Confluence Investment Management

Second Quarter
2021

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.

Mid-Year Market Update

Emerging market equities registered strong returns during the second quarter of 2021, despite a sell-off in May, as higher-than-expected U.S. inflation renewed concerns over the timing of global monetary policy actions. Optimism in emerging market equities was high as vaccine rollouts gained traction globally, massive economic re-openings were initiated in many of the world's developed markets, and global growth estimates were revised significantly higher. Economic expansion continues to be driven by copious amounts of monetary and fiscal accommodation, especially in the world's developed markets. However, some of the optimism has given way to disappointing pandemic events surrounding the emergence of the highly contagious delta mutation.

The pace of the recovery varied widely across the emerging market universe. Although vaccinations are trending up, the rollout in the first half of the year was slower than expected. China, South Korea, and Taiwan all responded quickly to control the initial outbreak, and their economies reopened for several quarters. Recently, India has endured several waves of outbreaks, significantly taxing its healthcare system. Latin America (LatAm) continues to suffer additional waves and lockdowns as vaccine distribution has not materialized as hoped. Relatively little vaccine manufacturing capacity exists in emerging market countries, contributing to the low vaccination penetration. COVAX, a global initiative led by the World Health Organization, and the GAVI Alliance have committed to distributing vaccine doses equitably to developed and developing countries. As vaccination rates accelerate in H2 2021, GDP growth forecasts in emerging markets will be revised upward.

Rising commodity prices due to strong global demand are also a factor in recent emerging market performance and benefit commodity-exporting economies. Raw material companies benefit from firmer commodity prices, and they reduce fiscal and current account deficits. As economies rebound, the focus will shift to large infrastructure programs and focus on environmental sustainability and higher CapEx spending, especially in the world's developed economies. Forecasts for spending are expected to be higher year-over-year worldwide. Global technology firms are leading the capital spending initiatives. Apple, Taiwan Semiconductor Manufacturing, Intel, and Samsung Electronics have announced plans to spend hundreds of billions of dollars to expand manufacturing capacity globally over the next several years. Governments in the U.S. and the U.K. have announced large-scale infrastructure projects, which should be major catalysts for economic growth, benefiting both developed and emerging markets. These ventures could meaningfully increase the demand for raw materials and boost commodity-exporting emerging market countries. Pent-up demand, plentiful government stimulus, and renewed CapEx all support a sustainable period of high global growth.

Inflationary pressures have returned to the global economy. Rising inflation in the emerging markets is driven by pandemic-related uncertainty, supply bottlenecks/logistical issues, and higher energy prices. Producer prices are sharply higher, but the pass-through to consumer inflation is uneven. Several emerging market central banks have had to reverse dovish policies put in place during the pandemic, and interest rates are being edged higher to offset the inflationary pressures. For example, Brazil has increased the Selic rate three times (75 bps) during the second quarter. Russia has had to raise interest rates twice in the past few months to address its highest level of inflation in five years. Hungary was the first European country to raise rates, its first increase in 10 years, and the Mexican central bank also raised rates in June.

Generally, inflation is a major problem for emerging market economies. However, this rise in inflation is a signal of strong economic growth, which is positive for equity prices. In addition, the earnings outlook is strong. Some inflation can be tolerated, but if it rises to a level where global growth is adversely affected, emerging markets may suffer. The best scenario is one in which there is strong economic growth and inflation gradually rises but fails to reach levels that would curtail growth. The Confluence macroeconomic team feels the inflationary pressures will prove to be transitory and will fade as the global reopening comes full circle and global supply chains are re-established.

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Quarterly Trading Summary

In late April, we sold Norilsk Nickel (NILSY), Russia's leading metals and mining company. The decision followed a series of operational mishaps and political concerns surrounding the company's long-time CEO Vladimir Potanin, a billionaire and Russian oligarch. In June of last year, a massive diesel fuel spill at an arctic power station resulted in a $2 billion fine for environmental damages and a criminal investigation. More recently, in February 2021, the company halted operations at two Siberian mines due to flooding. These two mines account for 36% of the ore mined in Russia by Norilsk, and output forecasts were reduced by at least 15%-20% with no clear restart date.

The proceeds of the sale were used to purchase Vale S.A., a Brazilian mining conglomerate. The company, together with its subsidiaries, produces and sells iron ore and iron ore pellets for use as raw materials in steelmaking in Brazil and internationally. Vale operates through Ferrous Minerals, Base Metals, and Coal segments. The Ferrous Minerals segment produces and extracts iron ore and pellets, manganese, ferroalloys, and other ferrous products and provides related logistics services. The Base Metals segment produces and extracts nickel and its by-products, such as copper, gold, silver, cobalt, precious metals, and others. The Coal segment is involved in the extraction of metallurgical and thermal coal, and it also provides related logistic services. The company is also the largest producer of nickel, which is an important component of electric vehicle battery technology. Vale will benefit from increased corporate CapEx spending and a weakening U.S. dollar (USD). The addition of Vale to the portfolio increased our overweight position in Brazil and helped close the large underweight to Materials.

Performance Review

The second quarter performance of the MSCI Emerging Markets Index was 5.0% in USD terms, underperforming the return of developed international markets (MSCI EAFE, +5.2%) and the U.S. markets (S&P 500, +8.5%). On a year-over-year basis, the MSCI Emerging Markets Index is up 40.9%, exceeding the performance of the MSCI Developed International Markets (MSCI EAFE), which rose 32.4%. LatAm was the best-performing region during the quarter, driven by strong performance in Brazil, followed by Europe, the Middle East, and Africa (EMEA), and Asia. From a sector perspective, Health Care, Industrials, and Energy recorded double-digit returns. The Materials sector also outperformed the benchmark, while Real Estate, both Consumer sectors, Communication Services, and Information Technology lagged for the quarter. As vaccinations trend higher and global capital expenditures begin to restart in a meaningful way, we expect a strong recovery in emerging market economies during the second half of 2021.

During the second quarter, the Confluence Emerging Markets strategy posted a return of 4.3% (gross of fees). Year-over-year, Confluence Emerging Markets was up 41.9% (gross of fees) versus 40.9% for the benchmark. [*Net-of-fees returns for the same periods were +3.5% QTD and +37.7% year-over-year. See disclosures on p.4 for fee description; actual investment advisory fees may vary.*]

The two best-performing countries within our portfolio on an absolute basis were Chile (+26.1%) and Colombia (+14.8%), and the worst returns were recorded by Peru (-11.3%) and South Africa (-8.4%). Health Care (+35.7%) and Consumer Staples (+18.7%) were the strongest sectors during the quarter, while Consumer Discretionary (-7.1%) and Communication Services (-3.8%) were the weakest.

The top contributors and detractors during the quarter:

Security	Avg Weight (%)	Contribution (%)
Top 5		
WuXi Biologics (Cayman) Inc.	4.82	1.89
Companhia Brasileira de Distribuição	1.69	0.59
ENN Energy Holdings Limited	3.66	0.58
PagSeguro Digital Ltd.	2.52	0.51
Vale S.A.	2.15	0.46
Bottom 5		
Melco Resorts & Entertainment Ltd.	1.53	(0.29)
Ping An Insurance (Group) Company of China, Ltd.	1.76	(0.33)
China Southern Airlines Company Ltd.	2.37	(0.39)
Tencent Music Entertainment Group	1.86	(0.57)
Vipshop Holdings Limited	3.42	(1.36)

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

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What We Are Watching

The outlook is improving for the world's developing economies. This premise is based on several factors, including increased availability and broad distribution of effective vaccines to fight COVID-19; interest rates remaining relatively low; and copious amounts of monetary and fiscal policy combined with increasing levels of capital spending. These factors provide an ideal growth backdrop for emerging markets.

As vaccine distribution improves within emerging markets, the restoration of damaged supply chains that have created bottlenecks within the broader global economy should follow. This upturn should also help lessen global inflation fears as supply is increased to meet the post-pandemic surge in demand.

However, we expect results and outcomes to vary by country. LatAm and Africa will continue to be challenged by vaccine acquisition/distribution issues. The Asian emerging market economies have reopened, and economic activity is returning to near pre-pandemic levels.

The USD has strengthened slightly during the second quarter, which is reflected in the weaker performance of international and emerging market returns relative to the U.S. We expect this dollar strength to reverse and reestablish the weakening trend, and the macroeconomic environment supports this thesis moving forward. History suggests these trends tend to last for 7-10 years, and we believe the recent pattern of USD weakness (despite the H1 2021 rally) has just begun. It is important to remember that emerging market equities have tended to outperform developed international equities and U.S. equities during periods of dollar weakness.

We continue to identify countries and regions that have better adapted to the pandemic and implemented fiscal and monetary policies effective in minimizing the negative consequences, preparing their economies for a rebound. Vaccine distribution and availability were not as robust as other parts of the world, so some emerging market economies are seeing subsequent waves of rising infections and hospitalizations. Global supply chains are being restored in most emerging market economies, but bottlenecks persist. We continue to explore the emerging market-based Information Technology companies that have developed innovative systems and products, keeping them in competitive positions. The pandemic "pulled forward" the adoption of several trends, and people will likely not revert to their former operating environments. These new technologies will provide greater efficiencies, higher satisfaction, lower costs, and improved quality of life.

These factors combined with an expected weaker USD bode well for emerging market equities. Top-down macro factors, bottom-up fundamentals, and favorable valuations are all now aligned and support the case for strong equity returns across the world's emerging markets.

Risks to the positive outlook include:

- Slowdown in global economic activity caused by COVID-related outbreaks/lockdowns:
  - Persistent problems associated with the delta variant
  - Further disruptions in global supply chains
- Excessive bottlenecks in vaccine acquisition/distribution:
  - Achieving herd immunity may not be realistic until sometime in 2022
- Declining fiscal stimulus on a global scale:
  - Massive spending initiatives still must be approved by regulators who fear diminishing returns on investment and/or taxpayer backlash
- Excessive inflation causes emerging market central banks to sharply raise rates to combat inflationary pressures:
  - The Confluence macroeconomic team recently addressed this issue in an ***Asset Allocation Weekly*** report, published June 18, 2021
- Escalation in tensions with China:
  - Chinese regulatory actions on Chinese companies
  - Tensions between China and Taiwan:
    - The Confluence macro team also recently published a two-part *Weekly Geopolitical Report* entitled "Taiwan and the Risk of Deglobalizing the World's Semiconductor Industry" (**Part I**, **Part II**) that details the possibility of important changes on the horizon.

A link to these macroeconomic reports, as well as a multitude of other research from Confluence Investment Management, can be found on our **website**.

About Confluence Investment Management LLC
Confluence Investment Management is an independent Registered Investment Advisor located in St. Louis, Missouri, that provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates evaluation of market cycles, macroeconomics and geopolitical analysis with the firm's value-driven, company-specific approach. The portfolio management philosophy begins by assessing risk and follows through by positioning clients to achieve their income and growth objectives.

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(as of 6/30/21)

10 Largest Holdings	Weight
WuXi Biologics (Cayman) Inc.	5.6%
Yandex N.V.	4.2%
Taiwan Semiconductor Manufacturing	4.1%
MercadoLibre, Inc.	3.9%
Tencent Holdings Ltd.	3.8%
Huazhu Group Ltd.	3.7%
Alibaba Group Holding Ltd.	3.6%
PagSeguro Digital Ltd.	3.4%
ENN Energy Holdings Limited	3.3%
HDFC Bank Limited	3.0%

Sector Allocation	Weight
Consumer Discretionary	20.1%
Information Technology	14.6%
Financials	14.3%
Communication Services	12.4%
Health Care	8.2%
Consumer Staples	8.0%
Industrials	7.4%
Materials	6.7%
Energy	3.6%
Utilities	3.3%
Cash	1.4%

10 Largest Countries	Weight
China	39.5%
India	13.4%
Brazil	12.4%
Mexico	7.0%
South Korea	4.7%
Russia	4.2%
Taiwan	4.1%
Argentina	3.9%
Hong Kong	3.6%
South Africa	2.6%

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 June 30, 2021)

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	MSCI EM
Since Inception**	7.0%	3.8%	6.0%
10-Year*	6.1%	2.9%	4.3%
5-Year*	11.1%	7.8%	13.0%
3-Year*	9.0%	5.7%	11.3%
1-Year	41.9%	37.7%	40.9%
YTD	6.8%	5.2%	7.4%
QTD	4.3%	3.5%	5.0%

*Average annualized returns
**Inception is 10/1/2009

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%
2020	22.9%	19.2%	18.3%	4.6%	14	$11,350	$6,889,798	21.3%	19.6%	1.9%

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 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, 2019. 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.

GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. 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. 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.

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. 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. 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.*