

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

Emerging market indexes moved lower during the third quarter of 2023, registering the first negative quarterly return since Q3 2022. Emerging markets were driven primarily by continued weakness in the Chinese economy and earnings weakness across the spectrum. 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 remains China, whose fourth quarter economic outlook is much improved but remained a drag on benchmark performance during the third quarter.

China is the world's second largest economy behind the U.S. and the largest economy in the emerging market universe. The Chinese equity markets have fallen more than 25% from the January highs, which were a reaction to the "reopening" following the strict COVID lockdowns that had paralyzed the Chinese economy for the prior two years. In the latest quarter, we have noticed improving economic conditions in China including the Purchasing Managers' Index now eclipsing 50, indicating the strongest pace of expansion since February 2023. The government has also made several policy support announcements to help the country's troubled real estate sector. Monetary policy pronouncements from the People's Bank of China will also help homeowners and property developers meet their commitments. The hope is that growth can be restored to the Chinese economy without a massive stimulus package, which would further burden a highly indebted central government. Upcoming Chinese Communist Party meetings may highlight additional measures the central government may undertake to provide support for the economy.

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 appreciated by 3.2% in the third quarter, reversing the trend that started around year end. Year-to-date, the USD has appreciated by 2.6%, creating a drag on emerging market equities. The stronger USD also exerts additional financing requirements on emerging market firms that issue debt denominated in USD, as their debt servicing costs rise as the USD strengthens. The Confluence macroeconomic team still feels the USD is weakening; however, its strength may be "stickier" than initially anticipated.

During the late August BRICS Leaders' Summit in South Africa, discussions of the use of a common currency for trade between the BRICS nations (Brazil, Russia, India, China, and South Africa) was discussed but no decision was formalized. These nations will continue to facilitate trade among the group in their local currencies where it makes sense as discussions on the use of a common currency will continue. Also, more than 40 countries have shown keenness to join BRICS initiative and two dozen have reportedly made formal appeals, while six countries – Argentina, Egypt, Ethiopia, Iran, Saudi Arabia, and the UAE – are slated to become members of the group in 2024. These actions are not consistent with USD strength.

The relative earnings growth differential between emerging market companies and developed market companies will determine their relative performance momentum. Year-to-date, emerging market equities earnings growth has lagged that of the developed markets, resulting in underperformance; however, looking forward, we believe the earnings growth profile of emerging market companies is likely to exceed that of the developed markets. For 2024, earnings forecasts are approximately 9% higher in emerging markets than developed markets, driven by improving outlooks in South Korea, Taiwan, Turkey, and India. The outlook in China is also improving on higher expectations in the Health Care, Materials, Consumer Staples, and Consumer Discretionary sectors. These emerging market returns would be further enhanced by a weakening USD, as described above.

Tightening cycles were a key feature of 2022 across the emerging world, but we expect continued interest rate moderation as we enter the fourth 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. The median headline inflation rate for emerging economies has fallen to 4.7% from a peak of nearly 8% in July 2022. Policymakers in Asia have also turned less hawkish and/or slowed the pace of rate hikes, hence those tightening cycles appear to be in their final stages. We anticipate that lower interest rates will help jumpstart these emerging economies as developed markets are still struggling with persistent inflationary pressures.

Market Commentary continued...

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 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, we expect emerging markets are likely to enter a period of economic recovery beginning in 2024. Emerging market economic growth is starting to move higher as growth slows in developed markets and as emerging markets are being led by countries other than China.

The asset class continues to be under-owned as evidenced by emerging markets trading at a forward P/E of 11.5x versus 18.5x in the U.S. Emerging markets continue to trade with high and improving return on equity, free cash flow yield, and a dividend yield double that of the U.S. (3.1% for the MSCI Emerging Markets versus 1.6% for the S&P 500). Earnings growth in emerging markets in 2024 is expected to rise 19%, far outpacing that of the U.S. and the world's developed markets which are expected to grow 12% and 10%, respectively.

Quarterly Trade Summary

A few changes were made to the Confluence Emerging Markets portfolio during the third quarter. First, in July, South Korean steel company Posco Holdings Inc (PKX, Materials) recorded substantial gains over a two-week span following better-than-expected earnings and positive announcements made during its Battery Materials Business Day presentation. The significant appreciation in its share price presented us with a timely opportunity to take gains and return the overweight allocation from 5.5% to 2.5%.

In late August, we purchased Mexican bottler Coca-Cola FEMSA S.A.B. de C.V. (KOF, Consumer Staples), a franchise bottler that produces, markets, sells, and distributes Coca-Cola trademark beverages across Latin America. KOF is the largest Coca-Cola franchise bottler in the world by sales volume. The company offers sparkling beverages, including colas and other flavored sparkling drinks, along with other beverages such as waters, juice drinks, coffee, tea, milk, value-added dairy products, sports and energy drinks, alcoholic beverages, and plant-based drinks. It provides this portfolio of products through retail outlets, wholesale supermarkets, points-of-sale outlets, and home delivery. In addition, the company distributes and sells Heineken, Estrella Galicia, and Therezopolis beer products in its Brazilian territories. KOF operates in Mexico, Guatemala, Nicaragua, Costa Rica, Panama, Colombia, Brazil, Argentina, and Uruguay. KOF replaced Brazilian retailer Companhia Brasileira De Distribuicao (CBD, Consumer Staples) in the portfolio. CBD spun-off its stake in Éxito S.A. (EXTO), another Brazilian retailer, whose sales had collapsed due to deflation and faced headwinds from the changing competitive landscape in Brazil. We exited both positions in favor of the more stable and growing opportunity we saw in KOF.

Performance Review

The third quarter performance of the MSCI Emerging Markets (EM) Index was -2.9% in U.S. dollar terms, outperforming the returns of developed international markets (MSCI EAFE, -4.1%) and the U.S. markets (S&P 500, -3.3). Improvements in inflation and the outlook for future earnings growth were the drivers of the relative outperformance.

Among the regions, EM Europe, Middle East, and Africa (EMEA) was the best performing region, only falling 1.8% led by the Middle East and African emerging market economies, especially Turkey, Egypt, and the United Arab Emirates. EM Asia fell 2.9%, in line with the benchmark, and finally EM Latin America was down 4.8% due to weak returns in Mexico, Chile, and Brazil. EM Latin America should benefit from North American near-shoring and the Brazilian economy is expected to benefit from lower policy rates as inflation moderates. From a sector perspective, Energy and Consumer Discretionary were the best performers, while Information Technology and Communication Services were the worst-performing sectors.

During the third quarter, the Confluence Emerging Markets strategy posted a return of -1.6% (gross of fees) versus -2.9% for the benchmark, as stated above. Year-over-year, Confluence Emerging Markets gained 20.4% (gross of fees), outperforming the benchmark at 11.7%. *[The strategy's net-of-fees returns for the same periods were -2.4% QTD and 16.8% year-over-year. See disclosures on last page for fee description; actual investment advisory fees may vary.]*

The best-performing countries within our portfolio, on an absolute basis, were South Korea and Colombia, whereas South Africa and Hong Kong recorded the worst returns. Energy and Health Care were the strongest sectors during the quarter, while Industrials and Communication Services were the weakest.

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

| Security | Avg Weight (%) | Contribution (%) |
|-----------------------------------|----------------|------------------|
| Top 5 | | |
| Vista Energy S.A.B. de C.V. | 4.76 | 3.44 |
| MakeMyTrip Ltd. | 3.19 | 1.45 |
| MercadoLibre Inc. | 3.87 | 1.32 |
| POSCO Holdings Inc. | 1.57 | 1.00 |
| Fomento Economico Mexicano S.A.B. | 2.30 | 0.78 |
| Bottom 5 | | |
| HDFC Bank Ltd. | 3.65 | (0.50) |
| Sendas Distribuidora S.A. | 1.52 | (0.68) |
| AIA Group Ltd. | 2.38 | (0.69) |
| Wuxi Biologics Cayman Inc. | 2.65 | (0.74) |
| ENN Energy Holdings Ltd. | 2.91 | (1.29) |

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

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 2024 and beyond.

We continue to identify countries and regions that have better adapted to macroeconomic changes related to increasing levels of inflation, slowing global growth, and shortening supply chains. 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.

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; however, some recent appreciation in the USD suggests that its strength may be stickier than previously anticipated.
 - ◆ History suggests these USD market cycles generally last 8-10 years, with a significant decline in the USD.
 - ◆ The BRICS nations (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 or in the Middle East 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 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.
- ◆ Mexican President Andrés Manuel López Obrador (AMLO) has recently roiled the local stock market by challenging the merits of Mexican contract law in a feud with Mexican airport operators over fees:
 - ◆ We expect corporations worldwide to closely monitor these developments and potentially to slow investment in Mexico until there is more clarity.
 - ◆ AMLO's term as president is scheduled to end when elections take place next June.
 - ◆ The Mexican constitution prevents Obrador from seeking another term, but we are closely following any developments.
- ◆ Geopolitical tensions escalate:
 - ◆ Tensions between the U.S. and China
 - ◆ Tensions between China and Taiwan
 - ◆ Russia/Ukraine war
 - ◆ Middle East tensions/war

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Portfolio Characteristics² (as of 9/30/2023)

| 10 Largest Holdings | Weight | Sector Allocation | Weight | 10 Largest Countries | Weight |
|---|--------|------------------------|--------|----------------------|--------|
| Vista Energy S.A.B. de C.V. | 6.6% | Consumer Discretionary | 17.3% | Mexico | 20.7% |
| MakeMyTrip Ltd. | 4.3% | Consumer Staples | 12.2% | China | 20.2% |
| MercadoLibre Inc. | 3.8% | Energy | 8.7% | India | 17.8% |
| Taiwan Semiconductor Manufact. Co. Ltd. | 3.8% | Financials | 17.1% | Brazil | 9.7% |
| Localiza Rent a Car S.A. | 3.5% | Health Care | 5.2% | South Korea | 5.1% |
| Fomento Económico Mexicano S.A.B. | 3.5% | Industrials | 12.5% | Argentina | 3.8% |
| Wal-Mart de México S.A.B. de C.V. | 3.4% | Information Technology | 6.6% | Hong Kong | 3.8% |
| ICICI Bank Ltd. | 3.1% | Materials | 7.1% | Taiwan | 3.8% |
| Dr. Reddy's Laboratories Ltd. | 3.1% | Communication Services | 4.9% | South Africa | 2.7% |
| Grupo Financiero Banorte S.A.B. | 3.0% | Utilities | 1.9% | Indonesia | 2.2% |
| | | Cash | 6.5% | | |

Performance Composite Returns³ (For Periods Ending September 30, 2023)

| | Since Inception** | 10-year* | 5-year* | 3-year* | 1-year | YTD | QTD |
|---------------------------------------|-------------------|----------|---------|---------|--------|------|--------|
| Emerging Markets | | | | | | | |
| <i>Pure Gross-of-Fees⁴</i> | 3.9% | 3.3% | 1.4% | 0.4% | 20.4% | 8.4% | (1.6%) |
| <i>Max Net-of-Fees⁵</i> | 0.9% | 0.2% | (1.6%) | (2.6%) | 16.8% | 5.9% | (2.4%) |
| MSCI Emerging Markets (Net) | 2.7% | 2.1% | 0.6% | (1.7%) | 11.7% | 1.8% | (2.9%) |

| 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 | *West*

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

Internal Sales Desk: (314) 530-6729

Denis O'Grady

dogrady@confluenceim.com

Wayne Knowles | *ID, MT, WY*

Advisory Director

(314) 526-0914

wknowles@confluenceim.com

Michael Kelnosky | *North-Central*

Regional Sales Director

(314) 526-0622

mkelnosky@confluenceim.com

Jason Robertson | *FL & SC*

Regional Sales Director

(314) 526-0776

jrobertson@confluenceim.com

Matt Winter

mwinter@confluenceim.com

Colin Kalish

ckalish@confluenceim.com

Disclosures

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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, 2022. 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 inceptioned 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.