Confluence INVESTMENT MANAGEMENT

THIRD QUARTER 2020

International Growth • International Equity Strategies

International Growth invests primarily in large cap, growth-oriented companies in both developed and emerging markets. 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. The maximum direct exposure to emerging markets is 25% of the portfolio's total value.

Market Commentary

For the past year and a half, we have written intently about the impact that a strong versus weak U.S. dollar (USD) has on both domestic and foreign equity markets. Simply stated, the direction of the USD is an important factor that must be considered when investing in both domestic and foreign equities. The U.S. Dollar Index, a measure of the relative strength of the dollar against a basket of major global currencies, has been in a strengthening phase since March 2008. During this time frame, the S&P 500 recorded an annualized return of 9.4% compared to 2.1% for the MSCI World ex-U.S. Index. This continued and meaningful relative outperformance has caused investors to raise questions regarding whether they need to have an allocation to companies domiciled outside the United States. However, during the most recent extended period of USD weakness from January 2002 through March 2008, the MSCI World ex-U.S. Index, on an annualized basis, returned 13.6%, while the S&P 500 posted a gain of 3.8% (annualized). Thus, a prolonged weakening of the USD would very likely serve as a catalyst for non-U.S. stocks. On a year-to-date basis, the U.S. Dollar Index has weakened by 2.3% but has fallen by nearly 9% since the 2020 peak recorded on March 20.

In our **podcast** dated 9/25/2020 (Asset Allocation Weekly, episode 12), Confluence Market Strategist Patrick Fearon-Hernandez broaches the subject of whether now might be a good time to increase the allocation to international equities. He states that weaker population growth within large developed countries, less economic diversity, lower exposure to fast-growing sectors such as Information Technology, and differing financial systems all weighed on foreign equity performance over the past decade. Still, the predominant factor contributing to U.S. outperformance has been dollar strength. We invite you to give the podcast a listen.

A fair question for investors to ask is that if we are nearing the end of this extended USD "bull phase," which factors, beyond currency, are in place to support non-U.S. equity markets, considering the list of headwinds? Looking first at global growth, according to 2019 World Bank data, only six of the 25 largest countries in the world (by population) are classified as developed markets. Further, the average population growth rate of these six countries (U.S., Japan, Germany, France, U.K., and Italy) was 0.3% compared to an average increase in the developing and emerging 19 countries of 1.4%. Looking at the data differently, the World Bank showed that the U.S. registered population growth last year was 0.5%. Although this rate of growth is faster than much of Europe, Asia recorded a population increase of 0.9%, while the world average was 1.1%. This data suggests that an increasing percentage of forward growth opportunities will transpire abroad. Additionally, *Capital Economics* is currently forecasting that emerging economies will outgrow developed markets by a ratio of nearly 2:1 over the next two years. Therefore, in addition to a weakening USD, the prospects for growth within many international markets appear to be improving.

One of the key drivers of global equities during the past 10 years has been Information Technology. This sector's performance, on an annualized basis, has nearly doubled the total return of the S&P 500 domestically, and the MSCI World ex-U.S. Index in developed markets outside the U.S. However, a main difference between these benchmarks is that nearly 30% of the S&P 500 Index is concentrated within the Information Technology sector compared to only 8.9% in the MSCI World ex-U.S. Index. The U.S. market also carries nearly a double allocation to the growth-oriented Communication Services sector. International markets are much more exposed to Financials, Industrials, and Consumer Staples, which have traditionally been slower growing and more value-leaning sectors. Confluence's macroeconomic team recently published an **Asset Allocation Weekly**, coinciding with the aforementioned podcast, that includes illustrations of the interplay between a strong or weak USD and sector-level returns. In this report, we show how the U.S. market has demonstrated superior returns during the last two strong-dollar periods, and also how foreign stocks considerably outperformed during the period of USD weakness that occurred between the two strong-dollar periods.

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Market Commentary continued...

One additional note relating to sector allocation within developed markets outside the U.S. is that during the past 12 months there has been a notable shift in sector weightings. At the end of September 2019, the largest weighting within the MSCI World ex-U.S. Index was Financials. As a result of the pressure banks have endured during the past 12 months (pandemic, lack of loan demand, negative yield curve), the allocation to Financials has decreased by 3.5%, making Industrials the largest single sector within the benchmark. In addition, the Energy sector's representation was halved during the past year. The two largest increasing segments of the index have been Information Technology and Health Care. The increased importance of these two sectors has contributed to our relative outperformance on a year-to-date basis as we have positioned portfolios with a relative overweight in these areas.

For more than a decade, investors have been undeniably rewarded for greater exposure to domestic equities. However, based on a potential turn in the strength of the USD, strong forecast growth abroad, and attractive relative valuations, we believe a strong tailwind for equity markets abroad could develop. Ten years ago, the U.S. represented roughly 41% of the market cap of the MSCI ACWI Index, following a more than six-year period of USD weakness. Today the U.S. allocation within the MSCI ACWI has risen to nearly 57%. Should the reversal in USD strength continue as it has so far this year, we may be at the beginning of a long run benefitting the asset class of international stocks. As such, it may be an opportune time to consider an increase in international equity allocations depending on investors' risk tolerance.

Quarterly Trading Summary

While there were no trades made during the third quarter within the International Growth strategy, the International Equities Investment Committee spent a significant amount of time reviewing multiple companies for possible portfolio inclusion in the event that fundamentals supporting the equity market changed significantly. However, we remain mindful of growing evidence that a second wave of COVID-19 is beginning in Europe and here at home, and we believe, based on what happened earlier this year, that our portfolio is correctly positioned. We remain vigilant and ready to implement new opportunities as they arise, utilizing our combined experience and following our well-defined process when making any future changes.

Performance Review

During the third quarter, Confluence International Growth posted a return of 8.2% (gross of fees) compared to 4.9% for the MSCI World ex-U.S. Index. On a year-to-date basis, International Growth was up 6.5% (gross of fees) versus the -7.1% return for MSCI World ex-U.S. [*Net-of-fees returns for the same periods were +7.4% QTD and +4.1% YTD. 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 Taiwan (+43.5%) and Denmark (+21.8%), while the weakest returns were recorded by Israel (-3.9%) and Singapore (-1.4%). From a sector standpoint, Consumer Discretionary (+16.0%) and Communication Services (+14.7%) were the strongest-performing sectors during the quarter, whereas Energy (-17.6%) and Financials (-1.2%) were the worst-performing sectors.

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

Security	Avg Weight	Contribution
Top 5		
DSV Panalpina A/S	3.88	1.16
Taiwan Semiconductor Manufacturing Co.	3.27	1.13
Alibaba Group Holding Ltd.	2.90	0.91
Nintendo Co., Ltd.	2.39	0.62
Icon plc	4.41	0.59
Bottom 5		
Total S.A.	0.63	(0.06)
Chubb Limited	1.73	(0.13)
Royal Dutch Shell plc (Class A)	1.03	(0.25)
Elbit Systems Ltd.	2.51	(0.32)
ZTO Express (Cayman) Inc.	2.34	(0.47)

(Contribution data shown from a sample account)

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What We Are Watching

There are several storylines that we are closely monitoring at present. The ongoing Brexit saga between the European Union and the United Kingdom is supposed to be finalized by year-end. Current negotiations remain fluid as literal brinksmanship looms over these discussions. There are sticking points, such as fishing rights and state aid, among others, that threaten to derail a "soft" exit for the U.K from the EU. While the British pound has oscillated between 1.24 and 1.34 versus the USD during the past three months, the currency ended September up 4% against the greenback. In the event of a "hard" exit, the greatest risk will likely come in the form of unintended consequences and headwinds for European companies with complex supply chains (think large industrial companies and autos). We remain underweight to the U.K.

Japanese Prime Minister Shinzo Abe, who reached the milestone of Japan's longest continuous term as PM, was forced to step down in August due to health concerns. Abe's Chief Cabinet Secretary, Yoshihide Suga, quickly won the Liberal Democratic Party leadership election and was named Prime Minister of Japan on September 16. We do not expect Suga to deviate significantly from Abe's policy initiatives and will carefully monitor new developments and weigh possible investment implications. We remain underweight to Japan.

The COVID-19 pandemic continues to overshadow global economic improvement; a much-feared second wave appears to be striking Europe and parts of the U.S. as of this writing. Several European leaders are currently implementing new lockdowns and societal restrictions to stymie the spread of the disease. While monetary policy remains very loose around the world, the cessation of targeted support to businesses, businesses forced to close, and individuals out of work, all due to the medical emergency, threatens the intensity and duration of what had been a strong economic recovery. The possibility remains that the economy becomes bifurcated between segments that wallow in a deep recession and those that experience strong recovery.

We are also surveilling how the result of the U.S. presidential election could change the path of relations between the U.S. and China. Whether or not pressure will continue to build once the election ends can be debated. However, as the rhetoric has ratcheted higher, and the restrictions on trade become more resolute, we remain focused on the issue of market access and the potential investment implications therein. Already U.S. investors are going to miss out later this year on what will likely become one of the largest IPO offerings in history for Chinese financial technology company Ant Group. Should the United States continue to pursue the implementation of capital restrictive measures on Chinese companies, U.S. investors risk losing out on new investment opportunities within the world's second-largest economy.

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(as of 9/30/20)

10 Largest Holdings	Weight
DSV Panalpina A/S	4.3%
Icon plc	4.2%
Shopify Inc.	3.7%
Taiwan Semiconductor Manufacturing	3.6%
Accenture plc	3.5%
LVMH Moët Hennessy Louis Vuitton	3.5%
Sony Corporation	3.4%
Franco-Nevada Corporation	3.3%
Waste Connections, Inc.	3.3%
Alibaba Group Holding Ltd.	3.3%

Sector Allocation	Weight
Industrials	18.1%
Information Technology	17.3%
Consumer Discretionary	13.4%
Health Care	12.7%
Financials	12.6%
Consumer Staples	9.3%
Materials	8.4%
Communication Services	5.3%
Energy	1.5%
Cash	1.4%

10 Largest Countries	Weight
Canada	17.6%
Ireland	13.9%
Japan	9.7%
Switzerland	8.6%
China	7.9%
Denmark	7.1%
France	6.8%
United Kingdom	5.6%
Israel	5.1%
Taiwan	3.6%

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 9/30/20

	Pure Gross-of-Fees[1]	Net-of-Fees[2]	MSCI World ex-US
Since 10/1/99	6.2%	3.1%	3.7%
15-Year*	6.5%	3.3%	3.7%
10-Year*	6.2%	3.0%	4.4%
5-Year*	7.9%	4.7%	5.3%
3-Year*	7.4%	4.2%	0.6%
1-Year	15.0%	11.6%	0.2%
YTD	6.5%	4.1%	(7.1%)
QTD	8.2%	7.4%	4.9%

**Average annualized returns*

Portfolio Benchmarks

MSCI World ex-U.S. (Net) Index – Free float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. 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 World exUS	Difference (Gross-MSCI World exUS)	# of Portfolios	Composite Assets (000s)	Total Firm Assets (000s)	Composite 3yr Std Dev	MSCI World exUS 3yr Std Dev	Composite Dispersion
1999**	26.6%	25.6%	17.4%	9.2%	131	$48,987	-	N/A	N/A	N/A
2000	(15.0%)	(17.6%)	(13.4%)	(1.7%)	58	$15,193	-	N/A	N/A	3.0%
2001	(18.1%)	(20.5%)	(21.4%)	3.3%	42	$7,128	-	N/A	N/A	1.1%
2002	(17.9%)	(20.4%)	(15.8%)	(2.1%)	32	$4,654	-	17.1%	16.1%	0.7%
2003	40.2%	36.1%	39.4%	0.8%	26	$4,642	-	18.1%	17.7%	0.9%
2004	18.7%	15.2%	20.4%	(1.6%)	25	$5,004	-	15.4%	15.3%	1.1%
2005	18.2%	14.7%	14.5%	3.8%	25	$6,651	-	12.1%	11.3%	0.5%
2006	29.5%	25.6%	25.7%	3.8%	35	$11,866	-	11.6%	9.5%	1.1%
2007	23.4%	19.7%	12.4%	10.9%	49	$16,292	-	12.5%	9.7%	2.9%
2008	(37.8%)	(39.6%)	(43.6%)	5.8%	76	$14,221	-	20.7%	19.5%	1.5%
2009	31.8%	27.9%	33.7%	(1.8%)	114	$28,437	-	23.0%	23.9%	2.1%
2010	13.2%	9.9%	8.9%	4.3%	168	$60,558	-	24.3%	26.3%	1.3%
2011	(11.4%)	(14.1%)	(12.2%)	0.8%	253	$80,988	-	20.1%	22.3%	0.6%
2012	16.1%	12.7%	16.4%	(0.3%)	254	$94,222	-	17.6%	19.0%	0.6%
2013	19.1%	15.6%	21.0%	(1.9%)	291	$113,801	-	14.4%	16.0%	0.6%
2014	(1.7%)	(4.6%)	(4.3%)	2.6%	177	$88,982	-	11.4%	12.7%	0.7%
2015	(2.1%)	(5.0%)	(3.0%)	0.9%	191	$81,898	-	11.5%	12.3%	0.4%
2016	(5.1%)	(7.9%)	2.7%	(7.8%)	113	$39,444	-	12.0%	12.3%	0.7%
2017	25.2%	21.4%	24.2%	1.0%	62	$28,303	-	11.1%	11.7%	0.8%
2018	(13.5%)	(16.1%)	(14.1%)	0.6%	30	$15,707	$5,486,737	11.7%	11.1%	0.2%
2019	30.1%	26.3%	22.5%	7.6%	24	$14,419	$7,044,708	12.5%	10.8%	0.3%

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 12/31/2019. 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 International Growth Strategy was incepted on October 1, 1997, and the current International Growth 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. 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 International Growth Composite contains fully discretionary International Growth wrap accounts. The International Growth portfolio invests in U.S.-listed shares of large capitalization, growth-oriented, non-U.S. companies from developed markets with up to 25% from emerging markets. *(Prior to March 31, 2020, the S&P/BNY 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.)* **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. 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 World ex-U.S. 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.*