Emerging Markets

International Equity Strategies

Confluence INVESTMENT MANAGEMENT

Fourth 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

The emerging markets saw their share of elections in 2024, with agenda items that were voted on this year to be implemented in 2025. While the elections went mostly as expected, the outcomes produced several surprises. In India, Narendra Modi's party lost their majority in Congress, while Claudia Sheinbaum's Morena party received a super majority in Mexico. In South Africa, a coalition government was established, replacing a 30-year African National Congress majority. These elections have introduced some uncertainty as to how the new policies will be perceived by their economies.

In the US, Donald Trump was reelected for a second term. The Republican majority captured control of both houses of Congress and a staunchly anti-establishment mandate. The markets are focused on the trade tariffs promised by Trump to level the playing field for trade across global economies. Trump has threatened to increase tariffs on all goods imported from Mexico and Canada by 25% and from China by 10% unless they take major steps to stop the fentanyl traffic into the US. The ramifications of these tariffs will have very meaningful impacts on these economies and many in the emerging markets and across the global economy will feel the effects. Long-term asset allocators are particularly well positioned to look through the back-and-forth debates on tariffs and capitalize on the investment opportunities that arise from global trade realignments.

It is hard to believe that Trump would potentially destroy the North American supply chain by levying large indiscriminate tariffs against Mexico and Canada as they would also be quite painful for the American economy. Countries whose economies rely heavily on exports to the US will be most impacted by any US tariffs. Mexico, Vietnam, Canada, Taiwan, Thailand, Malaysia, Hong Kong, and Singapore are the most vulnerable to a protectionist US. Moreover, tariffs alone will not close the US external imbalances. Rather, they will most likely lead to a short-term inflationary shock, which would impact growth in the US and countries affected by the tariffs. To truly close the trade deficit, the US must reduce aggregate demand by meaningfully reducing the large fiscal deficit.

Another factor influencing the strong move in emerging market equities during the quarter was an additional reduction in the fed funds rate of 50 bps, despite no change in inflationary pressures and a rather strong job market. These recent cuts have forced longer-term interest rates and the US dollar (USD) higher as the market fears less rate cuts from the Fed in the future, with inflation and interest rates remaining higher for longer.

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 strengthening USD is historically consistent with lower emerging market equity prices. During the fourth quarter, the USD strengthened by 7.6%, crashing emerging market equity returns. Over the past year, the USD rose 5.9% which had a negative impact on emerging market equity prices. The stronger USD provides additional headwinds to emerging market firms that issue debt denominated in USD since their debt-servicing costs increase as the greenback strengthens. What stands out about the current period of USD strength is that the two previous extended periods of USD strength since 1970 lasted an average of 6.5 years. The current stretch of USD strength has lasted about 14 years. Therefore, many investors have not experienced an environment where the dollar is weak, although these conditions may be changing. The Confluence macroeconomic team still feels that the USD will be under pressure longer term; however, its strength may be stickier than initially anticipated.

Over the past three years, emerging market equities have lagged the 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 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...

Emerging market equities remain one of the most mispriced asset classes, in our opinion, with valuations reaching historically attractive levels. As of December 31, 2024, the MSCI Emerging Markets Index was trading at a forward P/E of 11.9x versus 13.8x for the MSCI EAFE Index 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, high free cash flow yield, and a dividend yield near a 20% premium relative to historical figures and double that of the US (2.6% for MSCI Emerging Markets versus 1.3% for MSCI USA). 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 the emerging markets relative to developed as growth forecasts for 2024 are 3.9% in emerging economies compared to the 1.5% 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 and 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. Expectations of higher economic growth and accelerating corporate earnings should also support prices.

Quarterly Trade Summary

While there were no portfolio changes completed in the Emerging Markets strategy during the fourth quarter, we did have the sale and restructure of one holding that had been halted for trading, Yandex (YNDX), now Nebius Group N.V. (NBIS).

Following Russia's invasion of Ukraine, US regulators, along with the New York Stock Exchange and NASDAQ, made the collective decision in February 2022 to issue a trading halt for all Russian stocks trading on US exchanges. While the halt was initially proposed as temporary, trading in Russian equities has yet to resume. The sudden decision to ban the trading of Russian stocks created a challenging situation where investors were forced to hold equities that could not be traded. This regulatory action ensnared Yandex (YNDX), the longest-tenured holding within the Confluence Emerging Markets portfolio when the trading restrictions went into place.

Yandex (also known as the "Google of Russia") is Russia's preeminent technology company and operates various businesses that include internet search, ride-share, and a fast-growing e-commerce platform. Since Q1 2022, we at Confluence met regularly to discuss updates relating to Yandex. The situation remained status-quo until earlier this year when members of Yandex management and various Russian authorities agreed to a two-stage sale process that separated the Russian assets Yandex owned from the remaining company-owned assets based outside of Russia, which was finalized in July 2024.

Following the successful sale, the assets held outside of Russia were formed into a new entity called Nebius Group. As of the July close, it has been communicated that Nebius operates free from any Russian control and has zero sales within Russia. This important development has allowed Nebius to work with domestic US regulators to lift the ban on the trading of its shares. In October, Nebius was permitted to resume trading on the NASDAQ.

Nebius Group operates as a Netherlands-based AI infrastructure company that generates the majority of its sales from the US market as well as Europe ex-Russia. The founder of Yandex serves as the CEO of Nebius, with his longtime business partner assuming the role of chairman of the company. Today, Nebius operates four businesses and maintains a minority equity stake in a private company called ClickHouse. The principal business that Nebius operates includes a primary data center in Finland, one of Europe's most powerful commercially available supercomputers, and plans to build out a network of data centers (primarily in Europe) designed to meet the needs of AI developers.

The investment team made the decision to hold the shares of Nebius and establish a position in our Emerging Markets portfolio as we continue to evaluate the company, even as we recognize that the country of domicile (Netherlands) is outside the universe for this strategy. Based on forecasts provided by management, we assess that the company is currently undervalued versus our internal price estimates and that it offers differentiated exposure to an area of technology not previously held in the strategy.

Performance Review

During the fourth quarter of 2024, the MSCI Emerging Markets Index was down 8.0% in USD terms, slightly outperforming the returns of developed international markets (MSCI EAFE, -8.1%) and well behind the US market (S&P 500, +2.4%) over the same period. By comparison, the Confluence Emerging Markets strategy was down only 2.5% for the quarter for a full-year gain of 5.6% (both gross of fees) versus 7.5% for the benchmark in 2024. [*The strategy's net-of-fees returns for the same periods were -3.2% QTD and +2.5% YTD. See disclosures on last page for fee description; actual investment advisory fees may vary.*]

Performance Review continued...

Among the regions, EMEA performed best, falling by 4.0% as markets in Eastern Europe, the Middle East and North Africa performed relatively well. MSCI Asia performed in line with the benchmark, with South Korea (-19.2%) and India (-11.3%) the noticeable laggards. China (-7.7%) marginally outperformed the benchmark. EM Latin America was the laggard, dragged down primarily by poor performance in Brazil (-19.4%) and Mexico (-10.6%).

Despite a very slow start, Chinese equities finished the year up 19.4%. Due to a series of geopolitical issues, we remain 12.8 percentage points underweight China, which created a significant performance headwind in 2024.

The MSCI Emerging Markets Growth Index outperformed the MSCI Emerging Markets Value Index (-6.9% versus -9.2%) during the quarter. On a one-year trailing basis (as of December 31), the MSCI Emerging Markets Growth is 5.8% ahead of the Value index (10.3% versus 4.5%). However, in similar fashion to international developed markets, the value component of the emerging markets index outperformed growth (0.2% versus -3.9%) on a three-year trailing basis.

Quality stocks, as measured by the MSCI Emerging Markets Quality Index (-7.3%), outperformed the broad MSCI Emerging Markets Index (-8.0%) and the MSCI Emerging Markets Value Index (-9.2%), while underperforming the Emerging Markets Growth Index (-6.9%) during the past three-month measurement period. The Emerging Markets Quality Index has now underperformed the MSCI Emerging Markets Index by over 560 bps on a year-to-date basis, accounting for a significant performance headwind for our strategy.

In the fourth quarter, the two best-performing countries within our portfolio, on an absolute basis, were the Netherlands (the aforementioned former Russian holding restructured into NBIS) and Taiwan, while South Korea and Argentina recorded the worst returns. From a sector standpoint, Information Technology and Communication Services were the strongest sectors during the quarter, while Health Care was the weakest.

From a relative standpoint, the most accretive country allocation was the overweight to India, followed by the underweight to China. An overweight allocation to Argentina detracted the most from performance, while an overweight positioning to Hong Kong also proved unfavorable. From a sector perspective, our underweight allocations to Communication Services and Financials added the most alpha during the quarter, whereas our overweight positioning to the Consumer Staples sector coupled with our underweight allocation to Health Care contributed negatively to returns.

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

Security	Avg Weight (%)	Contribution (%)
Top 5		
MakeMyTrip Ltd.	5.74	5.30
Taiwan Semiconductor Manufacturing	5.53	3.65
Vista Energy S.A.B. de C.V.	5.17	3.00
Nebius Group N.V.	0.33	1.97
Tencent Holdings Ltd.	3.15	1.15
Bottom 5		
POSCO Holdings Inc.	1.27	(0.96)
Arcos Dorados Holdings Inc.	1.69	(0.96)
Vale S.A.	1.73	(0.96)
Betterware de México S.A.P.I. de C.V.	1.38	(0.98)
Wal-Mart de México S.A.B. de C.V.	3.18	(1.41)

(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 2025 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 the developed markets.

The positive effects of post-pandemic structural reforms and fiscal discipline have been evident in the last two years of economic data, with emerging market GDP growth consistently surprising to the upside. Economic fundamentals improved alongside credit metrics in downgrades this year, a trend expected to continue into 2025. Countries that neglected fiscal discipline and approved detrimental reforms, such as Brazil and Mexico, have struggled.

What We Are Watching continued...

Our lens that surveils global trade will need to be further divided should the Trump administration implement a global tariff regime. However, no country is more at risk of the application of new trade rules and tariffs than China. While our Emerging Markets portfolio is underweight Chinese holdings, the health, or lack thereof, of the Chinese economy has international ramifications. President Xi's government has recently made multiple proclamations aimed at shoring up the local economy, including the vast distortions in real estate, debt, and the reignition of confidence in consumer spending. While investors initially cheered these announcements, the air has leaked from the proverbial balloon, with markets once more turning lower partially because of the limited details provided for these new plans. Adding substantive new tariffs to Chinese exports that are directed to the US could further complicate the ability of China's central planning to recover domestic growth and consumption.

As of now, there have been "fits and starts" in terms of generating sustained improvement in China's economic health. Services PMI has strengthened, while manufacturing PMI has softened. Domestic car sales remain buoyant, though imports have dropped for two consecutive months. Even within the Chinese housing market, where more concrete measures have been put in place to improve conditions — including tax incentives, smaller down payment requirements, and mortgage rate relief — the National Bureau of Statistics of China reports that housing prices have now declined for 17 straight months. The takeaway is that sustained improvements within the Chinese economy remain tenuous, at best. However, as the world's second-largest economy, and a sizeable trading partner with Europe and throughout Asia, any material or lasting change to Chinese economic health will be measurable, even in the world's developed markets.

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, during the past few months, inflationary pressures have largely subsided, at least in the world's developed markets, allowing central banks to ease rates. And much of the movement occurred this past quarter. The US Federal Reserve lowered rates by 100 bps. The European Central Bank lowered rates by 110 bps in 2024, while the Bank of Canada cut rates five times for a total reduction of 175 bps. The Bank of England only had two 25 bps rate reductions in 2024, leaving policy rates relatively high at 4.75%. Emerging market central banks are cutting rates as inflationary pressures within their economies continue to abate. However, on the other side of the coin, the Bank of Japan proceeded with two rate hikes in 2024. 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.

The war between Russia and Ukraine continues to rage. President Donald Trump has promised to help negotiate a peace deal between Vladimir Putin and Ukrainian President Zelensky. Confluence's macroeconomic team has also highlighted the elevated tensions brewing in the South China Sea. We have previously discussed the potential for China to take military action against Taiwan, and now pressure is building in a territorial dispute between China and the Philippines. 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. Our international equities investment team is diligently monitoring each of these theaters to manage our strategies accordingly.

Portfolio Characteristics[2] (as of 12/31/2024)

10 Largest Holdings	Weight
MakeMyTrip Ltd.	7.0%
Taiwan Semiconductor Manufacturing	6.3%
Vista Energy S.A.B. de C.V.	6.3%
MercadoLibre Inc.	4.5%
KB Financial Group Inc.	3.6%
ICICI Bank Ltd.	3.5%
Dr Reddy's Laboratories Ltd.	3.1%
Tencent Holdings Ltd.	3.0%
Gold Fields Ltd.	2.9%
Infosys Ltd.	2.6%

Sector Allocation	Weight
Consumer Discretionary	22.8%
Consumer Staples	9.0%
Energy	7.6%
Financials	19.3%
Health Care	3.1%
Industrials	8.5%
Information Technology	8.9%
Materials	5.1%
Communication Services	6.2%
Cash	9.5%

10 Largest Countries	Weight
India	20.2%
Mexico	18.5%
China	15.0%
South Korea	7.0%
Taiwan	6.3%
Brazil	5.5%
Argentina	4.5%
Hong Kong	4.1%
South Africa	2.9%
Netherlands	1.9%

Performance Composite Returns[3] (For Periods Ending December 31, 2024)

	Since Inception**	10-year*	5-year*	3-year*	1-year	YTD	QTD
Emerging Markets *Pure Gross-of-Fees*[4]	4.4%	4.2%	2.8%	1.8%	5.6%	5.6%	(2.5%)
Max Net-of-Fees[5]	1.3%	1.1%	(0.3%)	(1.3%)	2.5%	2.5%	(3.2%)
MSCI Emerging Markets (Net)	3.5%	3.6%	1.7%	(1.9%)	7.5%	7.5%	(8.0%)

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%
2023	15.7%	12.2%	9.8%	5.8%	6	$5,807	$7,200,019	18.5%	17.1%	1.9%
2024	5.6%	2.5%	7.5%	(1.9%)	7	$6,051	$7,280,773	17.4%	17.5%	0.9%

*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)*

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See Territory Map on the Confluence website for sales coverage.

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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.