



Brandes reports:

THE BRANDES
PERSPECTIVE
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The Plot Thickens in European Sovereign Debt Crisis Story

Executive Summary

- Unfolding events in Europe have shaken global markets, with concerns over a debt default spreading to Italy
- Portfolios are closely monitored given the developments in Europe, specifically on how these affect company-level valuations
- We believe Brandes holdings in Italy have more than priced-in current uncertainties

The European sovereign debt crisis has engulfed Italy, as evidenced by stock market volatility and spiked 10-year interest rates. This has caused too many investors to completely dismiss any and all Italian investments.

Events in Europe are accelerating with Italian Prime Minister Berlusconi being replaced by the Premier-designate Mario Monti. We are closely monitoring the unfolding events in the region. Although we don't anticipate any material changes to our company level valuations, we remain ready to make adjustments as required.

Brandes Portfolio Holdings in Italy

Brandes has direct exposure to Italy: a 7% allocation for the International Equity Portfolio and a 5% to 6% allocation for the Global Equity Portfolio. ¹

A fair question to ask is why would clients want exposure to Italy now? We believe the Italian holdings in the portfolios today have more than priced-in the

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current uncertainties, and that for patient, long-term investors, they offer favorable risk/reward profiles. Italian holdings included in the portfolios share a number of common characteristics:

- Sound balance sheets
- Good cash flow generation
- Substantial dividend yields
- Solid industry market positions

Financials

We have looked closely at Italian financial companies, but wariness to the current crisis has led us to avoid almost the entire sector. The only exception is a single bank, whose risk is controlled by a small allocation in the portfolio of roughly 1%. On a valuation basis, we believe it screens very attractively, trading well below book value. But in the current environment, the bank's strong capital position is paramount. For example, during the financial crisis of 2008, this bank did not need to receive government assistance. Also, it has the largest market share in deposits and loans in its domestic home market.

Telecoms and Energy

The Brandes International and Global portfolios also hold an Italian telecommunications and an Italian energy company. Our telecom holding is a leading Italian fixed-line and mobile operator with strong positions in several mobile services markets in Latin America. The company has committed to both a strong dividend policy and a healthy deleveraging policy that puts the vast majority of free cash flow in the hands of investors.

Our holding in the energy sector is a vertically integrated oil firm with operations at all levels of exploration, production, and refining. The company's operations are primarily in North Africa, Italy, and the North Sea. The stock is trading at a compelling earnings multiple and has one of the highest dividend yields among European integrated oil majors.

Brandes Views and Outlook

If you consider the following points, it will become evident that Italy is going through a credibility crisis, not a credit crisis:

- No property bubble – Italy did not go through a property bubble like Spain, Ireland, or the United States
- Higher household income – Italy's black market is roughly 20% of gross domestic product (GDP), which likely means Italian household income is under-reported²
- Tax revenues sufficient to cover debt interest payments – Italy's total

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interest bill next year is roughly 85 billion euro versus 500 billion euro in projected tax revenue ²

- Expected increase in tax collection – enhanced tax recovery methods could help pay down national debt

At Brandes Investment Partners, we understand the severity and seriousness of the current escalation of the European debt crisis. In this environment, we believe a select number of Italian companies are trading at significant discounts to our estimates of their intrinsic value that justify inclusion into our portfolios. Our investment professionals are vigilantly monitoring the European crisis and waiting patiently to identify investment opportunities that adhere to our Graham & Dodd approach to building diversified portfolios pursuing long-term wealth creation.

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Brandes Update on Spain

At the time of this writing, November 17, 2011, the crisis has moved to Spain. Brandes has only one position in Spain – a phone company with solid fundamentals, deriving half of its revenues from Latin America. We have no direct exposure to Spanish banks.

¹ 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.

² "Pain in the Azzurri." *The Financial Times*. Nov. 8, 2011

Book Value: The value at which an asset is carried on a balance sheet.

Dividend Yield: Annual income from the dividend divided by the current market price of the investment.

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