Confluence INVESTMENT MANAGEMENT

FOURTH QUARTER

2021

## International Developed • International Equity Strategies

International Developed invests primarily in large cap, growth-oriented companies in developed markets (excluding U.S.). 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 Update

International developed market equities recorded an outstanding and historically significant performance during 2021. The full-year return for the MSCI EAFE Index was +11.3%, which was +5.4% higher than the average annual return dating back to 2000 and +2.5% stronger than the average return during the past decade. Additionally, Bloomberg estimates that the Earnings Per Share (EPS) for the MSCI EAFE Index will reach $133.63 for all of 2021, the second-highest year of earnings realized in more than 25 years and higher than any single year dating back to 2007. The strong earnings and returns did not come at the expense of valuation. As of December 31, 2021, the P/E ratio of the MSCI EAFE Index was 17.7. This means that on a Price-Earnings basis, international developed market equities are now trading at a 2% discount to where they traded during the past decade. For comparison, the S&P 500 ended the year with a P/E of 24.6, a 23% premium above the average 10-year P/E for large cap domestic equities. The dividend yield of the MSCI EAFE Index was 2.5%, nearly double that of the S&P 500 at 1.3%.

One of the macro calls that we made, and admittedly got wrong, was that the U.S. dollar (USD) would weaken over the past 12 months. Instead, the U.S. Dollar Index strengthened by over 6%, which helped boost U.S. stock returns during the year. We continue to believe we are nearing the end of this extended phase of USD strength. When that happens, it should provide an additional tailwind to international stocks. A popular index for global stock managers is the MSCI World Index. This benchmark, established in March 1986, incorporates both domestic and foreign developed market equities. The U.S. stock allocation within this benchmark reached over 69% as of 12/31/21. It is the highest allocation to the United States in more than 20 years and is 16.2% above the average weight during this time, something to consider when making allocation decisions for 2022. Also worth mentioning is that the end of "cheap" and "free" money combined with higher interest rates has historically caused a rotation out of non-cyclical stocks and into more cyclical equities. This change in monetary policy globally may result in new areas of equity leadership. The largest sector and the largest contributor to domestic equities during the past several years has been Information Technology. InfoTech makes up more than 29% of the S&P 500 (versus just less than 10% for MSCI EAFE). Should investors want to shift their equity exposure to markets that are more cyclically biased, a transition to international stocks could be considered. For example, the Financials sector weighting of the MSCI EAFE Index is nearly 17% versus 11% for the S&P 500. So, as we enter a new year with a backdrop of asymmetric global monetary policy, an increased allocation to international equity markets can be supported given the compelling relative valuation of international stocks, differentiated market construction between domestic and foreign equity markets, higher overseas dividend yields, historically high U.S. exposure within global benchmarks, and a possible meaningful tailwind for international shares should the USD finally begin to weaken.

### Quarterly Trading Summary

In November, we sold AIA Group, a Hong Kong-based insurance company. AIA Group currently derives nearly 60% of its business from either Hong Kong or China-based customers. The Chinese government has recently begun to impose strict new laws and regulations on companies with potentially "sensitive" Chinese consumer/financial data on company servers. As a result, many companies have had to alter their business practices abruptly to comply with these new requirements or face significant punishment, including fines, partial government ownership, forced divestitures, and/or pre-approval for business activities. This novel regulatory regime has added a new, unknown, and potentially severe level of risk that did not exist prior to implementation. While MSCI categorizes Hong Kong as a developed market, the significant and growing influence that China is imposing upon the island nation has caused us to reconsider the ownership of Hong Kong stocks within a developed market-only portfolio at this time. Based on these elevated risks, we closed our position (purchased in September 2016) with a share price gain of over 80% during our holding period.

Proceeds from the sale of AIA Group were immediately reinvested in shares of France-based BNP Paribas, maintaining the portfolio allocation to the Financials sector. BNP offers clients a complete suite of products and services, including retail, commercial, investment, private, and corporate banking solutions, as well as asset and investment management capabilities.

## Quarterly Trading Summary continued…

BNP derives more than 70% of its revenues from continental Europe. This was an important part of the rationale used to select this security as we wanted to add exposure in advance of Europe's more durable post-COVID economic recovery. BNP offers an attractive dividend yield, trades below book value, and trades with an efficiency ratio (method of determining how effective bank management is in terms of controlling costs) that is superior to most of its large cap European peers. It is the first Eurozone banking position held within the portfolio since the summer of 2018. Our investment committee is becoming more constructive on banks globally, and as a result, exposure to the Financials sector may increase during the coming months.

## Performance Review

International developed market equities recorded positive returns during the final quarter of 2021, while equities within developing economies continued their marked underperformance. During the fourth quarter, the MSCI EAFE Index posted a return of +2.7%, while the Confluence International Developed strategy recorded a return of +7.4% (gross of fees). The MSCI EAFE Growth and MSCI EAFE Quality indices outperformed the MSCI EAFE Value during the quarter (+4.1% and +5.5% versus +1.2%, respectively). On a full-year basis, the Confluence International Developed strategy has recorded a return of +18.2% (gross of fees) versus +11.3% for the MSCI EAFE Index. [*Net-of-fees returns for the same periods were +6.6% QTD and +14.7% in 2021. 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 Ireland (+15.6%) and France (+13.7%), while the worst returns were recorded by Hong Kong (-4.1%) and Sweden (+0.6%). From a sector standpoint, Consumer Staples (+15.7%) and Consumer Discretionary (+14.0%) were the strongest sectors during the quarter, whereas Communication Services (-0.5%) and Energy (+0.4%) were the weakest.

The top contributors and detractors for the portfolio in 2021 are shown in the accompanying table.

| Security | Avg Weight (%) | Contribution (%) |
|---|---|---|
| **Top 5** | | |
| Icon plc | 4.65 | 2.46 |
| Accenture plc | 3.72 | 2.03 |
| DSV Panalpina A/S | 4.84 | 1.68 |
| Novo Nordisk A/S | 2.88 | 1.51 |
| GW Pharmaceuticals plc | *Sold* | 1.34 |
| **Bottom 5** | | |
| Fanuc Corporation | 1.79 | (0.26) |
| Smith & Nephew plc | 1.77 | (0.32) |
| Melco Resorts & Entertainment Limited | *Sold* | (0.34) |
| Jazz Pharmaceuticals plc | 1.56 | (0.39) |
| Nintendo Co., Ltd. | 2.03 | (0.68) |

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

## What We Are Watching

As we collectively begin to chart a course to navigate our way through 2022, it would be beneficial to note the events that could cause a change in our investment direction. Virtually everyone on Earth remains impacted by COVID-19, especially the highly contagious omicron variant. The virus has created global distortions in demand, and this, accompanied by the lack of consistent supply to satiate that demand, has apparently lit the fuse on more durable inflationary pressures worldwide. An early January conversation with Norbert Ore, former chair of the ISM Manufacturing Report and current head of industry surveys with Strategas Research Partners, reinforced the struggles within the manufacturing sector. Ore described the current global manufacturing environment as "solid" but "not typical" because everyone worldwide is seeing the same picture, and this has not happened in the past. The current rise of input prices is outpacing manufacturers' ability to recover costs, creating a situation where Ore states that "inflation is looming." Should the present set of circumstances persist, consumers are only likely to experience the onset of rising prices. In time, we expect supply constraints to lessen, but the increased labor costs associated with re-hiring and attracting new talent are likely to continue to increase prices, regardless of supply; stay tuned.

The unequal worldwide economic recovery from COVID coupled with inconsistent measures to prevent the spread of the virus have created a unique set of global central bank policy applications. No longer is practically every central bank employing an accommodative policy. Some emerging market central banks (Mexico, Russia, and Brazil, for example) have already increased interest rates multiple times in attempts to stem inflation. On December 16, 2021, the Bank of England became the first major central bank to begin a policy normalization campaign by increasing its main interest rate to 0.25%. The U.S. Federal Reserve has already commenced asset tapering and has forecast at least three rate hikes for the upcoming year.

**What We Are Watching continued...**

The European Central Bank (ECB) plans to end its Pandemic Emergency Purchase Program (PEPP) by March and will return to its previously implemented (pre-pandemic) Asset Purchase Program. The ECB does not currently forecast an increase in interest rates before 2024. It plans to taper its Asset Purchase Plan from 40 billion during Q2 down to 20 billion by year end. The Bank of Japan (BoJ) has also announced its aim to remain highly accommodative in an effort to support a recovery in the Japanese economy. However, the BoJ announced in December that the pandemic-necessitated emergency funding would be decreased. Significantly less policy accommodation on a global scale will impact economic activity and profit levels. In addition, non-homogenous central bank policy application provides differentiated investment opportunities for us to consider.

We are also tracking several national elections scheduled to transpire throughout 2022. Italy is set to elect a new president in late January. In March, a presidential election will be held in South Korea, while a new chief executive will be chosen in Hong Kong. We expect the winning candidate in Hong Kong will be much more closely aligned with Beijing's agenda as China continues to exert influence over and detract from Hong Kong's independence. French President Emmanuel Macron faces re-election in April, and Australian Prime Minister Scott Morrison will attempt to retain his post in May. Elections will be held in Brazil this coming October, where current polls show former Leftist leader Luiz Inácio Lula de Silva is currently leading over Jair Bolsonaro. The U.S. will hold what are likely to be even more polarizing mid-term elections in November. This fall, Chinese President Xi Jinping is expected to appoint himself to at least a third term (if not for life) at the Communist Party National Congress. Finally, while not an upcoming election, we will be closely monitoring the policy initiatives and implementations made by German Chancellor Olaf Scholz and his newly formed coalition government. Germany has long held (under former Chancellor Angela Merkel) the dominant leadership position within the Eurozone in terms of political leadership and regional economic stewardship. It will be interesting to see how quickly Scholz asserts himself in this vein.

Events within the sphere of geopolitics could also create market instability. We are keenly surveilling several potential hotspots around the globe. Russia has recently built a large military force on the border of Ukraine and is using "threat" as its platform to negotiate more regional freedom and less NATO interference. Mid-January talks between the Biden and Putin governments appeared to make little progress in de-escalating tensions. Even though the U.S. and China held direct discussions during the later stages of 2021, tensions between the two countries remain elevated. There are many facets to this relationship that we continue to track, but any reachable common ground between the two global powers would be welcomed economically. China's persistent and agitative threats toward Taiwan remain "high" on our geopolitical threat list. To be clear, we do not believe, at present, that military action between China and Hong Kong is imminent. Nevertheless, we do believe that an attempted takeover of Taiwan remains a possibility. We currently have no direct exposure to Turkey, but Confluence Chief Market Strategist Bill O'Grady notes the unorthodox approach that Turkish Prime Minister Erdogan has employed to curtail a collapse in the Turkish lira. The choice not to raise interest rates as inflation ravages the local economy threatens to destabilize the country. Turkey has served as a regional power in the Mediterranean Sea basin, and this has helped to ensure regional stability. However, should discontent grow within the country, it could open the door to increased regional volatility.

Finally, while this portfolio heavily depends on growth within developed markets, the economic health of the world's second-largest economy, China, is also an important factor to consider. The OECD, in its latest forecast, expects Chinese GDP to fall from an expected expansion of 8.1% in 2021 to near 5% for both 2022 and 2023. This forecast pairs nicely with Chinese President Xi's desire to slow credit growth and re-focus Chinese economic initiatives. Slowing growth within China is headline-grabbing, but we realize if the Chinese economy expands at a 5% rate for the next three to four years, using IMF nominal GDP figures, it would be equivalent to China adding an economy the size of the United Kingdom to its own during that time frame.



20 Allen Ave., Ste. 300, St. Louis, MO 63119 • (314) 743-5090 www.ConfluenceInvestment.com

# International Developed • International Equity Strategies

(as of 12/31/21)

| 10 Largest Holdings | Weight |
|---|---|
| Novo Nordisk A/S | 4.4% |
| DSV Panalpina A/S | 4.0% |
| Accenture plc | 3.7% |
| Icon plc | 3.5% |
| Diageo plc | 3.5% |
| Brookfield Asset Management Inc. | 3.2% |
| DBS Group Holdings Ltd. | 3.1% |
| L'Oréal S.A. | 3.0% |
| Shopify Inc. | 3.0% |
| LVMH Moët Hennessy - Louis Vuitton | 2.9% |

| Sector Allocation | Weight |
|---|---|
| Financials | 20.9% |
| Health Care | 18.1% |
| Information Technology | 15.9% |
| Industrials | 15.0% |
| Consumer Staples | 8.7% |
| Consumer Discretionary | 8.3% |
| Materials | 6.2% |
| Energy | 2.3% |
| Communication Services | 2.3% |
| Cash | 2.3% |

| 10 Largest Countries | Weight |
|---|---|
| Canada | 14.7% |
| Ireland | 14.5% |
| Switzerland | 14.2% |
| United Kingdom | 11.6% |
| France | 9.3% |
| Denmark | 8.4% |
| Japan | 8.4% |
| Singapore | 5.2% |
| Germany | 5.1% |
| Sweden | 4.1% |

*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 December 31, 2021)

| | Pure Gross-of-Fees[1] | Net-of-Fees[2] | MSCI EAFE |
|---|---|---|---|
| Since 10/1/99 | 6.0% | 2.9% | 4.6% |
| 20-Year* | 7.4% | 4.3% | 6.3% |
| 15-Year* | 5.7% | 2.5% | 3.6% |
| 10-Year* | 9.3% | 6.1% | 8.0% |
| 5-Year* | 13.4% | 10.0% | 9.5% |
| 3-Year* | 21.1% | 17.5% | 13.5% |
| 1-Year | 18.2% | 14.7% | 11.3% |
| YTD | 18.2% | 14.7% | 11.3% |
| QTD | 7.4% | 6.6% | 2.7% |

**Average annualized returns*

**Portfolio Benchmarks**

***MSCI EAFE (Net) Index*** – Free float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. Performance results presented net of estimated foreign withholding taxes on dividends, interest and capital gains. *(Source: Bloomberg)*

| Calendar Year | Pure Gross-of-Fees[1] | Net-of-Fees[2] | MSCI EAFE | Difference (Gross-MSCI EAFE) | # of Portfolios | Composite Assets (000s) | Total Firm Assets (000s) | Composite 3yr Std Dev | MSCI EAFE 3yr Std Dev | Composite Dispersion |
|---|---|---|---|---|---|---|---|---|---|---|
| 1999** | 26.0% | 25.0% | 17.0% | 9.0% | 506 | $204,990 | - | N/A | N/A | N/A |
| 2000 | (12.7%) | (15.3%) | (14.2%) | 1.5% | 339 | $94,891 | - | N/A | N/A | 3.1% |
| 2001 | (20.2%) | (22.5%) | (21.4%) | 1.3% | 216 | $52,064 | - | N/A | N/A | 2.0% |
| 2002 | (20.0%) | (22.4%) | (15.9%) | (4.1%) | 181 | $39,739 | - | 16.9% | 16.0% | 1.1% |
| 2003 | 37.2% | 33.1% | 38.6% | (1.4%) | 168 | $35,515 | - | 17.9% | 17.8% | 1.1% |
| 2004 | 15.9% | 12.4% | 20.2% | (4.4%) | 191 | $42,465 | - | 15.5% | 15.4% | 0.9% |
| 2005 | 16.7% | 13.2% | 13.5% | 3.2% | 176 | $37,524 | - | 11.4% | 11.4% | 0.8% |
| 2006 | 23.9% | 20.2% | 26.3% | (2.4%) | 243 | $62,300 | - | 10.5% | 9.3% | 0.8% |
| 2007 | 19.1% | 15.6% | 11.2% | 8.0% | 269 | $75,983 | - | 10.5% | 9.4% | 1.4% |
| 2008 | (38.2%) | (40.0%) | (43.4%) | 5.2% | 256 | $43,507 | - | 18.9% | 19.2% | 1.2% |
| 2009 | 22.5% | 18.8% | 31.8% | (9.3%) | 235 | $47,380 | - | 21.7% | 23.6% | 1.7% |
| 2010 | 15.3% | 11.8% | 7.8% | 7.5% | 206 | $47,360 | - | 23.4% | 26.2% | 0.8% |
| 2011 | (9.7%) | (12.3%) | (12.1%) | 2.5% | 164 | $31,229 | - | 20.0% | 22.4% | 0.7% |
| 2012 | 16.5% | 13.0% | 17.3% | (0.8%) | 154 | $34,823 | - | 17.3% | 19.4% | 0.6% |
| 2013 | 20.9% | 17.4% | 22.8% | (1.8%) | 174 | $47,418 | - | 14.5% | 16.3% | 0.5% |
| 2014 | (0.4%) | (3.4%) | (4.9%) | 4.5% | 116 | $34,435 | - | 11.0% | 13.0% | 0.7% |
| 2015 | (2.3%) | (5.2%) | (0.8%) | (1.5%) | 53 | $19,412 | - | 11.3% | 12.5% | 0.3% |
| 2016 | (5.1%) | (8.0%) | 1.0% | (6.1%) | 30 | $7,163 | - | 11.8% | 12.5% | 0.4% |
| 2017 | 23.4% | 19.7% | 25.0% | (1.7%) | 25 | $6,957 | - | 11.0% | 11.8% | 0.3% |
| 2018 | (14.4%) | (17.0%) | (13.8%) | (0.6%) | 2 | $352 | $5,486,737 | 11.7% | 11.2% | 0.1% |
| 2019 | 29.6% | 25.7% | 22.0% | 7.6% | 1 | $261 | $7,044,708 | 12.4% | 10.8% | N/A |
| 2020 | 15.9% | 12.4% | 7.8% | 8.0% | 1 | $241 | $6,889,798 | 19.3% | 17.9% | N/A |
| 2021 | 18.2% | 14.7% | 11.3% | 6.9% | 1 | $280 | $7,761,687 | 18.3% | 16.9% | N/A |

*(Prior to March 31, 2020, the S&P/BNY Developed 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, 2020. 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 International Developed Strategy was incepted on April 1, 1992, and the current International Developed 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: 0.60% on the first $500,000; 0.55% on the next $500,000; and 0.50% 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. 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.

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 International Developed Composite contains fully discretionary International Developed wrap accounts. The International Developed portfolio invests in U.S.-listed shares of large capitalization, non-U.S. companies from developed markets.

**Results shown for the year 1999 represent partial period performance from October 1, 1999, through December 31, 1999. 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 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 EAFE 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.*