



Brandes

analyzes:

Looking Beyond Short-Term Concerns: Positive Themes Help Support the Long-Term Case for Emerging Markets

Executive Summary

- The selloff in emerging market equities may reflect investor worries that the economic slowdown in developed markets could adversely affect emerging market (“EM”) countries.
- Traditional views that emerging markets are higher risk and are more vulnerable to frequent macroeconomic crises may need to be reevaluated.
- Solid fundamentals and attractive valuations support Brandes’ view that emerging market stocks should remain an integral part of investors’ long-term portfolios.

Year to date, emerging market equities, as measured by the MSCI Emerging Markets Index, have declined 15% in the face of worries over a possible contagion from the European sovereign debt crisis and slowing economic growth globally.

The recent market downturn appears to be driven more by risk aversion due to prevailing uncertainties, rather than evidence of a significant deterioration in economic fundamentals in emerging countries.

Compelling EM Fundamentals Inspire Optimism

Despite market declines earlier in the year, emerging countries remain sources of significant investment opportunities. A number of positive fundamentals help make emerging markets attractive:

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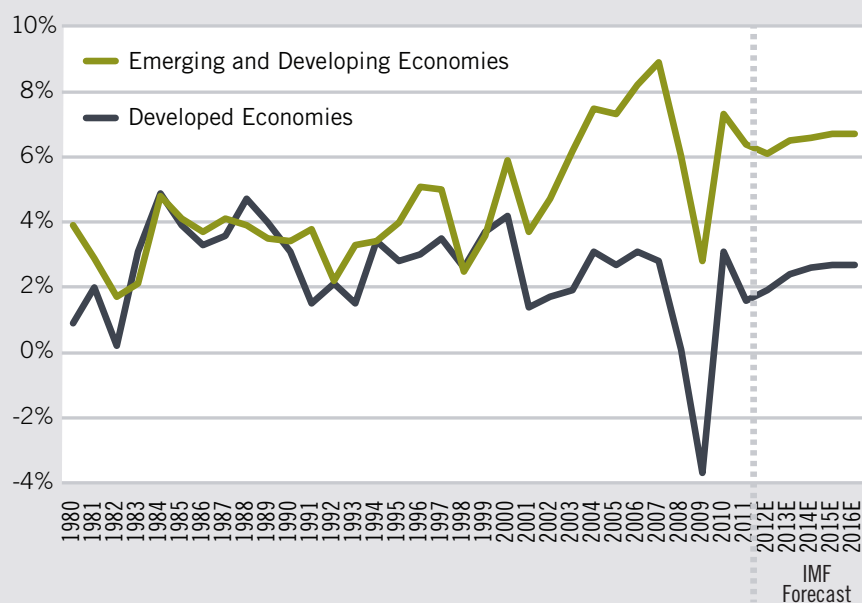
- **Expansion opportunities** – Over the past decade, growth in emerging markets has outpaced developed nations. By 2012, emerging economies are expected to make up over 50% of the world's gross domestic product (GDP). Moreover, many of the larger emerging markets have sizeable domestic markets capable of sustaining a base level of growth despite weakening demand from developed nations. Recent headlines have centered on China's slowing economy, yet overall growth prospects in emerging markets remain more promising than elsewhere in the world. See Exhibit 1.

Financial wealth in EM has improved over ten-fold in the last two decades. This has helped fuel increased consumer spending.

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Exhibit 1: Emerging Markets Expected to Drive Future Global Economic Growth

(Annualized GDP Growth; 2012-2016 are IMF Estimates)



Source: IMF as of 11/1/2011. There is no assurance that a forecast will be accurate. Because of the many variables involved, an investor should not rely on forecasts without realizing their limitations.

- **Favorable sovereign debt levels** – EM debt ratings are improving, which is good news for EM investors in light of rating agencies' downgrades of several developed countries' creditworthiness, including that of the United States and Italy. In fact, emerging countries' government debt as a percentage of GDP has been in decline since 2001 and as of September 30, 2011 was only 36.2% of EM GDP versus 103.2% for developed countries.
- **EM corporations are becoming stronger** – The economic growth in EM has been spurred by greater industrial production, which in turn has contributed to significant earnings growth. Moreover, just like governments, EM corporate balance sheets have also become more solid, allowing a greater potential ability for companies to service their debt obligations and finance operations.
- **Rising individual wealth** – Financial wealth in EM has improved over ten-fold in the last two decades. This has helped fuel increased consumer spending. Moreover, a number of mature industries in developed regions remain underpenetrated in emerging markets, such as automotives and pharmaceuticals. Individual savings rates have also been higher in emerging markets relative to developed nations, giving consumers the ability to potentially spend more in the future.

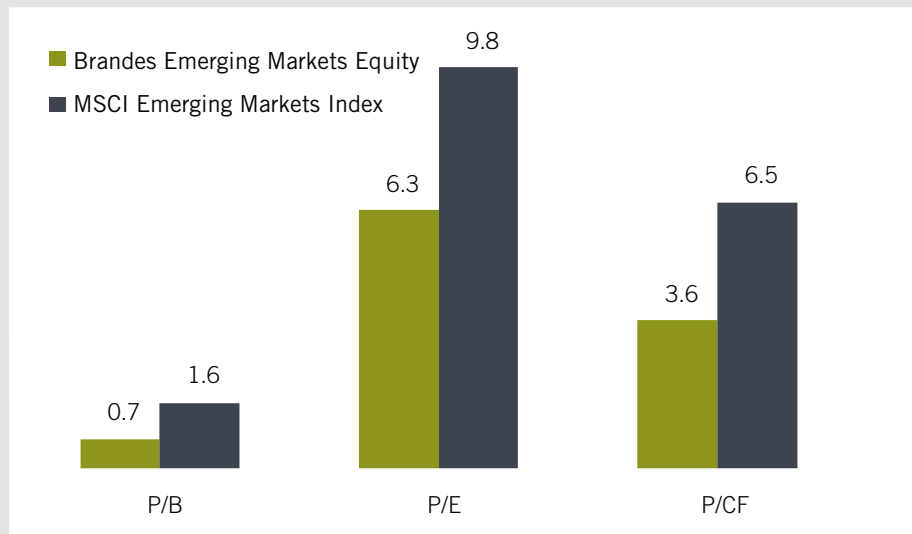
Attractive Valuations

Aside from solid fundamentals, valuations for emerging markets are also attractive. As value investors, we believe low valuations drive higher future performance. Consider the following:

- Below average price-to-earnings (P/E) ratio: As of 12/5/11, the MSCI EM Index was trading at a forward P/E (2012) of 10.3x, well below the 13x average over the last decade and below the developed markets P/E of 12.7x as measured by the MSCI World Index as of 12/5/11
- Exhibit 2 shows attractive valuation measures for the Brandes Emerging Markets Portfolio as compared to those of the MSCI EM Index

Exhibit 2: Take Advantage of Attractive Valuations for the Brandes Emerging Markets Portfolio

(Price-to-book, price-to-earnings and price-to-cash flow ratios well below index levels)



Source: MSCI; Brandes; as of 9/30/2011. Past performance is not a guarantee of future results.

The portfolio characteristics shown relate to a single account as of date noted, deemed by Brandes to be generally representative of its standard account noted. Not every account will have these exact characteristics. The actual characteristics with respect to any particular account will vary based on a number of factors including but not limited to: (i) the size of the account; (ii) investment restrictions applicable to the account, if any; and (iii) market exigencies at the time of investment. Data is updated on a quarterly basis.

Brandes Portfolio Holdings in Emerging Markets

We remain committed to our holdings in emerging markets. They continue to meet our value criteria despite short-term setbacks. The slowdown in EM has provided the opportunity to add or strengthen our holdings in many high-quality emerging market franchises. For example, we recently increased our position in a leading Chinese telecommunications provider. Its stock price has traded down due to economic concerns as well as increased capital expenditures. Nonetheless, the company remains well run and has perhaps the most efficient wireless network in China. Beyond having an attractive valuation, it has a high level of cash on its balance sheet, generated positive free cash flow over the past 5 years, and has provided a decent dividend yield.

We remain committed to a number of allocations in emerging markets that continue to meet our value criteria despite short-term setbacks.

On behalf of our clients, we continue to closely monitor global developments that may influence emerging markets.

European Bank Exposure Update

The Brandes Emerging Markets Portfolio owns two well-capitalized banks in Turkey as well as an Austrian bank that competes in the Central and Eastern European regions. Stock prices for these three banks declined year-to-date primarily due to geographic proximity to Western Europe and the potential second order economic effects of the European debt crisis, an unexpected adverse earnings announcement, and central bank measures impacting margins.

In Brandes' view, the changes are short term and cyclical in nature. These banks are positioned to potentially take advantage of a marketplace where credit and financial product penetration is low, lending spreads are wide, and the economic growth outlook is better than average.

Brandes Views and Outlook

On behalf of our clients, we continue to closely monitor global developments that may influence emerging markets. In our opinion, recent declines in emerging market stock prices have *not* mirrored declines in fundamental strengths. In fact, fundamentals, as noted here, are solid. Brandes sees exceptional opportunities in emerging markets to take advantage of short-term fears and purchase strong businesses at attractive prices.

Price/Book: Price per share divided by book value per share.

Price/CF: Price per share divided by cash flow per share.

Price/Earn: Price per share divided by earnings per share.

The MSCI Emerging Markets Index with gross dividends is an unmanaged, free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. As of May 27, 2010 the MSCI Emerging Markets Index consisted of 21 emerging market country indices. This index includes dividends and distributions, but does not reflect fees, brokerage commissions, withholding taxes, or other expenses of investing.

International investing is subject to certain risks such as currency fluctuation and social and political changes which may result in greater share price volatility; such risks are increased when investing in emerging markets. Additional risks associated with emerging markets investing include smaller-sized markets, liquidity risks, and less established legal, political, social, and business systems to support securities markets. Stocks of small-sized and mid-sized companies usually experience greater volatility than stocks of larger companies. Emerging markets investments can experience substantial price volatility in the short term and should be considered long-term investments. Investments in small and medium capitalization companies tend to have limited liquidity and greater price volatility than large capitalization companies.

The information provided in this material should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any security transactions, holdings, or sectors discussed were or will be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance discussed herein. Portfolio holdings and allocations are subject to change at any time and should not be considered a recommendation to buy or sell particular securities. Strategies discussed herein are subject to change at any time by the investment manager in its discretion due to market conditions or opportunities. Indices are unmanaged and are not available for direct investment. Market conditions may impact performance. The performance results presented were achieved in particular market conditions which may not be repeated. Moreover, the current market volatility and uncertain regulatory environment may have a negative impact on future performance. International and emerging markets investing is subject to certain risks such as currency fluctuation and social and political changes; such risks may result in greater share price volatility. Stocks of small companies usually experience more volatility than mid and large sized companies.

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