

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Buying on Market Overreactions: SS&C, Equifax and Cigna



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SECTOR — GENERAL INVESTING

TWST: Let's start with an introduction to Brandes Investment Partners. What do you think is good for readers to know about the overall business? What might differentiate or distinguish the firm?

Mr. Fredberg: The key is that we're fundamental value investors. We're trying to buy businesses for less than what they're worth. We talk about essentially trying to buy a dollar for 70 cents, but we want to make sure that dollar is going to grow over time. We don't want companies where the issues are structural and long term, but instead, we're trying to find those where the issues are more short term and fixable.

We don't define value as simply low multiples, but rather we appreciate that growth, quality, and moats are components of value.

I'd also say we have a strong contrarian bias, but we're not blindly contrarian. We appreciate the market gets it right a lot, and so we're looking for the selective opportunities where we have an edge.

It can be from a variety of causes. Maybe it's time arbitrage. The market is getting more myopic, so maybe it's a cyclical company for which the next several quarters look bad, or maybe a company that has experienced some operational issues that we think are fixable but may take some time to resolve.

There are a bunch of analysts out there who are modeling the next quarter's earnings and trying to predict if a company is going to beat or miss consensus. We're more focused on what the economic earnings power of the company is going to look like in three to five years, and whether the issues that are dominating the headlines today are going to still be relevant for that company in five years.

We try to take advantage of some of the behavioral excesses that may exist in the market. Career risk is one of them; with all the pod shops, the hedge funds, and the short-term focus, analysts often fear for their jobs if they look stupid for a bit. It's the old adage that it's better for

your reputation to fail conventionally than to succeed unconventionally. So, we try to take advantage of that.

We appreciate that frequently the market gets the direction right but the magnitude wrong. When something negatively impacts a company, stock prices frequently sell off in a much bigger way than the fundamentals would suggest. We try to be dispassionate about it and just do the work to quantify the impact. That's our approach and philosophy.

In terms of the actual structure, we have a team of 25 analysts, supported by 18 research associates. It's a pretty tenured analyst group, with a median tenure of 24 years. We're sector specialists, so we can get to know the nuances of a sector and its companies pretty well, but we're global and all cap in our coverage, so we're close to potential competitive risks from overseas competitors or from smaller, disruptive competitors.

The final thing I'll mention is we're team based. Not only are our analysts grouped by sector teams, but our investment committees, which are essentially the portfolio managers managing various strategies, are comprised of three to five highly tenured portfolio managers. We think this reduces the key person risk, and it provides greater insights and various perspectives.

It's also harder in that kind of environment for us to react emotionally. Most committee members retain their roles as analysts as well, and this allows them to stay close to how the sausage is made, to allow them to push more on certain assumptions that an analyst may be making in their stock recommendations.

TWST: You mentioned the investment committees and everyone being sector specialists and the analysts working in teams. Would you expand a bit on the research process and the investment decision and portfolio construction process?

Mr. Fredberg: It starts with sourcing ideas, potential investment cases. We'll source ideas in a couple of different ways. A good portion,

maybe half or so, will come from our internal screens. Our screens will include not only standard valuation metrics, but also through-cycle metrics to indicate if a firm may be over- or under-earning. We'll also look at a variety of other metrics like balance sheet strength, quality, and growth metrics. We'll include all these in our screens when we're looking for value.

The other source of ideas comes from just paying attention to what's going on in our industry, reading the news and reading the trade publications and talking to management and the sell side. Given the tenure of our sector specialists, as I mentioned, we're close enough to our coverage to generally be aware of when good companies get punished and may be interesting.

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After an analyst or a team leader of that analyst's sector identifies a potential opportunity, the analyst will typically discuss it with the team leader and then do maybe a couple days of preliminary work. If it still looks interesting, the analyst may spend two weeks or a month researching the company, the threats and the opportunities and how fixable the issues are, things like that. Then they put together a report and recommendation of intrinsic value, and they present that to the appropriate investment committee based on its geography and the market cap.

1-Year Daily Chart of SS&C Technologies Holdings Inc.

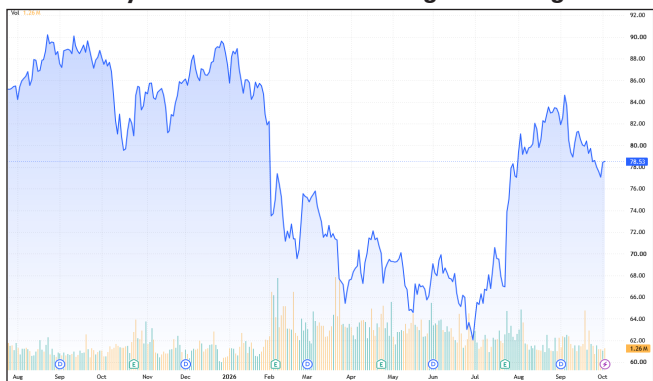


Chart provided by TradingView

Then the analysts present the company to the committee — in the case of the U.S. Value Equity Strategy that we're talking about, it's made up of four portfolio managers — and the committee members probe and challenge the assumptions. It's a friendly meeting, but one where essentially four people are constantly stress testing the ideas and the assumptions. In the end, the committee establishes what it considers to be the intrinsic value or the true worth of the business.

In the portfolio construction process, which is separate, that's where the committee looks to build a portfolio, in this case of 50 to 70 of the

most undervalued stocks on a risk-adjusted basis. The primary factors in stocks getting added to the portfolio are their margin of safety or their discount to intrinsic value. But we also want to ensure it's a diversified portfolio and the stocks play nice with each other, so we don't want a portfolio dependent on just one or two sectors or themes in case the world doesn't work out as we anticipated. So, we look different from the benchmark, and we have quite high active share, even relative to the Russell 1000 Value.

We also have guardrails. One of the guardrails is the industry concentration can be no more than 20% of the portfolio or one and a half times the benchmark at the time of purchase. We'll have constraints like that, but that still allows us plenty of latitude to look different than the benchmark.

Then finally, I'll just mention we typically risk-size our allocations. So, while more undervalued companies receive a higher allocation, the riskiness of a stock also influences its weighting. We're really trying to satisfy both goals of maximizing long-term returns while controlling for risk.

TWST: Specific to the U.S. Value ETF (BUSA), what would you add about the overall strategy behind it and the portfolio characteristics? In particular, I'm hoping you could talk a little bit about why it focuses on large-cap stocks.

Mr. Fredberg: I talked a bit about the strategy already, but a couple more points: The ETF is a very similar version of our main Brandes U.S. Value Equity strategy that we've been running for more than 30 years. So, unlike some of our peers, this is not a different approach, and it's not materially more or less concentrated than our traditional U.S. Value strategy.

Also, Brandes, the firm overall, has been around for over 50 years. All we do is value investing, and so it's just that this particular strategy is aimed only at the U.S. equity market. But it's the same approach and strategy of us trying to assemble a diversified portfolio of undervalued stocks by taking advantage of emotional excess, short-termism, fear and greed, those kinds of things. Many of our clients use us to complement their passive market cap-weighted holdings.

In terms of being a large-cap focus, that's just how a lot of our institutional clients allocate capital. We define large cap as anything greater than \$5 billion, which still gives us the flexibility to buy more modest-sized companies compared to how some other managers define large cap. We also, by the way, have a dedicated U.S. Small Cap and a Small-Mid Cap Strategy.

TWST: Can you tell us about a couple of examples of holdings? How do they illustrate what your ideal investments are?

Mr. Fredberg: I'll mention a couple that are of a similar theme derived from what's happened more recently. The first two touch on some of the opportunities that we think came out of some potential AI overreaction.

The first one is a company called **SS&C Technologies** (NASDAQ:SSNC). This is a software and services company to the asset

management industry, including traditional institutional asset managers, alternatives managers, hedge funds, and wealth managers. It's the leader in the space with 15% to 20% share. It does software as well as the services, but the software does back-office functions like portfolio accounting, reporting, compliance, and investor servicing. It's really a toll collector on the growth of financial assets.

It sold off with other data and software companies on the AI risk earlier this year, but the business is sticky with high switching costs as it provides mission-critical software with recurring revenue and a regulatory component to it. So, it should grow not only from the growth in financial assets, but also from the growth in alternatives.

Even though there has been fear of AI disruption, instead of suffering from AI, it's likely benefiting from AI. The company talks about having added a billion dollars in revenue over the past three years without adding any additional headcount. We were able to buy it below historical valuation levels and at a significant discount to the market.

data is proprietary, meaning the AI threat is not that great. In fact, it's also, similar to **SS&C**, using AI to enhance its productivity and margins.

Not only were we able to buy a quality company well below its historic multiple, but those earnings that the multiple is based on have upside when the depressed mortgage business, which is about 20% of its revenues, eventually improves when the housing market eventually improves.

I'll offer you one more that's a little different, **Cigna** (NYSE:CI), the health insurer. In fact, it's one of the leading health insurers. It offers health insurance primarily through commercial businesses, but it also has its own pharmacy benefit manager, or PBM, including Express Scripts that it acquired in 2018.

There's been a big cloud of regulatory threat over the PBM business, as PBMs have been deemed by the administration to be middlemen taking rebates from pharmacy companies resulting in higher list prices for the end consumers.

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Another one that we bought earlier this year that's somewhat of a similar vein is **Equifax** (NYSE:EFX). This is one of the three consumer credit bureaus in the U.S. The other ones are **Experian** and **TransUnion**.

It's historically grown revenues at mid-single digits or higher because financial institutions, banks and other lenders, they pull credit from all three of these bureaus because the cost is just low basis points as a percent of the loans. The customers aren't very price sensitive given that cost, but it's moving into adjacent verticals like identity and fraud, employment and income verification, and marketing intelligence.

1-Year Daily Chart of Equifax Inc.

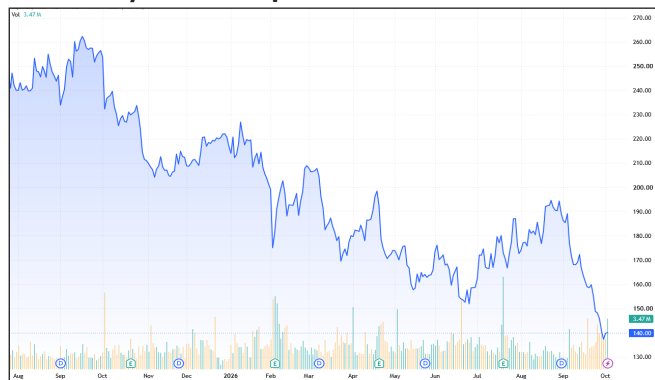


Chart provided by TradingView

This has been a long-term compounder. It generates good free cash flow. We bought it earlier this year when the market got really fearful about data-related companies getting disrupted by AI, so the stock traded down near its lowest valuation in a decade. But with **Equifax**, 90% of its

But in our country, with excessively high medical and drug prices, these PBMs are actually a needed mechanism to control costs. They determine what drugs can be on a formulary, bargaining against the pharma companies and ensuring the patients take the most economically appropriate medication. In some cases, that means generics over branded drugs, ensuring patients get the proper care without overspending.

The administration has threatened to disallow these PBMs getting compensated via rebate from the pharma companies, but **Cigna** and others proactively responded by already switching to a fee-for-service and rebate-free model. So now there's this reduced regulatory threat, but **Cigna** still trades at nine times forward earnings, less than half the market multiple, while it's growing revenues and earnings at about the market average in an oligopolistic business that generates a lot of free cash flow.

So those are three companies, a couple in a similar theme and another in healthcare, that get at different ways we see opportunities, and where there may be overreaction as well.

TWST: Where would you say we are in a growth-versus-value cycle? Is it an attractive environment for value investors now, and what do you anticipate for the foreseeable future?

Mr. Fredberg: These regimes of growth versus value last for a number of years. Historically, we've calculated them to be roughly eight to 10 years, but they can vary dramatically. It's been a very extended period of growth outperformance relative to value. But it may surprise many people that value has performed fairly close to growth over the past five years. Obviously this year, value has been outperforming.

We definitely think value is attractive right now for a couple of reasons, but one of the most important is just that it's an incredibly concentrated market. Not only do the top 10 stocks make up 38% of the S&P 500 Index, which is more concentrated than it's been at any time

since the Nifty Fifty, but it's really all one trade — it's the AI trade. If you think about both the winners and losers, those companies deemed to be winners and losers from AI, that's roughly half the market.

That's why we think the fundamental value strategy right now can provide a really helpful complement, just given the diversification, in case this AI buildout goes awry. The S&P 500 Index, just given its market cap weighting, it's really morphed into very much a growth-weighted index. So, value can be more complementary than it normally is right now.

The other thing I'd say about the current environment, though, is that while the market valuations overall look quite full, they don't look alarming. It looks like it's less of a valuation bubble in the market and more of an earnings bubble. I say that because when you have \$750 billion of hyperscaler capex that pushes through a supply chain that can't handle it, it's like attaching a firehose to a garden hose, and margins and profitability just start blowing out all over.

That's what we see with a lot of these pick-and-shovel companies to the whole AI buildout. The multiples on those companies don't look extreme. They look full, but they don't look extreme. The question is if the bubble is more in the earnings than multiple.

The final thing I'll say is when we look at value relative to growth, we look at a composite measure which includes a variety of metrics: price-to-earnings, forward price-to-earnings, EV-to-EBITDA, price-to-cash flow, price-to-book — a variety of metrics like that. Right now, value is trading materially cheaper relative to growth than it has historically, despite that better performance more recently this year that I mentioned.

So, for those various reasons, we think value is pretty attractive in this current environment.

TWST: Is there anything else that you'd like to discuss, or some final words of advice to conclude with?

Mr. Fredberg: A little color that I'd add is that, while I talked about the benefits of diversification being greater than really any time since the tech bubble, you can think that you're diversified by owning a tech company, an industrial, a utility, energy companies, and emerging markets, but really they're all dependent on this one AI buildout trade.

Value can be very much a diversifier, but you have to be careful with the kind of value that you're getting. Right now, many quant value ETFs are just giving you more of the same.

Through May of this year, tech alone contributed over 60% of the Russell 1000 Value return. During that time, we were viewing them as expensive and we were trimming. But in the Russell 1000 Value Index right now, the top three holdings are **Amazon**, **Apple**, and **Microsoft**, each at close to 5% or more.

Many so-called value ETFs, especially the more quantitative-based ones, have 30% to 40% allocation to tech. With 30% to 40% allocation to tech, you may not be getting the diversification to the rest of the market that you're thinking.

Overall, this is a good time to practice financial hygiene, including rebalancing and real diversification, as many investors may be more concentrated than they think.

TWST: Thank you. (MN)

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