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INVESTMENT PARTNERS

Brandes Investment Partners
Global Small-Mid Cap Equity Strategy Notes
Fourth Quarter 2022 (October 1 – December 31, 2022)

The Brandes Global Small-Mid Cap Equity Strategy rose 18.92% net of fees and 19.08% gross of fees, outperforming its benchmark, the MSCI World SMID Cap Index, which increased 11.21% in the fourth quarter.

Annualized total return as of December 31, 2022	1-year	5-year	10-year
Brandes Global Small-Mid Cap Equity Composite (net)	-4.75%	2.20%	8.07%
Brandes Global Small-Mid Cap Equity Composite (gross)	-4.22%	2.91%	8.96%
MSCI World SMID Cap Index	-18.93%	3.74%	8.11%

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. Please refer to the GIPS® Report for additional information.

Positive Contributors
Value outperformance provided a tailwind for the strategy. Financials holdings, including Ireland-based **AIB Group**, Greece-based **Piraeus Financial**, Austria-based **Erste Group**, and U.S.-based **National Western Life** were among the strongest performers, benefiting from the global rise in interest rates.

A variety of cyclical and economically sensitive businesses also aided returns as they outperformed the broader market (MSCI World SMID Cap Index). These included U.K.-based **Rolls-Royce** and **ITV**, as well as Brazil-based regional jet manufacturer **Embraer**.

Rolls-Royce rose as global air traffic continued to increase, helping engine flight hours recover. The company's shares were also boosted by an improved balance sheet and news that its engines would be used on the next-generation fleet replacing the Black Hawk helicopters, which currently use legacy GE engines.

Performance Detractors
In an overall rising market, only a few holdings declined, led by Indonesia-based tobacco company **PT Gudang Garam** as well as health care holdings **Pediatrix Medical Group** and **Taro Pharmaceutical**.

Other detractors included food products company **Toyo Suisan Kaisha** and technology company **Netgear**, which both declined.

Select Activity
In the roughly 15 years since the Global Financial Crisis, the portfolio has always held at least one homebuilder. Over time, the portfolio's allocation to a selection of homebuilder holdings has changed based on company-specific execution, regional differences in activity, and market perception. However, with the sale of **Taylor Morrison** (TMHC), the portfolio no longer has exposure to homebuilders.

TMHC was first added in 2018. The company completed its initial public offering in 2013 and subsequently restructured its operations through a series of acquisitions and divestitures. TMHC's footprint in the Southwest, Texas, and the Southeast underpinned its recovery as those regions continued to have faster than average population growth. At the time of first purchase, the U.S. housing market was still in the process of recovering to our estimate of normal cyclically adjusted housing starts. Additionally, TMHC built an inventory of land at low prices due to the slow recovery of the sector, and had recently exited the Canadian housing construction business. These factors along with what we consider a discounted market valuation made TMHC an attractive investment opportunity.

While the pandemic initially resulted in a slowdown in housing activity, it soon reversed course and the housing market became turbocharged with low interest rates and increased demand for single family homes. Today, TMHC screens as a traditional value stock. The company trades at low valuation multiples measured both on a price-to-earnings and price-to-

book-value metric. New housing starts in the U.S. are close to what we consider to be normal. Despite these positive characteristics, the risks of slowing demand and the potential for asset impairment from inflated land values threatens to overwhelm these positive attributes. In years past, steeply discounted market valuations have more than compensated the portfolio for holding a homebuilder while heading into a housing slowdown. While the housing market recovery from the Global Financial Crisis was not a straight-line recovery, nor did we ever expect it to be, market valuations today do not offer enough of a discount for us to “wait it out” like we have in the past. Consequently, our investment committee sold the last homebuilder.

In the fourth quarter, the investment committee added **Koninklijke Philips**. In a “normal” year, Philips derives half of its revenue from the sale of diagnostic imaging devices such as MRI, X-ray, and ultrasound machines. A quarter of the company’s revenue is generated from the sale of patient monitoring and respiratory care solutions. Lastly, around a fifth of the company’s revenue comes from consumer products in the categories of oral health, beauty, and child care.

Unfortunately for Philips, it has been a while since the company has had a “normal” year. The start of the pandemic caused a slowdown in the company’s business due to customers delaying purchases of equipment as elective medical procedures fell in 2020. In 2021, the industry began to recover along with patient volumes. The company, however, had a product recall of its sleep apnea devices in June 2021. It was determined that under certain circumstances, sound abatement foam used in the devices could degrade and expose patients to toxic substances. This caused the company to incur substantial costs associated with the recall and replacement of ~5.5 million respiratory machines. Philips is nearing completion of the product recall but resolving the legal claims against the company will take time.

Precisely estimating further costs in terms of both legal costs and lost market share costs with any precision is not possible. As more information came forth after the recall announcement, the magnitude of the issue became clearer and the share price continued its steep decline. Since the recall was announced, the company’s market value has fallen by more than $40 billion. To put the decline in perspective, the respiratory device segment represented around 15% of company revenue. While we cannot predict the value lost, we can reasonably estimate the value of the respiratory care business prior to the recall. We also know the approximate size of the patient population affected and can lean on a long history of past legal settlements related to medical devices. Additionally, Philips has a manageable amount of financial leverage with no significant debt maturities over the next four years and could likely survive even a very negative legal outcome. Despite the great amount of uncertainty, the market has already implied significant future costs will be incurred. The magnitude of the discount was sufficient for the committee to add Philips knowing that patience and uncertainty could also lead to opportunity. While investment risk inherent in any specific investment can never be eliminated, the price paid can contribute to lowering the risk even in the face of uncertainty. Philips presents a risky investment opportunity that we believe is made less risky by the current market valuation.

Year-to-Date Briefing

The Brandes Global Small-Mid Cap Equity Strategy declined 4.75% net of fees and 4.22% gross of fees, outperforming its benchmark, the MSCI World SMID Cap Index, which fell 18.93% for the year ended December 31, 2022.

As was the case in the quarter, the strategy’s outperformance was helped by the value tailwind. Return contributions came from various holdings, specifically those in financials and energy as well as stock selection relative to the benchmark in technology and communications services. From a geographic standpoint, allocation to companies in the U.S. and Japan generated solid relative returns, as did many of our holdings in emerging markets.

At the stock level, the largest drivers of our outperformance relative to the benchmark were led by U.S. energy company **Chesapeake Energy**, Irish bank **AIB**, and IT service firm **Amdocs**. Other contributors included France-based **Societe BIC** and Japanese companies **Calbee**, **Japex**, and **Sankyo**.

Major detractors included U.K. holdings **Marks & Spencer** and **De La Rue,** as well as health care holdings **Taro Pharmaceutical** and **Draegerwerk**. While **Embraer** performed well in the fourth quarter, it remained a detractor for the overall year.

Current Positioning

The strategy held key overweight positions versus the benchmark in the consumer staples and health care sectors. Our weights to health care companies increased as the market declined and we found new opportunities and added to existing ones. As a result, our overall cash weight decreased. Meanwhile, we remained underweight in typically cyclical sectors, such as materials, industrials, and consumer discretionary, as well as perceived “safe havens,” such as utilities, which have held up better and tended to trade at more expensive valuation multiples than other sectors, as investors seek yield and capital preservation.

Geographically, we continued to find value opportunities outside the U.S., especially in the U.K., Japan and specific emerging market countries. As of December 31, the portfolio remained materially underweight compared with the benchmark’s allocation to the U.S.

As we noted last quarter, a variety of headwinds face global stocks today, ranging from elevated inflation, slowing economic growth and recession concerns to energy risk and political as well as regulatory uncertainties. While our overall positioning is driven by a bottom-up stock selection with a focus on the long term, we do consider many of these concerns when we analyze an investment opportunity, determining how they can impact the fundamentals of a business and comparing our intrinsic value estimate against what is currently being priced in by the market. We believe the portfolio’s current positioning offers an attractive opportunity for long-term investors. Compared to the benchmark, the portfolio generally has less cyclical or what we consider expensive growth exposure, as seen through our underweights to technology and materials. In contrast, the portfolio provides more defensive exposure, as highlighted by our overweights to consumer staples and health care.

Within the global small-mid cap space, even after recent value outperformance (MSCI World SMID Cap Value vs. MSCI World SMID Cap), value stocks continue to trade at large discounts across a variety of metrics (e.g., price/earnings, price/book, enterprise value/sales) to growth stocks (MSCI World SMID Cap Growth). Wide discounts have boded well historically for value returns relative to growth. This, combined with the current margin of safety exhibited by our portfolio, drives our optimism about the prospects for the Brandes Global Small-Mid Cap Equity Strategy.

Margin of Safety: The discount of a security’s market price to what the firm believes is the intrinsic value of that security.

Price to Book: Price per share divided by book value per share.

Price to Earnings: Price per share divided by earnings per share.

Enterprise Value: Market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents.

Enterprise Value/Sales: Enterprise value divided by annual sales.

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

The MSCI World SMID Cap Growth Index captures mid and small cap securities exhibiting overall 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 World SMID Cap Index captures mid and small cap representation of developed market countries.

The MSCI World SMID Cap Value Index with net dividends captures small and mid cap securities across developed market countries exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

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Diversification does not assure a profit or protect against a loss in a declining market.

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