Emerging Markets

International Equity Strategies

Confluence INVESTMENT MANAGEMENT

Third Quarter 2024

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 higher during the quarter, rising 8.7% and outperforming the developed markets of the world, including the US. This marked two consecutive quarters of emerging market outperformance over the developed markets, which has not happened since 2020. Emerging markets were boosted by a late September rally in the Chinese equity markets and the US Federal Reserve's initial rate cut.

In late September, China unleashed an extensive array of monetary and fiscal measures designed to jumpstart the moribund Chinese economy. The People's Bank of China (PBOC) and the Politburo announced a far-ranging economic package with the promise of additional fiscal stimulus to follow. The MSCI China Index rose 24% in September alone, and year-to-date, the Chinese index has risen by more than 30%, well ahead of the MSCI US, MSCI World and MSCI Emerging Market indexes. The sectors that suffered the most in China's market downturn, stocks related to the housing market and consumption, have risen the most since the announcement of these measures. The measures implemented are designed to aid the weak property market and support the Chinese consumer. Some details of the broad policy changes include:

- The reserve-ratio requirement for banks will go down by 0.5%. This essentially allows an additional one trillion renminbi (RMB) for loans. The PBOC said another cut of 0.25% to 0.5% will likely follow.
- China has lowered existing mortgage interest rates by 0.5%. This will help roughly 50 million households. Specifically, it will slash total interest expenses per household by about 150 billion RMB annually.
- China has cut the minimum down payment for first and second mortgages by 15%.
- Brokerage houses, mutual funds, and insurance companies will receive 500 billion RMB — with the potential for more in the future — to buy mainland-listed large cap stocks and exchange-traded funds (ETFs).
- Banks will receive a 300 billion RMB lending facility to fund stock buybacks by listed companies.

Two days later, a release from President Xi Jinping after a high-level government meeting also acknowledged many of the current failings in the Chinese economy. It stated that some of the government's goals include:

- Stabilizing the real estate market;
- Boosting capital markets;
- Supporting mergers and acquisitions (M&A); and
- Focusing on stronger employment for youth and migrant workers.

Policymakers have indicated that additional fiscal policy initiatives may be announced following the Golden Week holiday (October 1 – October 7). Policies would be designed to encourage consumers to spend and save less. No major new initiatives have been announced to date and China has given back some of the September gains.

The second factor influencing the strong move in emerging market equities during the quarter was the 50 bps reduction in the fed funds rate following several months of softening inflationary pressures in the United States (a 25 bps reduction was widely expected). The larger than expected interest rate cut lead to some US dollar (USD) weakness, and emerging market banks now feel less market resistance to cutting their own interest rates. Emerging market currencies rallied on the interest rate cut news, which provided additional upside for USD-based investors.

Over the past three years, emerging market equities have lagged developed market equities by a wide margin. High interest rates in most major economies combined with a challenging geopolitical environment have resulted in poor returns and capital flight. Global ownership of emerging market equities is currently at a two-decade low. The emerging markets contain many high-quality companies with durable, long-term growth potential that are trading at very attractive valuations. These factors will become more pronounced as global interest rates continue to fall.

See GIPS Report on pages 5-6

Market Commentary continued...

The trajectory of the USD remains an important driver of emerging market equity returns. The MSCI Emerging Markets Index tends to move inversely with the USD, hence a weakening USD is consistent with higher emerging market equity prices. During the third quarter, the USD weakened by 4.6%, enhancing emerging market equity returns. Over the past year, the USD has fallen 5.1% with a positive impact on emerging market equity prices. The weaker USD provides additional tailwinds to emerging market firms that issue debt denominated in USD since their debt-servicing costs decrease as the greenback weakens. Historically, the two previous extended periods of USD strength since 1970 each lasted an average of about 6.5 years, but the current stretch of USD strength has lasted more than 13 years. Therefore, many investors have not experienced an environment where the dollar is weak; however, conditions may be changing. The Confluence macroeconomic team still feels that the USD is under pressure longer term, but its strength may be stickier than initially anticipated.

Emerging market equities remain one of the most mispriced asset classes, in our opinion, with valuations reaching historically attractive levels. As of September 30, 2024, the MSCI Emerging Markets Index was trading at a forward P/E of 12.4x versus 14.0x for the MSCI EAFE and 21.9x for the MSCI USA Index (representing around a 40% discount). Emerging markets continue to trade with stronger earnings growth, high and improving return on equity, strong free cash flow yield, and a dividend yield near a 20% premium relative to historical figures and double that of the US (2.5% for the MSCI Emerging Markets Index versus 1.3% for the MSCI USA Index). Earnings growth in emerging markets is expected to rise 17% in 2024, far outpacing that of the US and the world's developed markets, which are expected to grow by about 10%. Furthermore, GDP growth is set to accelerate in emerging markets relative to developed as growth forecasts for 2024 are 4.0% for emerging economies compared to the 1.2% forecast for developed markets. This recovery can be attributed to global monetary easing, which has already occurred in many emerging markets as monetary authorities reduced interest rates to quickly address the recent bout of inflation. While growth in the developed markets is slower than in the emerging markets, the outlook for developed markets has improved modestly due to lower inflation/interest rates. Resilient global GDP should support emerging market economies.

Looking ahead, additional Fed easing and potentially more stimulus from China should propel emerging market equity prices higher. Prices will also be supported by expectations of higher economic growth and accelerating corporate earnings.

Quarterly Trade Summary

There were no trades completed during the third quarter in the Emerging Markets portfolio. The three-year trailing turnover for this strategy is 10.5% as of 9/30/2024.

Performance Review

The third quarter performance of the MSCI Emerging Markets (EM) Index was up 8.7% in USD terms, outperforming the returns of developed international markets (MSCI EAFE, 7.3%) and the US market (S&P 500, 5.9%).

Among the regions, EM Asia performed best, rising by 9.5% as Chinese equity markets rallied strongly in late September. The solid Chinese performance was offset by weak performance in Taiwan (+0.5%) and South Korea (-5.6%). EM Europe, Middle East, and Africa (EMEA, +7.1%) underperformed slightly with Turkey weighing on returns. In Turkey, the shift to more orthodox economic policies (e.g., more prudent monetary policy, higher interest rates) is impacting consumers and may lead to a recession. EM LatAm (+3.8%) was the worst-performing region, dragged down by the poor performance of Mexican equities during the quarter as the new president, Claudia Sheinbaum, was sworn into office on October 1, 2024.

During the third quarter of 2024, the Confluence Emerging Markets strategy recorded a return of 7.0% (gross of fees) compared to the benchmark return of 8.7%, as stated above. On a year-to-date basis, Confluence Emerging Markets was up 8.3% (gross of fees) versus 16.9% for the index. [*The strategy's net-of-fees returns for the same periods were 6.2% QTD and 5.9% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Importantly, the Confluence Emerging Markets strategy was outperforming the broad index as of September 20. However, the historic rally in Chinese equities due to the announced stimulus measures (discussed in the Market Commentary) propelled Chinese stocks by nearly 22% during the final trading week. The remarkable outperformance of MSCI China (15.2% above the MSCI EM Index) created the conditions where our strategy lagged the benchmark by the end of the quarter. The actual weight of Chinese equities within our portfolio stood at 11.9% on September 20, a 16% underweight position to China versus the benchmark, which materially impacted our relative performance in a negative manner. Looking at this another way, the MSCI EM ex-China Index underperformed the MSCI EM Index by 5.1% during this same time frame. Thus, due to lack of or little exposure, the surprise rally in Chinese stocks likely caused most emerging market investors to underperform during the past quarter.

Performance Review continued...

The MSCI EM Growth Index outperformed the MSCI EM Value Index (9.3% versus 8.1%, respectively). On a one-year trailing basis as of September 30, the MSCI EM Growth Index is 3.2% ahead of the Value Index (27.6% versus 24.4%, respectively). However, in similar fashion to international developed markets, the value component of the emerging markets index outperformed growth (+3.3% versus -2.3%, respectively) on a three-year trailing basis.

Quality stocks, as measured by the MSCI EM Quality Index, up 6.8%, underperformed the broad MSCI EM Index as well as the MSCI EM Value and Growth indexes during the past three-month measurement period. The MSCI EM Quality Index has now underperformed the broad MSCI EM Index by 700 bps on a year-to-date basis, resulting in a significant performance headwind for our strategy.

In the third quarter, the two best-performing countries within our portfolio, on an absolute basis, were Hong Kong and China, while Mexico and Brazil recorded the worst returns. From a sector standpoint, Communication Services and Consumer Discretionary were the strongest sectors during the quarter, while Consumer Staples and Energy were the weakest.

From a relative standpoint, the most accretive country allocation was the underweight to South Korea followed by the overweight to Hong Kong. An underweight allocation to China detracted the most from performance, while an overweight positioning to Mexico also proved unfavorable. From a sector perspective, our underweight allocation to Information Technology and overweight to Industrials added the most alpha during the quarter, whereas our overweight positioning to the Consumer Staples sector coupled with our underweight allocation to Health Care both contributed negatively to returns.

The top contributors and detractors for the portfolio year-to-date in 2024 are shown in the accompanying table.[1]

Security	Avg Weight (%)	Contribution (%)
Top 5		
MakeMyTrip Ltd.	5.53	4.16
Taiwan Semiconductor Manufacturing Cc	5.37	2.90
Vista Energy S.A.B. de C.V.	4.99	1.88
MercadoLibre Inc.	5.02	1.49
Tencent Holdings Ltd.	3.03	1.30
Bottom 5		
Localiza Rent a Car S.A.	*Sold*	(0.81)
Betterware de Mexico SAPI de CV	1.36	(0.85)
Wuxi Biologics Cayman Inc.	*Sold*	(0.85)
Controladora Vuela Cia de Avia	1.91	(0.86)
Wal-Mart de Mexico S.A.B. de C.V.	3.43	(1.16)

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

What We Are Watching

Macro and micro factors are changing in a positive direction for emerging market equities, indicating that they are poised for a period of outperformance in 2024 and beyond. In general, we expect countries that are more exposed to the US to outperform relative to those more exposed to the eurozone or China.

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 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 reducing policy rates to stimulate stagnant growth. Provided that 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 the developed markets.

Capital Economics forecasts GDP growth for emerging economies to reach 4.3% this year at the aggregate level. This is more than three times the growth predicted for the world's developed market economies. Moving forward, emerging market GDP growth is expected to expand by 4% in both 2025 and 2026 – a rate of growth at least twice that of the developed world.

Bloomberg estimates that earnings growth for the MSCI Emerging Markets Index will rise by 16.5% to $83.59/share this year over last. Moreover, estimates for earnings growth are forecast to increase by another 16% to $96.98/share by year-end 2025.

What We Are Watching continued...

During the past several months, there has been an increase in the asymmetric application of monetary policy worldwide. A year ago, the international battle against inflation was raging, and monetary policy became more restrictive as a result. However, inflationary pressures have largely subsided during the past few months, at least in the world's developed markets, which allowed central banks to begin easing rates. Much of the movement occurred this past quarter when the US Federal Reserve lowered rates by 50 bps, the European Central Bank announced its second rate reduction, and the Bank of Canada cut rates for a third time. Meanwhile, the Bank of England held rates at 5% following a 25 bps rate reduction in July, and the Bank of Mexico also cut rates by a quarter point during its August meeting. However, on the other side of the coin, the Bank of Japan has proceeded with two rate hikes so far this year. Japan is the only G7 economy currently entrenched in a rate-hiking cycle. We anticipate that the BOJ will progressively adopt more restrictive measures to combat the country's prolonged period of domestic deflation. The Central Bank of Brazil also decided recently to raise rates to curtail a rise in Brazilian inflation.

Furthermore, the war between Russia and Ukraine may appear frozen, but dangers are lurking. Ukrainian President Zelensky is lobbying NATO countries to utilize more modern and powerful weaponry to attack deeper inside Russia, while Russian President Putin continues to threaten the use of nuclear weapons and consistently moves the goalposts regarding what type of attack would warrant a nuclear response. The Confluence macroeconomic team has also highlighted the elevated tensions brewing in the South China Sea. We have previously discussed the potential of China taking military action against Taiwan, and now pressure is building in a territorial dispute between China and the Philippines as there have been several encounters between the Chinese Coast Guard and Philippine vessels. Each of these situations carries a real risk of immediate escalation, which could impact investors around the globe. The International Equities Investment Committee is diligently monitoring each of these theaters to manage client portfolios accordingly.

Emerging Markets • International Equity Strategies

Portfolio Characteristics² (as of 9/30/2024)

10 Largest Holdings	Weight
MakeMyTrip Ltd.	5.6%
Taiwan Semiconductor Manufacturing	5.4%
MercadoLibre Inc.	5.3%
Vista Energy S.A.B. de C.V.	5.0%
KB Financial Group Inc.	3.8%
ICICI Bank Ltd.	3.4%
Gold Fields Ltd.	3.3%
Shinhan Financial Group Co. Ltd.	3.2%
Dr Reddy's Laboratories Ltd.	3.1%
Tencent Holdings Ltd.	3.0%

Sector Allocation	Weight
Consumer Discretionary	21.6%
Consumer Staples	10.0%
Energy	6.4%
Financials	20.5%
Health Care	3.1%
Industrials	8.4%
Information Technology	8.0%
Materials	6.3%
Communication Services	4.7%
Cash	11.0%

10 Largest Countries	Weight
India	20.5%
Mexico	18.8%
China	11.9%
South Korea	7.9%
Brazil	7.4%
Taiwan	5.9%
Argentina	4.6%
Hong Kong	3.7%
South Africa	3.4%
Peru	1.8%

Performance Composite Returns³ (For Periods Ending September 30, 2024)

	Since Inception**	10-year*	5-year*	3-year*	1-year	YTD	QTD
Emerging Markets *Pure Gross-of-Fees⁴*	4.7%	4.0%	5.1%	0.1%	15.6%	8.3%	7.0%
Max Net-of-Fees⁵	1.6%	1.0%	2.0%	(2.9%)	12.2%	5.9%	6.2%
MSCI Emerging Markets (Net)	4.2%	4.0%	5.7%	0.4%	26.1%	16.9%	8.7%

Calendar Year	Pure Gross -of-Fees⁴	Max Net - of- Fees⁵	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%
2023	15.7%	12.2%	9.8%	5.8%	6	$5,807	$7,200,019	18.5%	17.1%	1.9%

**Average annualized returns* ***Inception is 10/1/2009* *See performance disclosures on last page.*

Portfolio Benchmark

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)*

Confluence International Equities Investment Committee

Mark Keller, CFA	Tore Stole	Matthew Sinkovitz	Blair Brumley, CFA
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Indexes: 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 performance figures are reported as net returns.

[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, 2023. The verification report is available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards.**

Verification provides assurance on whether the firm's policies and procedures related to composite maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

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The 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 US 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 US-listed shares of companies from emerging markets.

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.

**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.