Brandes Investment Partners
Core Plus Fixed Income Strategy Notes
Third Quarter 2025 (July 1 – September 30, 2025)

The Brandes Core Plus Strategy rose 1.73% net of fees and 1.80% gross of fees, but underperformed its benchmark, the Bloomberg U.S. Aggregate Bond Index, which was up 2.03% in the quarter.

Annualized total return as of September 30, 2025	1-year	5-year	10-year
Brandes Core Plus Fixed Income Composite (net)	2.98%	0.75%	2.31%
Brandes Core Plus Fixed Income Composite (gross)	3.26%	1.01%	2.58%
Bloomberg U.S. Aggregate Bond Index	2.88%	-0.45%	1.84%

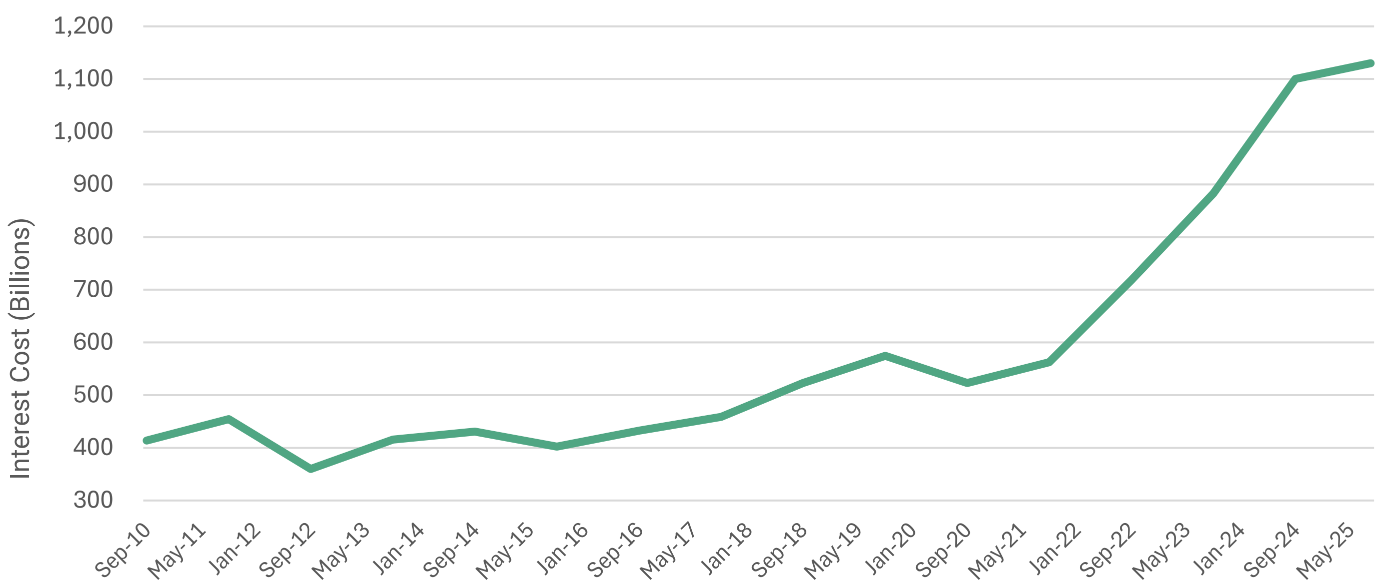
Past performance is not a guarantee of future results. One cannot invest directly in an index. Returns include reinvestment of all dividends and are reduced by any applicable foreign withholding taxes, without provisions for income taxes, if any.

All eyes in the markets were on the Fed (Federal Reserve) this quarter as the external pressure to deliver a rate cut rose to fever pitch. The Fed acceded to the wishes of the current administration and many market participants and cut the fed funds rate by 25 basis points in September. The question for us is whether this cut was justified by economic data or was it largely a transparent political move?

The Trump administration appointed a new Fed governor shortly before the meeting that delivered the rate cut. As we have previously discussed, two sitting governors appear to be openly angling for the job as the next Fed chairperson when Jerome Powell's term expires in May, leading to what appears to be a decidedly more dovish tilt to the Fed Board.

Annual U.S. Government interest expense has approximately doubled since the outbreak of COVID in early 2020. Federal debt and federal spending continue to set peacetime records. If there was any mystery as to why the administration has been putting a full court press on the Federal Reserve to lower interest rates, the exhibit below should clarify their motivation. The U.S. fiscal situation remains a *hot mess*, yet markets surprisingly appear to remain largely unconcerned.

Exhibit 1. There's No Mystery Why the Administration Would Like Lower Interest Rates
Annual U.S. Government Interest Expense ($ billions)



Source: U.S. Treasury Department. Interest Expense is the interest the government pays on its outstanding loans (Treasury securities).

In its Summary of Economic Projections, the Fed upgraded its GDP estimate, maintained its employment projections, and predicted that inflation will remain above target – yet still opted for a rate cut. So much for "data dependent" Fed policy. Chair Powell referred to the rate cut as a "risk management" cut, with his post-meeting comments largely focused on the slowing labor market as justification.

Labor dynamics, however, appear to be shifting due to near-zero net immigration growth, which has lowered the baseline for job creation. This may explain slower hiring without a corresponding rise in unemployment. While job creation is slowing, the labor market appears to be in stasis, with relatively balanced labor supply and demand. The Fed's focus on labor may be misplaced, as we believe inflation poses longer-term risks.

After a period of moderation into the spring, inflation appears to be trending upward once again. During the third quarter, we examined how many times over the past forty years the Fed has lowered the fed funds rate when core CPI was at least 3%. We found that it has happened only five times. Three instances were during market crises - the implosion of hedge fund Long-Term Capital Management in 1998, the bursting of the tech bubble in 2001, and the Global Financial Crisis in 2007. Excluding those market crises, the only occurrences were in 1995, and in the current rate cutting cycle (September 2024 when the Fed lowered rates by 50 basis points). In other words, absent a market crisis, it has been rare historically to see the Fed cutting rates when core inflation is at or above 3%. The market is now forecasting two additional rate cuts before year-end and expecting the fed funds rate to settle at 3% by the end of 2026.

Yield spreads on most taxable fixed income sectors tightened during the quarter and currently stand at or near their tightest levels for several decades.

Portfolio Performance

In the third quarter, the Brandes Core Plus strategy delivered positive returns but underperformed versus its benchmark, the Bloomberg U.S. Aggregate Bond Index.

The portfolios' underweight to agency mortgage-backed securities (MBS) modestly detracted from returns as the MBS sector saw yield spreads tighten to multi-year low levels.

Term structure positioning was a modest negative. The overall portfolio duration was maintained at 90% of the benchmark throughout the quarter. This duration positioning detracted from performance as interest rates declined during the period. The impact was somewhat muted as interest rates at the short end of the yield curve declined more than longer-maturity securities. The portfolio has been favoring shorter maturity securities – particularly in corporate bonds.

Select holdings in corporate bonds provided a positive contribution to returns during the quarter, led by holdings in communications (Univision & Fibercop), consumer cyclical (Kohl's Corp), and energy (Transocean).

The portfolio added a new position in a secured bond from Sabre Global (11.125% coupon, maturing 7/15/30, rated B3/B-) and a second lien security from Gray Media (9.625% coupon, maturing 7/15/32, rated B3/CCC).

Sabre is a global software and technology provider to the global travel industry. Sabre's business model is a transaction-based one that ties revenues to a travel supplier's transaction volumes. Sabre facilitates travel by connecting airlines with travel agents and other travel intermediaries. The company has been facing macro headwinds as the travel industry is in a recession. Sabre, however, has recently released a new technology platform that is gaining market share against its competitors. The company recently sold a division catering to the hospitality industry, with the proceeds earmarked for debt reduction. The core business is generating positive free cash flow. Essentially, Sabre is executing well: controlling what they can control. The company should be well positioned when the cyclical headwinds facing the industry begin to abate.

The portfolio experienced a maturity in Charter Communications and a call of our position in Toll Brothers.

Outlook

There are a variety of economic headwinds that in our view the market should be wary of: slowing labor markets, sticky inflation, tariff uncertainty, and the deteriorating fiscal situation. Yet the markets continue largely to chug along, continually setting new highs in equities, while corporate bond investors appear comfortable accepting less compensation in terms of yield spreads relative to U.S. Treasury securities.

While most market participants seem to be focused on *letting the good times roll*, there were two unexpected bankruptcies in the quarter: subprime auto lender Tricolor Holdings and auto parts company First Brands. In addition, a potential bankruptcy loomed late in the quarter for a large Brazilian petrochemical company, Braskem. These developments bear watching to assess whether each situation is unique or if these collectively might be an early signal of broader cracks forming in the credit markets.

Oaktree Capital Management's Co-Chairman Howard Marks recently said: "The worst loans are made at the best of times."[1] We would agree. The takeaway in our view is that deep, measured, fundamental research is essential as we move forward in an environment where idiosyncratic risks may be on the rise, but investor compensation is largely not commensurate with the risks being taken. We believe it's critical to be patient in adding to a portfolio: not just know what you own but why you own it.

We continue to tilt the Brandes Core Plus portfolio into what we believe is a defensive posture to mitigate some of the market uncertainty and potential for widening yield spreads. We believe that this remains a risk. Accordingly, the portfolio continues to favor shorter-maturity corporate bonds and those that we believe exhibit strong, tangible asset coverage. We are managing duration approximately 10% shorter than the portfolios' benchmark. We have a meaningful allocation to U.S. Treasuries and if 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.

We remain underweight agency mortgage-backed securities.

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 Portfolio.

Sincerely,

Timothy M. Doyle, CFA
Fixed Income Portfolio Manager

[1] Matt Wirz and Sam Goldfarb, "The Credit Market is Humming – and That Has Wall Street On Edge," Wall Street Journal, September 29, 2025

For term definitions, please refer to: https://www.brandes.com/termdefinitions.

For index definitions, please refer to: https://www.brandes.com/benchmark-definitions.

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