Brandes Investment Partners
European Equity Strategy Notes
First Quarter 2025 (January 1 – March 31, 2025)

The Brandes European Equity Strategy rose 9.31% net of fees and 9.44% gross of fees, underperforming its benchmark, the MSCI Europe Index, which increased 10.48% in the quarter as well as the MSCI Europe Value Index, which appreciated 16.13%.

Annualized total return as of March 31, 2025	1-year	5-year	10-year
Brandes European Equity Composite (net)	15.97%	19.10%	6.87%
Brandes European Equity Composite (gross)	16.64%	19.88%	7.54%
MSCI Europe Index	6.87%	13.14%	5.67%

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.

Positive Contributors

Within the MSCI Europe Index, the two best-performing industries by a fairly wide margin were aerospace and defense, and banks. The strategy's leading contributors were in these two industries, led by our investment in France-based bank BNP Paribas. European banks have performed well this year. Their performance has been driven by better-than-expected earnings growth plus an improved economic environment. These conditions have led to a growth in loans and improved market optimism, which has resulted in rising valuations. Due to this strong performance, we have pared some of our holdings modestly and are now near an equal weight for banks against the broad index.

Notable aerospace and defense contributors included Rolls Royce in the U.K. and Lisi in France. Rolls Royce's share price has appreciated substantially over the past few years as its end-markets recovered, leading improved earnings and cash flow generation. Rolls Royce announced upgraded fiscal year guidance and a share buyback as its balance sheet has improved significantly from the depths of the pandemic downturn.

Other contributors included communication service companies Magyar Telekom in Hungary and Orange in France. Magyar saw its share price rise after reporting earnings results that were ahead of market expectations and announcing a dividend increase. Consumer products producer Heineken Holding and luxury goods company Compagnie Financiere Richemont also rose after announcing improving earnings results.

Performance Detractors

Many technology-related stocks pulled back, and in keeping with that trend, our allocation to Netherlands-based semiconductor company STMicroelectronics detracted from overall returns. Market doubts about the recovery of its industrial and automotive end-markets continued to weigh on the stock. However, with our longer term focus, we continue to believe the shares offer an appealing investment opportunity at today's valuation levels.

Other material detractors included investments in the communication services and consumer sectors. These included advertising agencies WPP and Publicis, luxury goods companies Kering and Swiss watchmaker Swatch, as well as consumer staples holdings Henkel, J Sainsbury and C&C Group.

U.K.-based advertising agency WPP declined after issuing weaker guidance for 2025 because a potential turnaround continues to take longer than anticipated; the stock price of its France-based peer, Publicis, also fell due to concerns about weaker industry growth this year.

Despite improved earnings results, France-based luxury goods company Kering weakened after its recently appointed CEO announced a new creative director for the company's Gucci brand. This new hire will likely result in a potential rebound taking longer than the market had previously expected. Additionally, after rising early in the quarter, the luxury goods industry subsequently softened as a result of increasing uncertainty about the U.S. macro environment and the effect of tariffs on U.S. consumer purchases.

While substantial pessimism has undermined Kering in the short term, we believe the shares offer an attractive long-term opportunity given the company's robust free cash flow in different economic environments, durable brand recognition, management alignment with shareholders, and its current valuation discount relative to its own history and that of its peers.

Shares of Ireland-based beverage company C&C Group declined amid a weaker U.K. hospitality environment, as well as market uncertainty about the timing of a potential turnaround. Its new CEO took office during the quarter and is implementing a strategic plan to simplify its business segment lines and invest in a brand turnaround.

Compared to both the broad and value index, the strategy's underweight to financials, the best performing sector in the index, was a detractor from returns.

Select Activity in the Quarter

Activity was higher than it has been in recent periods as the investment committee divested several companies that performed well, notably Germany-based Heidelberg Materials and Spain-based Atresmedia. Meanwhile, short-term and company-specific market negativity also led the investment committee to deploy capital into more attractively priced investment opportunities, including spirits company Pernod Ricard, IT Service firm Capgemini, Ireland-based pharmaceutical firm Avadel, commercial services company U.K.-based Rentokil, and Germany-based consumer apparel company PUMA.

Capgemini is a global IT services/consulting company based in France. Capgemini is a well-regarded partner for many software providers (e.g., SAP and MSFT) in Europe. It has improved its product mix over time, increasing its exposure to higher-value-added offerings with secular growth potential (digital transformation, cloud, outsourced engineering and R&D, AI, etc.), while reducing its exposure to the low-growth outsourcing segment.

The IT services industry in general benefitted significantly during 2020–2022 as corporations sought to better digitize their capabilities during the pandemic. But during the past couple of years, the IT services industry has experienced a decline in corporate discretionary tech budgets (excluding AI and cybersecurity). While some of its peers are starting to show indications of resumed discretionary spending to normal levels, Capgemini has had lagging revenue growth. Sentiment soured after the company delivered lower-than-expected revenue guidance, which suggests its recovery may be prolonged.

Capgemini currently trades at a marked discount vis-a-vis its peers. This is partially warranted because of its greater exposure to Europe (~60% of revenues versus most competitors at 20–35%) and to manufacturing (particularly autos, which is cyclically depressed). However, we believe the current discount provides a compelling opportunity to own a structurally growing business that earns high return on capital at what we consider an attractive price.

France-based Pernod Ricard is one of the world's largest premium spirits companies (first by volume, second by value). It has a strong brand portfolio, owning 18 of the top 100 brands (e.g., Martell, Jameson, Absolut, Chivas) and significant exposure to emerging markets, which comprise nearly half of its sales.

However, the company's share price has declined recently primarily due to concerns over future prospects in the U.S. and China, which together make up ~29% of group sales. In the U.S., the spirits market declined in volume and value terms in 2023 for the first time in more than a decade. In China, growth expectations for the market remain uncertain due to a weak macro environment and downtrading in spirits. Despite these recent challenges, Pernod Ricard remains a high-quality business with defensive characteristics. We believe it represents a compelling opportunity in light of its low earnings multiple. And we think the company offers long-term growth potential, given its end-market exposure, as well as potential margin expansion from operating leverage. For these reasons, we initiated a position in Pernod Ricard.

Current Positioning

The Brandes European Equity Strategy holds key overweight positions in communication services and consumer staples, while maintaining significantly lower allocations to materials, financials and industrials than the benchmark.

On a geographic basis, the portfolio's largest allocations continue to be in France and the United Kingdom. The strategy remains underweight in Germany and Switzerland, as well as to companies in the Nordic Region.

The quarter witnessed a reversal of a number of market trends we have seen over the past several years as European stocks dramatically outperformed U.S. stocks (MSCI Europe vs. MSCI USA) and value stocks surpassed growth stocks (MSCI Europe Value vs. MSCI Europe Growth).

We cannot predict if this pattern will continue. But we do believe that European *and* value stocks offer compelling return potential based on their current valuation levels.

Before this quarter, U.S. stocks had outperformed European stocks for the past 15 years. However, that dominance was only partly shaped by fundamentals. The gap was also influenced by a climbing U.S. dollar and an increasingly expensive U.S. stock market based on various valuation multiples (or "multiple expansion"). These factors have powered ~5% annualized of U.S. outperformance versus European markets since 2011. Given elevated levels of the U.S. Dollar (it approached record highs as 2024 closed but started to wane as 2025 began) and U.S. valuations, it seems unlikely to us that this tailwind will continue. If it reversed modestly (as is occurring now), we believe it could become a strong tailwind for European stocks. On a sector-adjusted basis, European stocks continue to trade near some of the largest valuation discounts versus U.S. stocks; we believe that disparity should continue to bode well for value.

Value stocks outperformed the overall market during the quarter (MSCI Europe Value vs. MSCI Europe). But they continued to trade among the cheapest quartile relative to their history on a variety of valuation measures compared to growth stocks. Historically, those discounts have augured well for value during the subsequent three- to five-year period. Notably, our portfolio—guided by our value philosophy and process—has tended to outperform the benchmark when value stocks have outperformed the MSCI Europe Index, especially over longer term time horizons. We therefore believe the Brandes European Equity Strategy is an excellent complement and diversifier versus passive and growth-oriented strategies.

Uncertainty is an enduring feature of markets, though market unease may seem more elevated today than during many periods in the past 10–15 years. However, we believe it is also prudent to recall that markets do evolve over time, and companies will adapt to their changing environments. While recently announced tariffs add complications, their impact and duration could vary by company/industry. As a fundamental, bottom-up, research-focused manager, Brandes is in a favorable position to capitalize on over- and under-reactions as potentially mispriced companies adapt to their new operating realities.

Looking ahead, we remain optimistic about the long-term prospects of the companies owned by the Brandes European Equity Strategy. As of March 31, 2025, our strategy traded at what we consider more compelling valuation levels than the benchmark and the MSCI Europe Value Index.

Term definitions: https://www.brandes.com/termdefinitions

Multiple Expansion: an increase in a valuation multiple such as a Price to Earnings multiple.

The MSCI Europe Growth Index captures large and mid cap securities across developed Europe exhibiting growth style characteristics, defined using long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend.

The MSCI Europe Index with net dividends captures large and mid cap representation of developed market countries in Europe.

The MSCI Europe Value Index captures large and mid cap securities across developed Europe exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

The MSCI USA Index measures the performance of the large and mid cap segments of the U.S. equity market.

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