BRANDES
INVESTMENT PARTNERS

Brandes Investment Partners
Japan Equity Strategy Notes
First Quarter 2023 (January 1 – March 31, 2023)

The Brandes Japan Equity Strategy rose 5.12 net of fees and 5.18% gross of fees, underperforming its benchmark, the MSCI Japan Index, which was up 6.19% in the first quarter.

Annualized total return as of March 31, 2023	1-year	5-year	10-year
Brandes Japan Equity Composite (net)	6.59%	-0.73%	5.80%
Brandes Japan Equity Composite (gross)	6.87%	-0.27%	6.48%
MSCI Japan Index	-5.23%	1.27%	5.02%

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
Leading contributors included machinery companies **Komori Corporation**, **Asahi Diamond**, and **Sintokogio**. Both of our auto manufacturer holdings, **Honda** and **Nissan**, also helped performance.

Other contributors included **Dai Nippon Printing** and **Japan Petroleum Exploration** (JAPEX).

Performance Detractors
The MSCI Japan Value Index underperformed the MSCI Japan Index in the quarter, in part due to its underweight to the solid performing technology sector. Similarly, our underweight to technology stocks—especially semiconductors and electronic equipment, which were two of the best performing industries—weighed on relative returns.

At the stock level, detractors included banks **Concordia Financial** and **Shizuoka Financial**, as well as health care-related holdings **Taisho Pharmaceutical**, **H.U. Group Holdings**, and **Fukuda Denshi**.

Select Activity in the Quarter
Despite the volatile first quarter, trading was fairly subdued as we exited one position (**Wacoal**) and did not add any new companies to the portfolio. We did, however, reduce positions in well performing **Daiichi Jitsugyo** and JAPEX, and deploy some capital into underperforming holdings such as **Softbank Group**, **Kaken Pharmaceuticals**, and **Mitsubishi Shokuhin**. The investment committee also reviewed several investment candidates that could potentially be added to the portfolio in the near future. Furthermore, with the banking issues at Silicon Valley Bank (SVB) and Credit Suisse having an impact on the share price performance of our holdings in financials, in which the strategy holds an overweight, we discussed the potential ripple effects of the banking crisis on Japanese banks, in addition to reviewing the various long-term scenarios for the banking industry in case of a sharp increase in Japan's interest rates.

Full Sell – Wacoal
We initiated a position in Wacoal Holdings in 2017. The company designs, manufactures, and sells women's intimate apparel, and is the market leader in Japan's foundation garments and lingerie industry with approximately 20% market share. At the time of purchase, Wacoal traded below book value, with what we considered significant net cash and investments on its balance sheet. While there was not much growth opportunity in Japan given Wacoal's already high market share, we believed there was room for improvement in its operational efficiency both domestically and internationally.

During our holding period, Wacoal's management was able to turn around the struggling Peach John business (innerwear business acquired in 2006-2008) by withdrawing from unprofitable channels and making e-commerce the main pillar of growth. While the overall domestic business was adversely impacted by the pandemic and increased competition, the company was able to expand its international business, helping earnings recover. This improvement has not gone unnoticed by the market. With its valuations now seemingly reflecting more optimism, Wacoal exhibits a negative margin of safety and the investment committee decided to exit the position following a thorough review of the fundamentals and investment thesis.

We are aware of the negative secular trends in Japanese retail apparel and do not consider the market as having high growth prospects. Although the industry may not seem particularly attractive over the long term, we believe market valuations for select companies can, at times, provide upside potential that outweighs the downside risk of investing in these low-growth businesses. The investment committee also seeks to manage the potential downside risk with controlled allocations.

Current Thoughts
Global events can have major repercussions to investments in our dedicated Japanese equity portfolio, and thus, the investment committee was active during the first quarter in discussing the banking issues seen in both the United States and Switzerland, and what the potential ramifications may be for the Japanese companies we currently own on behalf of our clients.

Considering the portfolio's large overweight to financials, our first discussion centered on which institutions may be directly impacted by the recent events. While it is difficult to analyze in detail the investment portfolio and asset liability management of each of our bank holdings, based on their disclosures, none of them appear to have been materially impacted by the failure of SVB and the acquisition of Credit Suisse by UBS. Although deposit runs are difficult to monitor in real-time, the Japanese regional banks appeared to remain safe from such consumer action. Moreover, the fact that these banks have excess cash in reserves should help stem the flow to some extent if such a situation were to happen. It is also worth noting that interest rates in Japan have not increased much compared to recent increases in many other nations, potentially reducing the near-term risk of liquidity and capital issues.

We understand what a sudden increase in interest rates can mean for the assets and liabilities of banks over the long term, and how it relates to increased credit risks. The investment committee has experienced the Global Financial Crisis and has seen various stress situations at financial institutions in the past, and thus are highly cognizant of equity risks of banks. In our view, having strong capital levels is imperative and as such, the financial institutions that are held within the portfolio have this attribute, based on our analysis. We will continue to monitor the situation closely but believe the portfolio's current financials exposure is reasonable based on the risk/reward from a fundamental perspective.

The investment committee also discussed the potential indirect consequences of the recent global events on companies beyond the financials sector, including the reduction in capital availability and higher cost of capital for financially levered entities. For the Japan Equity portfolio, most of the positions held, excluding the financial institutions, have net cash on their balance sheets and thus should not have issues with liquidity and capital procurement, in our opinion. One holding that may be more impacted is Softbank Group, which has the Vision Funds that own and lend to start-up companies. While we have maintained a conservative allocation to Softbank, we did—as aforementioned—add to the position as the shares declined due to this concern. We believe the company's liquidity is sufficient with ample assets to potentially monetize if needed.

Conclusion
While the year has changed, our process, our belief in the value investment philosophy, and our dedication to construct and manage the portfolio for the best interest of our clients have not. We remain excited about the prospects of the Brandes Japan Equity Strategy. In an environment full of unknowns as markets globally deal with inflation, increasing interest rates, economic uncertainty, and political tension, we strive to be prepared to manage the downside risk, while also seeking to capitalize on potential investment opportunities. We believe that a value philosophy-based portfolio is the best way to pursue excess returns relative to the broader market (MSCI Japan) for our clients over the long run.

We are always open for any dialogue regarding the portfolio, our process and philosophy, as well as the firm, so please do reach out anytime. Critical comments and observations are always welcome as well.

Lastly, we sincerely appreciate the relationship over the years, and hope we can maintain and reward the trust given to us. It is truly a privilege to manage the portfolio on your behalf.

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

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

Net Cash: Total cash minus total debt.

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

The MSCI Japan Index with net dividends is designed to measure the performance of large and mid cap segments of the Japan market.

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

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