates, both actual and expected, and the excitement surrounding the opportunities available via artificial intelligence (AI) have rejuvenated emerging markets' Information Technology shares. Most emerging market momentum is still positive on encouraging economic trends such as slowing global inflation and a modest recovery in global growth. The laggard is China, whose second quarter economic weakness was a large drag on benchmark performance during the quarter. Nevertheless, this was the third consecutive quarter of positive returns for emerging markets.

The trajectory of the U.S. dollar (USD) remains an important driver of emerging market equity returns. The MSCI Emerging Markets Index moves inversely with the USD, hence a weakening USD is consistent with rising emerging market equity prices. The USD declined slightly in the second quarter, continuing the trend that started around year end. Emerging market financials remained stable and have not suffered large capital outflows or strains on the banking system. Based on prior disruptions, emerging market banks have made considerable progress in regulatory oversight and sound balance sheet construction.

The weakening USD is consistent with the outlook of Confluence Chief Market Strategist Bill O'Grady, and the rest of the Confluence macroeconomic team. Our macro team believes we entered a secular USD decline at the beginning of 2023. Since 1969, there have been six USD bull and bear cycles averaging more than 8.5 years in duration. Historically, during each of these USD bear markets, the currency has weakened by at least 30%. In every one of these USD bear markets, emerging market equities outperformed international developed markets, which outperformed the U.S. equity market. Non-U.S. equities tend to offer consistently better returns as the USD weakens.

Also, the BRICS nations (Brazil, Russia, India, China, and South Africa) are now spearheading the development of a new currency to be used for cross-border trade. Currently, 88% of international transactions are conducted in USD. Following the Russian invasion of Ukraine, the United States removed Russia from the SWIFT system which facilitates trade in USD, crippling the Russian economy's ability to conduct international trade. The BRICS countries, fearing this action could happen to anyone, are initiating this "de-dollarization" process. More than 20 other countries support the BRICS initiative. A final decision may be forthcoming in late August at the BRICS Leaders' summit in South Africa. These actions are not consistent with USD strength.

Tightening cycles were a key feature of 2022 across the emerging world, but we expect interest rate moderation as we enter the third quarter of 2023. Some emerging market central banks that began tightening early, such as Brazil, Chile, and Czech Republic, have already ended their hiking cycles. Emerging market central banks will press on with policy pivots as long as their domestic inflation rates are dropping sufficiently. Policymakers in Asia have also turned less hawkish and/or slowed the pace of rate hikes, and those tightening cycles are also in their final stages. Looking ahead, emerging markets tend to switch from monetary tightening to loosening fairly quickly, and, while high inflation will prevent rate cuts in the immediate term, the conditions for easing policy may already be in place in many emerging markets, which is sooner than in many developed markets. Ultimately, the domestic conditions will determine what the individual central banks do.

China continues to drive emerging market performance as it represents 29.5% of the MSCI Emerging Markets Index. China's economy is struggling to sustain the growth spurt that occurred following the lifting of the onerous Zero-COVID restrictions which had been in place since late 2019. A slowdown in imports and exports in May indicated that both domestic and global demand were softening. The Purchasing Managers Indices (PMI), both manufacturing and nonmanufacturing, have been falling since March with the manufacturing PMI falling below 50 which suggests a manufacturing slowdown. This recent slowdown has renewed calls for added central bank stimulus. Further worsening the problem is a real estate market that continues to struggle, high youth unemployment, and private fixed asset investment which has turned negative. The People's Bank of China (PBOC) recently announced a series of rate cuts and the National Development and Reform Commission has introduced 22 measures to reduce costs for firms and grant some tax breaks.

Market Commentary continued...

Much of the Chinese economy depends on real estate as one-third of China's GDP is tied to this sector. More than a year and a half following the demise of Evergrande, the government has not yet fully stabilized the market. While some temporary solutions are being contemplated, including loosening administrative burdens and supplying additional financial assistance to allow for the completion of unfinished homes, the ultimate solution is to solve the debt crisis for overleveraged property developers.

Diplomatic meetings between the U.S. and China are designed to increase cooperation between the world's two largest economies. After several meetings of lower-level representatives, U.S. Secretary of State Blinken traveled to Beijing to meet with President Xi Jinping and staffers to resume dialogue about trade, national security, and global multilateral relations. With U.S.-China relations at a low over national security issues, including Taiwan, U.S. export bans on advanced technologies, and China's state-led industrial policies, Washington has been trying to repair ties. More recently, Treasury Secretary Janet Yellen traveled to China to meet her Chinese counterpart. The U.S. diplomatic push comes ahead of a possible meeting between President Biden and President Xi either at September's Group of 20 summit in New Delhi or at the Asia-Pacific Economic Cooperation gathering scheduled for November in San Francisco.

Finally, we believe emerging market equities remain one of the more mispriced asset classes, with valuations reaching historically attractive levels. Demographic trends and continued urbanization are supportive of the long-term tailwinds. These trends support a growing middle class that contains consumers who are younger, more educated, and able to quickly adopt modern technology. This emerging middle class has constantly changing consumption patterns and preferences as real disposable income rises. Countries such as India and Indonesia are among the largest economies in the world with demographic trends that should ensure their economic growth will persist well into the future. Brazil and Mexico are benefitting from near-shoring trends and supply chains are being shortened since the COVID pandemic. For these reasons, emerging markets are likely to enter a period of economic recovery beginning in the second half of 2023.

The asset class continues to be under-owned as evidenced by emerging markets trading at a 61% discount (forward P/E) to U.S. counterparts. Emerging markets trade with high and improving return on equity, free cash flow yield, and a dividend yield more than double that of the U.S. (3.3% versus 1.5%). Earnings growth in emerging markets in 2024 is expected to rise 24%, far outpacing that of the U.S. and the world's developed markets which are expected to grow 10% and 8%, respectively.

Quarterly Trade Summary

There were no portfolio changes made to the Confluence Emerging Markets strategy during the second quarter of 2023.

Performance Review

The second quarter performance of the MSCI Emerging Markets (EM) Index was 0.9% in U.S. dollar terms, underperforming the return of developed international markets (MSCI EAFE, 3.0%) and the U.S. markets (S&P 500, 8.7%). Much of the weakness during the quarter can be attributed to slowing demand in China. Growth expectations for China were ratcheted down as the flurry of activity following the reopening of the economy after the COVID lockdowns is starting to lose steam.

Among the regions, EM Latin America posted the best performance by a wide margin (+14.0%) as the Latin American markets have benefited from near-shoring and the Brazilian economy is expected to benefit from lower policy rates as inflation moderates. In contrast, EM Europe, Middle East, and Africa (EMEA) rose 2.7% and EM Asia fell 0.8%. The impressive performance in India (+12.2%), Taiwan (+4.5%), and South Korea (+4.4%) were overshadowed by a very weak China (-9.7%). From a sector perspective, Energy (+12.3%) and Financials (+5.7%) were the best performers, while Real Estate (-10.2%) and Communication Services (-6.8%) were the worst-performing sectors.

During the second quarter of 2023, the Confluence Emerging Markets strategy posted a return of 1.0% (gross of fees) versus 0.9% for the benchmark, as stated above. Year-over-year, Confluence Emerging Markets gained 15.0% (gross of fees), outperforming the benchmark at 1.7%. *[The strategy's net-of-fees returns for the same periods were 0.2% QTD and 11.6% 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 Indonesia (+21.5%) and Peru (+17.4%), whereas China (-13.4%) and Argentina (-10.1%) recorded the worst returns. Communication Services (31.6%) and Energy (+18.3%) were the strongest sectors during the quarter, while Utilities (-8.6%) and Consumer Discretionary (-7.4%) were the weakest.

Security	Avg Weight (%)	Contribution (%)
Top 5		
Vista Energy S.A.B. de C.V.	4.29	1.98
Controladora Vuela Compañía de Aviación	3.36	1.64
Taiwan Semiconductor Manufacturing Co.	4.26	1.35
MercadoLibre Inc.	3.83	1.10
Gold Fields Ltd.	3.36	1.06
Bottom 5		
ENN Energy Holdings Ltd.	3.24	(0.33)
H World Group Ltd.	4.10	(0.35)
Sendas Distribuidora S.A.	1.59	(0.45)
Vale S.A.	2.51	(0.54)
Wuxi Biologics Cayman Inc.	2.86	(1.19)

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

The top contributors and detractors for the portfolio in 2023 are shown in the accompanying table.[1]

What We Are Watching

Many factors are changing in a positive direction for emerging market equities, indicating that they are poised for a period of outperformance relative to the world's developed markets in the second half of 2023.

We continue to identify countries and regions that have better adapted to changes resulting from the pandemic and recovery. Most emerging markets have weathered the post-COVID era rather well as they identified inflation in their economies and quickly raised rates to mitigate inflation expectations. As inflation is moderating and peaking in some areas, these economies are now in a position to reduce policy rates to stimulate stagnant growth. Provided a significant global recession can be avoided, we believe emerging market equities are trading at extremely attractive valuations relative to historical levels and relative to developed markets.

Emerging market risks in the first half of the year have mostly come from outside rather than within; however, there are still external factors that pose risks for emerging markets and are symptoms of an increasingly late-cycle developed market economic environment.

Inflationary pressures are moderating, and global growth is resuming, albeit at a slow pace. Nevertheless, risks to our positive outlook for emerging markets include:

- Persistent inflation that would cause central banks in both emerging and developed markets to raise/maintain high rates and reduce liquidity to combat inflationary pressures:
  - Emerging markets are particularly sensitive to inflationary pressures, although they tend to be in a better position to address these pressures as inflation has peaked in most cases.
- Prolonged U.S. dollar strength:
  - A strong USD could weaken local currencies, which would exacerbate inflation in the economy.
  - Debt service on USD-denominated emerging market sovereign debt is much more expensive to repay .
  - The Confluence macro team believes that a secular USD bear market started at the beginning of 2023.
    - History suggests these USD market cycles generally last 8-10 years, with a significant decline in the USD.
  - The BRICS (Brazil, Russia, India, China, and South Africa) are contemplating using alternative currencies to conduct global trade, potentially undermining the importance of the USD as the reserve currency:
    - This would exert downward pressure on the USD, benefitting non-U.S. assets, especially emerging markets.
    - Many other countries are interested in joining the BRICS.
- A long, drawn-out conflict between Russia and Ukraine would keep commodity prices (especially energy) artificially high, which may impact consumer spending on a global basis.
- China's economy meaningfully slows due to inadequate stimulus and/or a real estate crisis:
  - China's youth unemployment is nearing 20%, indicating a slowdown in economic growth.
  - China's existing debt problem makes solving the real estate crisis more challenging:
    - Authorities outside of China may not fully appreciate the magnitude of the indebtedness at all levels.
- Geopolitical tensions escalate:
  - Tensions between the U.S. and China
  - Tensions between China and Taiwan
  - Russia/Ukraine war

Portfolio Characteristics[2] (as of 6/30/2023)

10 Largest Holdings	Weight
Vista Energy S.A.B. de C.V.	5.1%
Taiwan Semiconductor Manufacturing Co.	4.3%
Controladora Vuela Compañía de Aviación	3.9%
Localiza Rent a Car S.A.	3.9%
Wal-Mart de México S.A.B. de C.V.	3.6%
MercadoLibre Inc.	3.5%
Gold Fields Ltd.	3.4%
Fomento Economico Mexicano S.A.B.	3.3%
ICICI Bank Ltd.	3.0%
HDFC Bank Ltd.	2.9%

Sector Allocation	Weight
Consumer Discretionary	15.6%
Consumer Staples	12.4%
Energy	6.9%
Financials	17.7%
Health Care	4.7%
Industrials	15.4%
Information Technology	6.8%
Materials	8.4%
Communication Services	5.1%
Utilities	2.8%
Cash	4.2%

10 Largest Countries	Weight
China	21.2%
Mexico	18.7%
India	16.4%
Brazil	12.5%
South Korea	5.3%
Hong Kong	4.4%
Taiwan	4.3%
Argentina	3.5%
South Africa	3.4%
Indonesia	2.4%

Performance Composite Returns[3] (For Periods Ending June 30, 2023)

	Since Inception**	10-year*	5-year*	3-year*	1-year	YTD	QTD
Emerging Markets *Pure Gross-of-Fees[4]*	4.1%	4.3%	0.4%	3.8%	15.0%	10.1%	1.0%
Max Net-of-Fees[5]	1.1%	1.2%	(2.6%)	0.7%	11.6%	8.5%	0.2%
MSCI Emerging Markets (Net)	3.0%	3.0%	0.9%	2.3%	1.7%	4.9%	0.9%

Calendar Year	Pure Gross-of-Fees[4]	Max 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%
2022	(13.7%)	(16.2%)	(20.1%)	6.4%	7	$6,068	$6,931,635	21.3%	20.3%	0.6%

*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.)

Confluence International Equities Investment Committee

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

For more information contact a member of our sales team:

Ron Pond, CFA | *Northwest*
Director of Sales
(314) 526-0759
rpond@confluenceim.com

Jason Gantt | *East*
Sr. Regional Sales Director
(314) 526-0364
jgantt@confluenceim.com

Jim Taylor | *Mid-South*
Regional Sales Director
(314) 526-0469
jtaylor@confluenceim.com

Denis O'Grady | *East & Mid-South*
Regional Sales Associate (Internal)
(314) 743-5294
dogrady@confluenceim.com

Wayne Knowles | *ID, MT, WY*
Advisory Director
(314) 526-0914
wknowles@confluenceim.com

Steve Mikez | *Southwest*
Sr. Regional Sales Director
(314) 526-0776
smikez@confluenceim.com

Michael Kelnosky | *North-Central*
Regional Sales Director
(314) 526-0622
mkelnosky@confluenceim.com

Matt Winter | *Southwest & North-Central*
Regional Sales Associate (Internal)
(314) 526-0522
mwinter@confluenceim.com

Disclosures

Market & Strategy Commentary—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 (net), 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.

[2] **Portfolio Characteristics—**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.

GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein.

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.