Confluence INVESTMENT MANAGEMENT

SECOND QUARTER 2020

Emerging Markets • International Equity Strategies

Confluence Emerging Markets invests in large cap, growth-oriented companies in the more mature emerging markets around the world. The strategy's management team employs both top-down and bottom-up fundamental analysis to identify attractive emerging market 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 & Strategy Commentary

Emerging market equities tallied their best quarterly performance in nearly 11 years during the second quarter of 2020. The impressive returns were driven by better than expected economic indicators, widespread financial and monetary stimulus, a rollback of pandemic-induced lockdowns, and optimism around potential COVID-19 treatments. Many developments outweighed fears of a second wave of outbreaks and renewed geopolitical tensions. The second quarter recovery erased a significant portion of the record first quarter losses, when the MSCI Emerging Markets Index fell by 24%. Stabilization of oil prices, a rise in energy demand, and increasing expectations of a global recovery further contributed to emerging market strength. Regional emerging market returns were strong despite some differences in how the pandemic affected the markets. A weaker U.S. dollar also helped propel emerging market equity returns ahead of those in the developed international markets for the quarter.

Economic activity in China recovered sharply during the second quarter following a massive lockdown that collapsed growth during the first quarter. Chinese equity markets have broadly retraced the COVID-19 losses and turned modestly positive on a year-to-date basis. Recent macro data confirms the economy continues to recover, and manufacturing activity has nearly returned to pre-pandemic levels. Consumer spending is accelerating, and domestic demand is rekindling within the infrastructure, real estate, and auto sectors. Exports are rising and supply chains are being reestablished as the world returns to work. In May, the National Party Congress announced additional stimulus in the form of sizable fiscal spending, which should provide positive catalysts for domestic recovery. Although China appears to have sustained a nearly full recovery, a second wave of infections and geopolitical tensions remain key risks. The government did not set an explicit growth target for China's economy in 2020 due to the high level of global uncertainty around the pandemic.

Other emerging economies are at various stages of recovery, reflecting the uneven impact caused by the pandemic and various governments' attempts to contain and treat the virus and support their local economies. Asia, Taiwan, and South Korea fared relatively well because they were able to limit the spread of the virus and its adverse effects. Technology companies in these countries remained relatively buoyant and continued to perform well in the first half of 2020. In Latin America, the global rebound continued as social distancing measures were relaxed. Aggressive monetary easing drove sentiment in Brazil as the central bank cut the Selic rate (the interest rate used by the Central Bank of Brazil to implement monetary policy) by 150 basis points to a record low of 2.25%. In Mexico, weak macroeconomic data and a sovereign credit downgrade overshadowed the central bank's monetary easing efforts. Russia had a solid quarter driven by strong appreciation in the ruble, higher oil prices, and easing quarantine measures. Other economies did not fare as well. Nations continue to struggle with containing the spread of the virus and finding treatment, in addition to the ramifications of the global shutdown. While global recovery efforts intensify, supply chain disruptions continue to impact some economies.

As geopolitical tensions remained in focus and the uncertain economic environment continued due to the deteriorating COVID-19 situation, gold prices rose to decade highs. Further, global interest rates have been pushed toward zero (and below) in many countries, minimizing the opportunity cost for holding the hard asset. Gold remains a significant hedge against global uncertainty and potential inflation.

The consequences of the pandemic were especially difficult for several emerging markets, causing economic activity to come to a standstill. Reasons ranged from overcrowded cities and inadequate health care systems to arrogant leaders' refusals to acknowledge the ramifications of the virus. Especially noteworthy is Brazil, where President Bolsonaro downplayed the virus and accused the media of causing hysteria—his "economy first" plan was dubbed "deny and defy." Coronavirus-related deaths in Brazil are second only to the U.S. and this number is expected to surpass the U.S. total if the political rhetoric continues. Ironically, Brazil is one of the few developing nations with the capacity to deal with COVID-19 in terms of health care and social policies as it has built one of the largest universal health care systems in the world.

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Market & Strategy Commentary continued...

The broad sell-off within emerging market equities during the opening months of the year provided opportunities to add high-quality, growth-oriented emerging market stocks at attractive valuations. We have found opportunities in economies best suited to handle the pandemic and reduced exposure to countries that we felt were less equipped to handle these dislocations. For example, China's recovery seems to have restored much of the pre-COVID-19 economic activity. One advantage of this recent upheaval in the emerging market equity markets is that high-quality growth stocks are trading at sharp discounts to their U.S. counterparts. This is demonstrated by the Price/Earnings ratio (P/E) of the MSCI Emerging Markets Index at 16x vs. 24x for the MSCI USA Index as of June 30, 2020.

Quarterly Trading Summary

We made several changes to the portfolio during the second quarter. In early April, we reduced our overweight position in Brazil as the country endured the effects of the coronavirus and President Bolsonaro showed he was ill-prepared to handle the outbreak. We sold our two Brazilian banks, Banco Itau and Banco Bradesco, as the Selic rate, already at record lows, was expected to be reduced again to help stave-off economic weakness. This action would further flatten the yield curve, making it very difficult for banks to make a profit. Additionally, the economic slowdown increased delinquencies of current loans and reduced demand for new loans. It appears bank profitability will be impaired for the foreseeable future. We also sold Brazilian Oil Company Petrobras. As a high-cost producer of oil, Petrobras is expected to suffer from low oil prices more than its peers. The proceeds of these sales were used to increase our Health Care exposure in China and India. Health care spending should increase in emerging markets as rising middle-class incomes demand a higher level of care.

WuXi Biologics, a Chinese biopharma contract development and manufacturing organization (CDMO), was increased to a full position. Biopharma is the future of the pharmaceutical industry despite its complexity in the drug development and manufacturing process, and WuXi ranks first in China and fifth globally in biologics CDMO. The company is well-positioned since the demand for biological drugs is growing much faster in China than in the global market. We also increased our position in Dr. Reddy's Laboratories, an Indian-based generic drug manufacturer. While North America remains its largest market, its growth in the emerging markets is accelerating.

Ping An Insurance Group was added to the portfolio in mid-May. The recovery in China was impressive, and thus we decided to increase the country's weighting in the portfolio following our underweight in the first quarter. Insurance products in China have been gaining in popularity, a result of rising incomes and the lack of a strong social safety net. Ping An offered good risk/reward dynamics, and provided an opportunity to add financial exposure while avoiding Chinese banks, which carry more uncertainty due to strong government influence and China's shadow banking industry.

Also in mid-May, we reviewed the Materials positions in the portfolio, considering the macro environment. We decided to sell our half-position in Sociedad Quimica & Minera de Chile as lithium and fertilizer prices have stalled despite increasing demand. Proceeds from the sale were used to increase the position in Norilsk Nickel, the world's largest nickel producer, which we felt had better upside. Nickel prices, along with demand for electric vehicles and stainless steel, are expected to increase as the Chinese economy continues to rebound.

Following a long period of stagnant gold prices, the zero-interest rate environment combined with very aggressive monetary policy and heightened geopolitical risk created the perfect opportunity for gold appreciation. As a hedge against uncertainty and possible inflation, we added Gold Fields Ltd. to the portfolio as the company offered the best upside among emerging market mining opportunities. Gold rallied throughout the quarter despite increasing market uncertainty.

Finally, in June, we added GDS Holdings, a Chinese data center developer and operator. GDS is the largest third-party, carrier-neutral high-performance data center operator in China. Globally, the overall data center growth pipeline remains strong with the proliferation of cloud computing, the Internet of Things, and 5G technologies. Specifically, the abundance of mobile devices in China along with the boom in e-commerce, social media, and video streaming applications should continue to fuel the demand for data centers. The move toward digitization of businesses, AI and deep learning, virtual reality, and autonomous driving all require tremendous data storage needs, and as such the value of the internet data center market in China is expected to double from current levels by 2022.

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Performance Review

During the second quarter, Confluence Emerging Markets recorded a return of 21.4% (gross of fees) compared to 18.1% for the MSCI Emerging Markets Index. On a year-to-date basis, the return for Emerging Markets was -7.5% (gross of fees) versus -9.8% for the benchmark. *(Net-of-fees returns for the same periods were +20.5% and -8.9%, respectively. See disclosures on p.4 for fee description; actual investment advisory fees may vary.)*

The two best-performing countries within the portfolio on an absolute basis were Argentina (+99.3%) and Brazil (+42.2%), whereas the weakest returns were recorded by Peru (-0.5%) and Hong Kong (+5.1%). Information Technology (42.8%) and Health Care (36.8%) were the strongest sectors during the quarter, while Consumer Staples (+3.0%) and Energy (+5.5%) were the worst-performing sectors.

The top-performing and worst-performing positions during the quarter were as follows:

Security	Avg Weight	Contribution
Top 5		
MercadoLibre, Inc.	3.50	2.80
ZTO Express (Cayman) Inc.	5.60	2.06
Yandex N.V.	3.68	1.59
Tencent Holdings Ltd.	4.72	1.42
PagSeguro Digital Ltd.	2.09	1.35
Bottom 5		
Sociedad Quimica y Minera de Chile S.A.	0.70	(0.12)
Banco Bradesco S.A.	0.03	(0.13)
Itau Unibanco Holding S.A.	0.03	(0.15)
China Mobile Limited	1.91	(0.20)
China Petroleum & Chemical Corporation	2.59	(0.23)

(Contribution data shown from a sample account)

What We Are Watching

Two conditions must be met to support economic growth in emerging markets: a weak U.S. dollar and the resumption of global trade.

The U.S. dollar (USD) has a significant impact on non-U.S. equities, and emerging market currencies were generally strong against the USD. Why is this important? Dating back to 1970, the year the MSCI EAFE Index was created, examining the U.S. Dollar Index (DXY), there have been three extended periods of USD strength and three extended periods of weakness. The three stretches of USD weakness have averaged 90 months in length, while the strong dollar averages a term of 104 months. Each of the three occurrences of dollar weakness has seen both developed market equities (outside of the U.S.) and emerging market stocks outperform versus the domestic indices. Likewise, when the USD is strong, the U.S. market outperforms, as seen by the current cycle of dollar strength, which began in 2008. However, as Confluence Chief Market Strategist Bill O'Grady has recently emphasized, the pre-conditions for a period of extended USD weakness are in place, and we are awaiting an event-driven catalyst to begin the long grind lower for the greenback. Bill's recent Weekly Geopolitical Report, **"The Geopolitics of the Eurobond" (6/29/2020)**, outlines how this process can unfold and identifies the type of event that could serve as a catalyst.

Global economic activity is accelerating. Aggressive monetary and fiscal policy measures, combined with relaxed social distancing directives, are allowing economies to reopen. Countries are returning to work and supply lines are resuming. Provided global supply chains are not severely compromised, emerging market growth should reaccelerate. The latest forecasts from the IMF and World Bank anticipate emerging market growth to be nearly two times the growth of the world's developed markets over the next several years. Nevertheless, uncertainty around the timeline for recovery and the pandemic's ultimate costs have created a set of risks for investors to consider. On the other hand, the COVID-19 pandemic has highlighted some of the best investment opportunities within the emerging markets, which include innovations in e-commerce, e-learning, financial services, and health care consumption.

Our focus on owning high-quality companies seeks to minimize the impact of adverse events on the long-term sustainability of our equity holdings. We believe that the positive demographic trends in conjunction with rising wealth within emerging markets will continue to create favorable long-term investment opportunities for this asset class.

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(as of 6/30/20)

10 Largest Holdings	Weight
Tencent Holdings Ltd.	5.2%
ZTO Express Cayman Inc.	4.9%
Alibaba Group Holding Ltd.	4.8%
Yandex N.V.	4.2%
Vipshop Holdings Ltd.	3.8%
MercadoLibre, Inc.	3.4%
Huazhu Group Ltd.	3.4%
PagSeguro Digital Ltd.	3.0%
ENN Energy Holdings Ltd.	2.8%
GDS Holdings Ltd.	2.8%

Sector Allocation	Weight
Consumer Discretionary	22.4%
Communication Services	15.5%
Financials	13.7%
Information Technology	10.7%
Industrials	8.9%
Consumer Staples	6.3%
Energy	6.1%
Materials	6.1%
Health Care	5.2%
Utilities	2.8%
Cash	2.1%

10 Largest Countries	Weight
China	45.8%
India	9.4%
Brazil	6.9%
Russia	6.4%
Mexico	6.4%
Hong Kong	5.7%
South Africa	3.6%
Argentina	3.4%
South Korea	3.4%
Taiwan	2.7%

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. Contact Confluence for a complete list of holdings.

All investments carry a certain degree of risk, including possible loss of principal. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager. Equity securities are subject to market risk and may decline in value due to adverse company, industry or general economic conditions.

Performance Composite Returns For Periods Ending 6/30/20

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	MSCI EM
Since Inception**	4.2%	1.1%	3.2%
10-Year*	4.5%	1.4%	3.3%
5-Year*	1.9%	(1.1%)	2.9%
3-Year*	0.7%	(2.2%)	1.9%
1-Year	(3.9%)	(6.8%)	(3.4%)
YTD	(7.5%)	(8.9%)	(9.8%)
QTD	21.4%	20.5%	18.1%

Calendar Year	Pure Gross-of-Fees[1]	Net-of-Fees[2]	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%

**Average annualized returns*

***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. An index is unmanaged and does not incur management fees, transaction costs or other expenses associated with separately managed accounts. It is not possible to invest directly in the index.)

Confluence claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Confluence has been independently verified for the periods of 8/1/2008 through 12/31/2018. A copy of the verification report is available upon request. Verification assesses whether: 1. the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis, and 2. the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

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.

[1] Pure gross returns are shown as supplemental information to the disclosures required by the GIPS ® standards.

[2] 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 is as follows: 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. Additional information regarding policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. 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. Beginning with year-end 2018, an equal-weighted standard deviation calculated for accounts in the composite for the entire year. 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.

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. *Material is published solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or investment product. Holdings identified do not represent all of the securities purchased, sold or recommended. Sector and country allocations along with securities mentioned represent a portion currently or previously held in a representative (model) portfolio invested in accordance with the stated investment strategy. Information is presented as supplemental information to the disclosures required by GIPS® standards. Opinions and estimates are as of a certain date and subject to change without notice. Investment or investment services mentioned may not be suitable to an investor and the investor should seek advice from an investment professional, if applicable. Past performance is no guarantee of future results. Investing in securities involves the risk of loss of the amount invested that investors should be prepared to bear. 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.*