BRANDES
INVESTMENT PARTNERS

Brandes Investment Partners
Global Small-Mid Cap Equity Strategy Notes
First Quarter 2023 (January 1 – March 31, 2023)

The Brandes Global Small-Mid Cap Equity Strategy rose 6.32% net of fees and 6.47% gross of fees, outperforming its benchmark, the MSCI World SMID Cap Index, which increased 4.39% in the first quarter.

Annualized total return as of March 31, 2023	1-year	5-year	10-year
Brandes Global Small-Mid Cap Equity Composite (net)	5.90%	3.98%	7.37%
Brandes Global Small-Mid Cap Equity Composite (gross)	6.48%	4.69%	8.24%
MSCI World SMID Cap Index	-9.32%	4.77%	7.57%

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

Our performance was led by a variety of cyclical holdings in aerospace and defense, as well as defensively oriented holdings in the consumer staples sector.

U.K.-based **Rolls-Royce** continued to recover from the downturn in demand for long-haul air travel. The company posted improved operating results and has been awarded with several new contracts over the last several months, strengthening expectations for free-cash-flow generation.

Similarly, Brazilian regional jet manufacturer **Embraer** remained on track in its post-COVID rebound, with deliveries for business and commercial jets continuing to increase. Additionally, one of its competitors announced it officially shut down its next-generation commercial regional jet program, which could leave Embraer to be the primary supplier in this market.

Several of our European grocer and retail holdings rose, led by U.K.-based **J Sainsbury** and **Marks & Spencer.** Other contributors included Indonesia-based tobacco company **PT Gudang Garam** and Greece-based bank **Piraeus Financial**.

Performance Detractors

The healthcare sector underperformed the MSCI World SMID Cap Index and our overweight was a detractor from relative performance. Several of our largest detractors included health care holdings which declined including **Taro Pharmaceutical, United Therapeutics, Elanco Animal Health, and Taisho Pharmaceutical.**

Other detractors included Irish beverage company **C&C Group**, U.K.-based currency manufacturer **De La Rue**, and Japan-based food products company **Calbee**. De La Rue declined as it suspended its printing operations in Kenya.

Select Activity

Over the past few months, the Small-Mid Cap Investment Committee sold **Krones AG**. The company is the largest manufacturer of bottling and packaging machinery with an estimated global market share of 25 percent. Krones is based in Germany but generates sales around the world with emerging markets accounting for around half of total revenue. The company is strongest in equipment for PET (plastic) containers but has bottling solutions utilizing a variety of materials.

Krones was first added to the portfolio in 2018. At the time, the company's share price had fallen by half as investors digested financial updates that highlighted slowing sales growth and escalating costs. By the end of 2018, Krones was trading at relatively low multiples of earnings and book value. Given the market concentration, barriers to entry, and expected long-term growth potential in the global packaged consumer goods industry, the investment committee was confident that the company would return to growth and margins would improve. In the meantime, the market valuations were sufficiently low enough to allow our investment thesis to unfold over years and still generate what we considered a good return.

Ultimately, Krones went through two years, 2019 and 2020, with low sales and depressed earnings before beginning to recover in 2021. The committee continued to average down as Krones' share price set new lows in 2020. By the end of 2022, margins had improved to historical averages and revenue reached an all-time high in dollar terms. The company's share price reflected this recovery and market multiples increased along with enthusiasm for the momentum in business fundamentals. Ultimately, market valuations became too rich for the investment committee, causing it to look for better long-term returns elsewhere.

A recent addition to the portfolio is **OneMain Holdings**. The company is the largest non-prime personal loan provider in the United States with a market share in excess of 20 percent. Since non-prime consumer finance companies provide credit to borrowers with impaired or limited credit histories, the asset quality of the lenders tends to be highly sensitive to the economic cycle. This economic sensitivity gave rise to the creation of OneMain as an independent company. After the Global Financial Crisis (GFC), many banks sold or shuttered their non-prime consumer finance businesses with OneMain being the combination of AIG's and Citigroup's former subsidiaries. Another national non-prime lender, HSBC, shut down its consumer finance business in 2010. As the economy slowly improved after the GFC, so did the non-prime consumer lending industry. Increased market share concentration, falling interest rates and a strong job market created a perfect environment for the companies. Financial stimulus during Covid lockdowns shielded the industry from significant loan losses. However, good times usually don't last, and the market is already anticipating a significant change in OneMain's fortunes as the share price has fallen by more than half from its 2021 peak.

The greatest risk with investment in OneMain is the possibility of a significant economic recession in the U.S. Despite this concern, we are comfortable with OneMain as an investment as the company has conservatively reserved for loan losses, has lower financial leverage compared to its past, and has a history of industry-leading underwriting quality. Most importantly, we believe the falling market valuation of the company provides some potential for capital protection in the event of an economic slowdown. Additional risks such as increasing borrowing costs, increasing competition from online lenders and the threat of regulation were considered by our committee when making the investment decision, but we believe that ultimately these risks were dwarfed by a potential economic downturn. In a diversified portfolio with a long investment time horizon, the committee took a small position in a company such as OneMain to help enhance the risk-reward profile of the portfolio.

Current Positioning

The strategy held key overweight positions versus the benchmark in the consumer staples and health care sectors. Meanwhile, we remained underweight in typically cyclical sectors, such as materials, industrials, and consumer discretionary. We also remained underweight in perceived "safe havens," such as utilities, which have 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 March 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 and regulatory uncertainties. While our overall positioning is driven by bottom-up stock selection with a focus on the long term, we do consider many of these concerns and how they can impact the fundamentals of a business, 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.

Book Value: Assets minus liabilities. Also known as shareholders' equity.

Free Cash Flow: Total cash flow from operations less capital expenditures.

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

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

Price/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.