A commentary from Brandes on Fixed Income –

Has the 40-year fixed income party come to an end?

Dear Clients and Friends,

This quarter, we are writing to you about fixed income. We appreciate that most of our clients and friends know us as a dedicated global value equity manager whose core business has not changed since the founding of the firm in 1974.

However, what some of you may not know is that we have a separate fixed-income group based in Milwaukee. As is the case with the equity side of our firm, the Milwaukee-based team applies a strict fundamental Graham & Dodd value approach to selecting fixed-income securities for clients.

We believe we may have entered a new cycle for fixed income where attention to fundamentals such as cash flow generation, margins, and balance sheet positioning is critical, capping the multi-decade party that favored technical factors like momentum, yield and investor enthusiasm.

When we established our fixed-income group in 1999, we were confident that a value approach could be applied to fixed-income investments as well as equities and that a careful fundamental analysis could identify occasional opportunities where markets mispriced risk. What we did not anticipate, however, was that after the global financial crisis, the Federal Reserve and governments around the world would embrace *quantitative easing* (QE), ushering in a long period of perpetually falling interest rates which in some cases, went negative. These unprecedented conditions favored yield-hungry investors who seemed willing to purchase any issue with a yield over Treasuries, regardless of creditworthiness or risk.

While this period was challenging for our investment approach, we remained patient and committed to our long-term strategy. We firmly believe that patience is an important component of the temperament that successful value investors need. As we watched what was happening in the fixed-income markets, we took the view that QE and actions by central banks around the world would create a *"lower interest rates for longer"* environment. However, we were quick to note that *"lower for longer"* should

Fixed Income Group

Established in 1999

Team Members:
Charles Gramling
Director
29 Years of Investment Experience
22 Years with Brandes

Tim Doyle
Fixed Income Portfolio Manager
27 Years of Investment Experience
22 Years with Brandes

David Gilson
Senior Fixed Income Analyst
34 Years of Investment Experience
20 Years with Brandes

Stephen Comerford
Associate Portfolio Manager / Analyst
25 Years of Investment Experience
6 Years with Brandes

Products:
Government Securities
Corporate Bonds
Structured Products

not be interpreted as *"lower forever."* The lower forever party started to slow down earlier this year, a shocking reminder for many investors that interest rates and inflation can rise—and rise they did.

Bear in mind that the environment for fixed-income investing is not just changing, it's seemingly reverting to its long-term historical norm as central banks have started to move to *quantitative tightening* (QT). To put a little bit of context around this, consider for a moment that over the long term (12/31/1976 to 12/31/2021) returns on U.S. investment-grade fixed-rate bonds averaged 98% from income and 2% from price appreciation. However, if we focus on 2019 and 2020 , price appreciation accounted for 72% and 62% of returns, respectively.[1]

Despite it being a prolonged and heady period, in the long history of fixed-income investing, the bull market for bonds was an anomalous time. We believe we have now entered a more *normal* period where a fundamental value approach, like ours, is more appropriate.

On a year-to-date basis, our fundamental value approach and nimble size has allowed us to show meaningful outperformance relative to our largest peers. We compared our Sep. 30 YTD performance (net of fees) to the mean return (gross of fees) of the five largest U.S. core plus bond separate account composites and noted that although our strategy posted a negative absolute return it outperformed the average by almost 400 basis points.[2]

We are delighted to reproduce here the most recent letter from our fixed income team authored by our colleague, Tim Doyle. Tim is a 27-year veteran of fixed-income investing and trading, bringing important perspective on fixed income and the current environment.

In 1975, REO Speedwagon released an album titled: *This Time We Mean It*. Those words appear to be an apt description of the Fed's messaging to the market during the third quarter regarding its resolve to tame rampant inflation.

While the Federal Reserve (Fed) adopted a more hawkish stance throughout the earlier part of the year and backed up their rhetoric with the fastest rate hikes since the summer of 1980, up until this quarter there appeared to be a lack of market belief in the Fed's conviction to fully commit to bringing inflation under control if it meant causing elevated market volatility. The Fed has *talked tough*, but during the first half of this year, the market seemed to be continually expecting a *pivot* in policy, back to a more accommodative stance.

The last fifteen years of Fed policy are analogous to a long car trip with temperamental children in the back seat. To make the ride smoother and more tolerable you give the kids a bit of sugar, and for a while they're all happy and well behaved. Eventually, however, the sugar rush wears off. As a parent, in the back of your mind you know that the right thing to do is cut off the sugar and deal with the consequences; but it's been such a lovely ride, you wonder what's the harm in keeping the rush going? The problem is that the longer you prolong the inevitable *normalization* the higher the behavioral volatility will likely be.

The Fed made a change to its messaging during the quarter. It effectively told the markets that it is not supplying any more *sugar*. Not unlike the antics of temperamental children, we saw a dramatic sell-off in equites and bonds. Both the S&P 500 and the Bloomberg U.S. Aggregate Index declined by nearly 5% during the third quarter.

Earlier in the year the Fed's message was focused on guiding the economy to a soft landing, which evolved into a "softish landing", and then to more recent rhetoric that there will likely be some economic pain in the efforts to bring down inflation. The Fed has a dual mandate to maintain price stability and full employment. Fed Chair Jerome Powell indicated that the Fed's priority is now keenly focused on price stability.

The open question as we enter the fourth quarter is whether the Fed will stick to its newfound conviction. It's relatively easy to *talk tough* when the unemployment rate is the lowest in nearly 50 years. It's another thing to stay on track if the economy starts shedding jobs or heads into a recession.

The silver lining around the rapid rise in fixed income yields however, is that overall yields are at levels last reached over a decade ago. It seems like a novel idea – tongue firmly in cheek – but by the end of the third quarter, and for the first time in a long time, fixed income securities actually provided an income component.

Annualized total returns as of September 30, 2022	1 Year	5 Years	10 Years
Brandes Core Plus Fixed Income (net of fees)	-12.03	-0.08	1.38
Bloomberg U.S. Aggregate Bond Index:	-14.60	-0.27	0.89

Returns include reinvestment of all dividends and are reduced by any applicable foreign withholding taxes, without provisions for income taxes, if any. Please refer to the GIPS® Report for additional information.

Portfolio Performance

In the third quarter, the Brandes Core Plus portfolios delivered negative absolute returns net of fees but had meaningfully positive relative performance versus their benchmark, the Bloomberg U.S. Aggregate Bond Index.

The underweight in agency mortgage-backed securities (MBS) aided performance during the quarter. During September, agency MBS experienced their worst monthly performance on record versus U.S. Treasury securities. We had previously expressed caution about MBS given our belief that agency MBS valuations have largely been supported by Fed purchase activity since 2008. The Fed finally ended its 15-year outright agency MBS purchase plan that saw its agency MBS holdings grow from zero in 2008 to $2.7 trillion at quarter-end. While the Fed is now allowing up to $35 billion in agency MBS to roll-off its balance sheet each month, we have yet to see that balance sheet contract as higher interest rates have caused mortgage prepayments to shrink to almost nothing. Agency MBS yield spreads have moved wider, and we have yet to see any real decrease in Fed holdings. Returning to our previous analogy of dealing with fractious kids on a road trip: “no, we aren’t there yet!”

At some point, if the Fed is truly serious about reducing exposure to agency MBS, outright sales will have to be considered. While agency MBS yield spreads look more attractive than we’ve seen for some time, there remain strong technical headwinds facing the sector.

Term-structure positioning was a positive factor in performance as interest rates continued their march higher. The portfolios were positioned near the bottom of their duration-controlled band during the quarter, helping to mitigate the impact of rising rates on a relative basis.

Overall, while we are starting to see more value come into the corporate bond market, credit yield spreads have not been as volatile as they were in previous episodes of market instability such as 2002 (Enron and WorldCom bankruptcies), 2008 (Global Financial Crisis), and 2020 (COVID pandemic). Most of the widening in corporate bonds yields has been attributable to the rise in U.S Treasury rates rather than outright weakness in corporate bonds. This reinforces our view that the most prudent approach is to continue to seek value in a measured and deliberate manner.

Outlook

Markets now appear to be exiting a period where valuations were largely artificially propped up by huge injections of liquidity and easy policy by the Fed - not to mention extraordinary stimulus from the federal government. This transition has been painful for virtually every financial asset class over the short-term. In our view, over the last several years fundamentals like cash flow generation, margins, and balance sheet positioning have taken a back seat to technical factors like momentum and investor enthusiasm.

As the market continues to adapt to what appears to be a post-pandemic financial reckoning, we’ve started to see signs of a rise in idiosyncratic risk. For example, one of the first casualties has been a telecommunications company named Avaya. As recently as June, Avaya was able to raise new debt, despite being highly leveraged. As of 9/30/22, the price of those bonds has fallen nearly 40% since issuance after Avaya cut earnings forecasts and disclosed “substantial doubt” about its ability to keep operating. (We did not invest in these bonds).

As we move forward, we believe that understanding how inflation and higher interest rates affect individual companies’ revenue, costs, and ability to refinance has taken on much more importance than it did in a *zero-rate world*. There are an increasing number of bonds that we believe offer attractive yields, but there are also companies facing margin pressures that may have trouble refinancing at higher rates.

Interest rates are higher and yields on bonds are more attractive than they have been in quite some time. We believe, however, that careful security selection rooted in fundamental value principles is the key to successfully guiding portfolios through this uncertain and volatile landscape.

For a considerable period now, we have attempted to tilt the Brandes Core Plus portfolios into what we believe is a defensive posture in order to mitigate some of the potential detrimental impact of rising interest rates and widening yield spreads. The portfolios continue to favor shorter-maturity corporate bonds and those that we believe exhibit strong, tangible asset coverage. We are managing duration toward the shorter end of our duration-controlled range. We have a meaningful allocation to U.S. Treasuries and if recent market uncertainty and volatility continue to cause credit fundamentals to become mispriced relative to our estimates of intrinsic value, then we will look to redeploy some of those Treasury holdings thoughtfully and effectively to take advantage of opportunities.

During the quarter we found a few new bonds that we believe meet our criteria as attractive value opportunities and market volatility provided chances to add to a number of securities that we currently own.

We remain underweight agency MBS.

As we move forward, we believe prudence dictates that we continue our search for value in a measured and deliberate manner while continuing to tilt the portfolios to what we believe is a relatively defensive posture.

We remain optimistic about the prospects for the Brandes Core Plus Portfolios.

Sincerely,

Timothy M. Doyle, CFA
Fixed Income Portfolio Manager

If, like us, you believe that the multi-decade fixed income party is over and a nimble, fundamental approach makes sense going forward, we invite you to contact your Brandes representative to set up a call with Tim or one of his colleagues. We are certain that the perspective you will get from the Brandes fixed-income team will be different to what you typically hear from other fixed-income firms.

Thank you,

Brandes Investment Partners

[1] **Source:** Bloomberg Indices (12/31/1976 to 12/31/2021). Bonds represented by Bloomberg U.S. Aggregate Bond Index. Past performance is not a guarantee of future results. One cannot invest directly in an index.

[2] **Source:** eVestment, Morningstar as of 9/30/2022. Represents 5 largest composites by total strategy assets in Morningstar's U.S. separate account intermediate core-plus bond category for which performance data as of 9/30 and AUM data as of either 6/30 or 9/30 were available. Performance for 12/31/2021 to 9/30/2022: Brandes Core Plus: -11.80% (net of fees) and -11.63% (gross). Mean return of top 5: -15.70 (gross).

Quantitative easing (QE): A form of monetary policy in which a central bank, like the U.S. Federal Reserve, purchases securities from the open market to reduce interest rates and increase the money supply.

Quantitative tightening (QT): Refers to monetary policies that contract, or reduce, the Federal Reserve System (Fed) balance sheet. This process is also known as balance sheet normalization.

Agency mortgage-backed securities (MBS): An MBS issued by one of three quasi-governmental agencies: The Government National Mortgage Association (GNMA or Ginnie Mae), the Federal National Mortgage Association (FNMA or Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). A MBS is an investment similar to a bond that is made up of a bundle of home loans bought from the banks that issued them.

Asset Coverage: Measures how well a company can repay its debts by selling or liquidating its assets.

Basis Point (BPS): 1/100 of 1%.

Cash Flow: The amount of cash generated minus the amount of cash used by a company in a given period.

Coupon: The annual interest rate paid on a bond, expressed as a percentage of the face value and paid from issue date until maturity.

Credit Spread: The difference in yield between two bonds of similar maturity but different credit quality.

Duration: The weighted maturity of a fixed-income investment's cash flows, used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates.

Federal Funds Rate: The interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight.

Floating Rate: A debt instrument that does not have a fixed rate of interest over the life of the instrument.

Idiosyncratic Risk: The risk that is endemic to a particular asset and not a whole investment portfolio.

Term Structure of Interest Rates: A graph that plots different yields offered by bonds of different maturities.

Yield: Annual income from the investment (dividend, interest, etc.) divided by the current market price of the investment.

Yield Curve: A graphical comparison of the relationship between interest rates for loans of various maturities with similar credit quality. A typical yield curve slopes upward to reflect higher interest rates for longer maturities.

Yield Spread: The net difference between two interest-bearing instruments of varying maturities, credit ratings, issuer or risk level.

The S&P 500 Index with gross dividends measures equity performance of 500 of the top companies in leading industries of the U.S. economy.

The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. This index is a total return index which reflects the price changes and interest of each bond in the index.

Bond ratings are grades given to bonds that indicate their credit quality as determined by a private independent rating service such as Standard & Poor's. The firm evaluates a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade. In limited situations when the rating agency has not issued a formal rating, the Advisor will classify the security as nonrated.

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Brandes Investment Partners, L.P.

Core Plus Fixed Income Annual Performance Presentation

As of December 31 Period End
Reporting Currency: USD

	Annual Performance %			Composite Characteristics					Annualized 3 Year Standard Deviation % (2)	
Period	Composite Gross*	Composite Net*	Benchmark (a)	Assets $Millions	Number of Accounts	Internal Dispersion (1)	Non-Fee Paying Accounts (%)	Total Firm Assets $ Millions	Composite Gross	Benchmark (a)
2021	-0.30	-0.53	-1.54	239	9	0.70	0	20,179	2.63	3.35
2020	7.01	6.73	7.51	234	7	0.43	0	18,595	2.58	3.36
2019	7.13	6.84	8.72	249	8	0.15	0	21,451	2.28	2.87
2018	0.01	-0.26	0.01	224	7	0.14	0	22,106	2.46	2.84
2017	3.36	3.09	3.54	176	5	0.32	0	25,578	2.66	2.78
2016	6.14	5.84	2.65	157	8	0.38	0	22,971	2.80	2.98
2015	-0.86	-1.15	0.55	140	11	0.22	0	20,666	2.68	2.88
2014	5.03	4.71	5.97	114	8	0.35	28	20,722	2.66	2.63
2013	1.07	0.73	-2.02	116	11	0.51	26	21,464	2.97	2.71
2012	10.72	10.34	4.22	133	12	0.66	24	22,171	3.15	2.38

(1) The measure of dispersion is the asset-weighted standard deviation for annual period gross returns in USD of all portfolios in the composite for the full reporting period. Beginning in 2017, dispersion is not presented for periods with less than 2 accounts in the composite. Prior to 2017, dispersion is not presented for periods with less than 6 accounts in the composite.

(2) The three-year annualized ex-post standard deviation measures the variability of the monthly gross composite returns and the benchmark returns over the preceding 36-month period.

* The net and gross annual returns, calculated in USD, presented for the Brandes Core Plus Fixed Income composite were calculated on a time-weighted and asset-weighted, total return basis, including reinvestment of all dividends, interest and income, realized and unrealized gains or losses and are net of brokerage commissions, execution costs, and any applicable foreign withholding taxes, without provision for federal and state income taxes, if any. Returns for some accounts in the composite reflect the deduction of a broker fee that includes transaction costs and may include advisory, custody, and other administrative fees.

Beginning January 1, 2018, Brandes Investment Partners includes Brandes Investment Partners, L.P., Brandes Investment Partners (Europe) Limited, Brandes Investment Partners (Asia) Pte Ltd. and the Brandes Investment Partners & Co. assets sub-advised by Brandes Investment Partners, L.P. For the period from 1/1/06-12/31/17 the SMA Division of Brandes was excluded from the GIPS firm definition. The firm was redefined to reflect the dissolution of the SMA Division and the firm bringing those former SMA Division assets into compliance with the GIPS Standards.

This composite was created in 2000. The inception date is 12/31/1999.

Prior to April 2014 accounts were included in the composite when the market value is US$1 million or greater.

The Brandes Core Plus Fixed Income Composite seeks long-term returns in excess of its benchmark (the Bloomberg U.S. Aggregate Bond Index) by investing primarily in United States government and agency debt, U.S. and non-U.S. corporate debt, mortgage-backed securities ("MBS") and asset-backed securities ("ABS"). The composite will be invested in a total of up to 25% in each of non-dollar denominated debt instruments and non-investment grade debt obligations, with the total combination of these two categories not exceeding 35% of the composite's assets as measured at the time of purchase. A minimum of 75% of the investments must be rated investment grade by a nationally recognized rating agency at the time of purchase. The composite may invest in a mutual fund (Separately Managed Account Reserve Trust, or "SMART") that is available only within the Brandes Income Strategies program. Generally SMART is predominantly invested in corporate debt, including non-dollar denominated and non-investment grade debt obligations, but may invest in other types of securities as well. The firm believes this fixed income composite to be aggressive with regard to certain risks, especially credit risk.

From 2010 to 2018 the composite performance after management fee returns were determined by reducing the gross of fee returns monthly by the highest applicable fee schedule per account. Composite performance after management fee returns were determined by using the highest applicable fee schedule per account in January – September 2019. As of October 2019, actual fees are used with the exception of select portfolios to which the applicable fee schedule was applied for the entire year to better reflect our typical management fees.

Standard fee schedule - First $20 million 0.325%; Next $30 million 0.25%; Next $50 million 0.20%; Next $150 million 0.175%; Amounts over $250 million 0.15%. Brandes' investment advisory fees are detailed in Part 2A of its Form ADV.

Brandes claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Brandes has been independently verified for the annual periods 1995 through 2021.

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 and pooled fund 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. The Core Plus Fixed Income Composite has had a performance examination for the periods since inception through year end 2021. The verification and performance examination reports are available upon request.

A list of composite and limited distribution pooled fund descriptions, a list of broad distribution pooled funds, and policies for valuing investments, calculating performance, and preparing GIPS Reports, are available upon request. Contact client service at 800-237-7119 or write P.O. Box 919048, San Diego, California 92191-9048 or email ClientService@Brandes.com.

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(a) The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. This index is a total return index which reflects the price changes and interest of each bond in the index. The benchmark returns are not covered by the report of independent verifiers.