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.

Year-End Market Commentary

Emerging market indexes moved higher during the fourth quarter of 2022, topping off a tumultuous year as the stronger U.S. dollar (USD), higher inflation, and slowing Chinese economy due to COVID restrictions and lockdowns weighed on emerging market equity prices. The MSCI Emerging Markets Index increased by 9.7%, bringing its year-to-date return to -20.1%. However, the fourth quarter may mark the turning point as signs of an emerging market recovery are starting to appear. During the quarter, we saw indications that the USD may have peaked, global inflation is moderating, and China is ready to reemerge as it has lifted many of its COVID restrictions and is stimulating its economy via additional monetary and fiscal policy measures. Key drivers supporting emerging market equity prices in 2023 include a weaker USD, an improving inflation outlook, the return of Chinese and developed market economic growth, and attractive emerging market company fundamentals.

The direction of the USD remains an important driver of emerging markets equity returns as the MSCI Emerging Markets Index tends to move inversely with the USD. Therefore, a weaking USD is consistent with rising emerging market equity prices. The USD has recently weakened following a sharp acceleration beginning with the first Federal Reserve rate increase on March 17, 2022. Since this time, the USD strengthened by as much as 15% before retracing to about 10%. The weakening USD is consistent with the Confluence macro team's outlook (see our *Current Perspectives* report, "The 2023 Outlook: A Recession Year"), and conditions remain favorable for additional USD weakness in 2023 and beyond. Factors that support this thesis include (1) the Federal Reserve is close to ending interest rate increases in the U.S. after aggressively raising rates during 2022; (2) the U.S. current account deficit is expected to contract further in 2024 -2025 due to the existing global macroeconomic backdrop; (3) growth in the U.S. is expected to moderate relative to the rest of the developed world and the emerging markets; and (4) the excessive "long dollar" positions will likely be removed as the dollar continues to weaken.

Inflation has risen sharply over the past two years, but inflation rates have started to moderate across the globe. Inflation generally has an outsized impact on emerging markets as higher food and energy prices have a more pronounced effect on consumer spending. The recent rise in inflation can be attributed to extremely accommodative monetary policies combined with economies reopening prior to the supply bottlenecks being fully restored, plus higher commodity prices due to the war in Ukraine have created supply and demand imbalances. Central banks were forced to raise interest rates to address the surge in demand. In 2022, the U.S. was very aggressive in raising rates as inflation pressures were less "transitory" than initially expected. The Fed's aggressive actions strengthened the USD, and lower inflation expectations should have a positive impact on emerging markets in the future.

Tightening cycles have been a key feature of 2022 across the emerging world, but the end is in sight as we enter 2023. Some EM central banks that began tightening early – e.g., Brazil, Chile, and Czech Republic – have already brought an end to their hiking cycles. Others in Latin America and Emerging Europe appear poised to follow imminently. Policymakers in Asia have also turned less hawkish and/or slowed the pace of rate hikes and tightening cycles there also seem to be in their final stages. Looking ahead, EMs 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 could be in place in many emerging markets by the middle of 2023, sooner than in many developed markets. That said, most analysts are currently not expecting interest rates to be lowered.

China continues to drive emerging market performance. China has initiated a more pro-growth, stimulus-oriented stance. Several geopolitical and economic factors are important here as we enter 2023. First, after nearly three years of the most stringent COVID controls in the world (Zero-COVID), China has scrapped its restrictive policies and begun efforts to reopen, including the Hong Kong border. However, as China begins its retreat from its Zero-COVID policy and lifts mobility restrictions for citizens, the country is experiencing its largest COVID surge yet. Numerous COVID lockdowns in 2022 significantly slowed economic growth on both the production and consumption side. Consequently, global supply chains remained disrupted which impacted many other economic recoveries. Large-scale social unrest in some of China's largest cities began during the second half of 2022, prompting President Xi to rethink his draconian position. China's reopening will be a massive tailwind for emerging market equities.

Market Commentary continued...

Second, in an effort to stabilize the reeling real estate market, Beijing launched a 16-point rescue plan to stabilize the nation's property sector, introducing a variety of new policies aimed at easing the liquidity crisis among property developers. The Chinese government has created a "floor" to protect both property developers and investors, and thus the real estate sector in China has emerged from the regulatory overhaul in a weakened but more fiscally responsible state. The financing assistance, worth potentially over $140 billion, will help with liquidity and unfinished projects. Real estate represents nearly two-thirds of Chinese citizens' household wealth. The rebound in the property sector should be reflected in higher consumption which has fallen significantly since the onset of COVID. Third, China has initiated liquidity injections aimed to stabilize the country's bond markets. In an effort to end one of the worst government bond market selloffs in recent years, China sought to maintain ample financial system liquidity using a combination of short-, medium-, and long-term tools exceeding 1 trillion CNY. China is attempting a tedious balancing act of injecting additional fiscal and monetary stimulus to jumpstart the economy without incurring more sovereign debt. With inflation at a modest 1.8%, monetary policy tools are still available to the Chinese central bank. Finally, there appears to be a moratorium on governmental regulations in certain industries that place onerous burdens on some companies, to the detriment of the companies' shareholders, to comply with the wishes of the Communist Party leadership.

The economic growth premium of emerging markets relative to developed markets is expected to return. The World Bank is currently forecasting higher 2023 GDP growth for China (+4.3%) and the emerging markets (+2.7%) compared to the U.S. (+0.5%), Europe (0%), and Japan (+1%). This premium, which moderated during the COVID-19 pandemic, is expected to widen due to improvements in the leading economic indicators in emerging market economies combined with much slower growth estimates in the developed world.

Finally, emerging market company fundamentals are attractive, in our view. While earnings estimates for most of 2022 were negative due to the unfavorable macroeconomic backdrop, earnings revisions for 2023 have moved into positive territory. Improving net profit margins are leading to improvements in return on investment. Valuations on P/E and P/B are cheap in absolute terms and relative to developed market equities. Currently, the MSCI Emerging Markets Index trades with a forward P/E of 11.3x compared to the MSCI World Index and the MSCI USA Index which trade at forward P/Es of 15.0x and 17.1x, respectively. The MSCI Emerging Markets dividend yield is 3.4% compared to MSCI World at 2.2% and MSCI USA at 1.7%.

Quarterly Trade Summary

We made two changes to the Confluence Emerging Markets portfolio during the fourth quarter. In early October, we added PT Astra International Tbk (PTAIY), an Indonesia-based Consumer Discretionary company. While it is a rather complex situation both in terms of its business mix and ownership structure, it can largely be thought of as a proxy for the Indonesian economy. PT Astra International Tbk (ASII) is a holding of several companies involved in the business of automotive, heavy machineries, financial services, mining, palm plantations, and others. It is the sole manufacturer and distributor of Toyota, Daihatsu, Isuzu, UD Trucks, and Peugeot automobiles in Indonesia. With its considerable population, improving living standards, and role as a major Southeast Asian economy that is neither China nor China-dependent, Indonesia has a number of attractive attributes, both in absolute terms and in the context of emerging market investing. Much of the country's economic activity is focused on the home market, which is not an export-driven economy and, unsurprisingly, Astra is much the same. Astra International reports operations in seven reporting segments, but two of them – automotive and heavy quipment/mining/construction/energy – account for roughly three-quarters of sales. Two additional operations – financial services and agribusiness – generate another 10% of sales each, making those four the dominant areas of focus.

Also in early October, we increased the positions in Brazil-based Companhia Brasileira de Distribuição SA (CBD) and Sendas Distribuidora SA (ASAI) following the spin-off of ASAI from CBD. CBD is the largest food retailer in South America, and it decided to spin-off its cash and carry subsidiary, ASAI, to unlock value. The investment committee feels both companies offer attractive outlooks, hence the increase to full positions.

In mid-November, we added Techtronic Industries Company Limited (TTNDY), a Hong Kong-based Industrials company. TTNDY engages in the design, manufacture, and marketing of power tools, outdoor power equipment, and floorcare and cleaning products worldwide. It offers power tools, power tool accessories, outdoor products, and outdoor product accessories for consumer, trade, professional, and industrial users. It holds the leading market position in both the professional and Do-It-Yourself (DIY) user groups for power tools, which comprise more than 90% of the company's business. While sales and manufacturing are worldwide, nearly 80% of its sales are to North America.

Performance Review

For the fourth quarter of 2022, the MSCI Emerging Markets Index returned 9.7% in USD terms, underperforming the developed international markets (MSCI EAFE Index, 17.3%) but outperforming the U.S. markets (S&P 500 Index, 7.5%). Much of the weakness during the quarter can be attributed to a challenging and dramatic course of events including a strong USD, higher inflation, global monetary tightening to minimize the impact of accelerating inflation across the major and emerging economies, and the potential for widespread recession. COVID-19 outbreaks are still challenging major Chinese cities and further pressuring global supply chains.

Performance Review continued...

Among the regions, EM Asia posted the best performance by a wide margin (+10.8%) following a resurgence in Chinese equities, while EM Europe, Middle East, and Africa (EMEA) and EM Latin America were much weaker, rising 5.8% and 5.7%, respectively. The Chinese market (+13.5%) propped up the MSCI Asian Index as COVID lockdowns were relaxed and/or eliminated and China continues to use monetary and fiscal stimulus measures to accelerate economic growth. From a sector perspective, Communication Services (13.7%), Health Care (13.1%), and Industrials (12.2%) recorded the best returns, while Energy (4.2%), Utilities (4.6%), and Financials (6.9%) were the worst.

The Confluence Emerging Markets strategy posted a return of 11.1% (gross of fees) for the fourth quarter of 2022 versus 9.7% for the benchmark. Year-over-year, Confluence Emerging Markets returned -13.7% (gross of fees) versus -20.1% for the benchmark over the same period. *[The strategy's net-of-fees returns for the same periods were 10.3% QTD and -16.2% 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 South Korea (+35.8%) and South Africa (+27.9%), while the two worst returns were recorded by Indonesia (-19.1%) and Brazil (-0.4%). Energy (+48.5%) and Materials (30.9%) were the strongest sectors during the quarter, and Information Technology (+2.2%) and Consumer Staples (+3.1%) were the weakest.

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

Security	Avg Weight (%)	Contribution (%)
Top 5		
Vista Energy S.A.B. de C.V.	0.99	1.41
Sendas Distribuidora S.A.	1.81	0.68
Vale S.A.	2.69	0.56
H World Group Ltd.	3.41	0.51
Grupo Financiero Banorte S.A.B.	2.28	0.43
Bottom 5		
JBS S.A.	1.31	(1.12)
MercadoLibre Inc.	3.12	(1.39)
Wuxi Biologics Cayman Inc.	3.56	(1.63)
Taiwan Semiconductor Manufacturing Co. Ltd.	4.48	(2.04)
Yandex N.V.	0.70	(4.34)

(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 indicating that emerging market equities are likely poised for a period of outperformance relative to the world's developed markets.

We continue to identify countries and regions that have better adapted to the pandemic and subsequent recovery. Emerging markets have weathered the recent weakness in global equities remarkably well. With inflation expectations moderating and peaking in some areas, the key question is whether tighter monetary conditions will result in a global recession. We expect any recession will be mild, so provided a significant global recession can be avoided, we believe emerging market equities are trading at very attractive valuations relative to historical levels and relative to developed markets. Accordingly, relative to developed markets, emerging market equities with impressive growth characteristics are now providing higher profitability, higher dividend yields, higher free cash flow yields, and return-on-equity profiles that have been improving since the end of 2020. Furthermore, earnings growth is also expected to recover in 2023. Sectors important in driving growth in emerging markets include non-traditional financial services, investment in technology and innovation, and a move up the value chain in manufacturing.

Inflationary pressures are moderating and global supply chains are being restored, but risks to our positive outlook for emerging markets include:

- Persistent inflation causes central banks in both emerging and developed markets to raise and/or maintain high rates and reduce liquidity to combat inflationary pressures:
  - Emerging markets are particularly sensitive to inflationary pressures.
  - Weaker demand could push commodity prices lower, benefiting commodity importers at the expense of commodity-exporting nations.
- 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 difficult to repay.
- A long, drawn-out conflict between Russia and Ukraine keeps commodity prices artificially high, which may impact consumer spending on a global basis.
- Chinese regulatory actions on Chinese companies:
  - Excessive oversight seems to have been relaxed, but further rules could be implemented now that the 20th National Congress of the Chinese Communist Party has concluded.
- Geopolitical tensions escalate:
  - Tensions between the U.S. and China
  - Tensions between China and Taiwan
  - Russia/Ukraine war

Portfolio Characteristics[2] (as of 12/31/2022)

10 Largest Holdings	Weight
HDFC Bank Ltd.	4.0%
Vista Energy S.A.B. de C.V.	3.8%
Wal-Mart de México S.A.B. de C.V.	3.6%
ICICI Bank Ltd.	3.6%
Infosys Ltd.	3.5%
ENN Energy Holdings Ltd.	3.4%
Taiwan Semiconductor Manufacturing	3.4%
ZTO Express Cayman Inc.	3.4%
MakeMyTrip Ltd.	3.3%
Wuxi Biologics Cayman Inc.	3.2%

Sector Allocation	Weight
Consumer Discretionary	16.0%
Consumer Staples	12.3%
Energy	5.7%
Financials	19.0%
Health Care	5.8%
Industrials	11.6%
Information Technology	11.6%
Materials	8.2%
Communication Services	5.1%
Utilities	3.4%
Cash	1.3%

10 Largest Countries	Weight
China	27.9%
India	20.0%
Brazil	13.0%
Mexico	12.7%
South Korea	5.3%
Hong Kong	5.0%
Taiwan	3.4%
Argentina	3.0%
South Africa	2.8%
Indonesia	2.0%

Performance Composite Returns[3] (For Periods Ending December 31, 2022)

	Since Inception**	10-year*	5-year*	3-year*	1-year	YTD	QTD
Emerging Markets *Pure Gross-of-Fees[4]*	3.5%	3.1%	(2.4%)	(2.1%)	(13.7%)	(13.7%)	11.1%
Max Net-of-Fees[5]	0.5%	0.0%	(5.3%)	(5.0%)	(16.2%)	(16.2%)	10.3%
MSCI Emerging Markets (Net)	2.8%	1.4%	(1.4%)	(2.7%)	(20.1%)	(20.1%)	9.7%

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.)

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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, 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.