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INVESTMENT PARTNERS

Brandes Investment Partners
U.S. Small Cap Value Equity Strategy Notes
First Quarter 2024 (January 1 – March 31, 2024)

The Brandes U.S. Small Cap Value Equity Strategy returned 12.61% net of fees and 12.79% gross of fees, outperforming its benchmark, the Russell 2000 Index, which gained 5.18% in the quarter, as well as the Russell 2000 Value Index, which was up 2.90%.

Annualized total return as of March 31, 2024	1-year	5-year	10-year
Brandes U.S. Small Cap Value Equity Composite (net)	26.93%	15.17%	10.85%
Brandes U.S. Small Cap Value Equity Composite (gross)	27.90%	16.17%	11.85%
Russell 2000 Index	19.71%	8.10%	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

Top contributors included holdings in the industrials sector. Among the most notable performers were aerospace and defense companies Park Aerospace, Moog, and Embraer, along with construction and engineering company Orion Group and machinery business Graham Corporation.

Our aerospace and defense holdings, including Park Aerospace, Moog, and Embraer, continued to benefit from the ongoing recovery in passenger air travel that has led to solid revenue growth, expanding profit margins, healthier cash-flow generation, and healed balance sheets. These positive fundamental developments helped confirm our long-term thesis around franchise quality, balance sheet durability, and end-market recovery potential for these holdings. Moreover, record backlogs highlighted—in our view—the appealing long-term secular growth outlook for global passenger air travel in an industry that has historically allowed incumbents to generate attractive returns on capital. Consequently, we revised our intrinsic value estimates for several of our aerospace and defense holdings upward, and believe they continue to offer an attractive risk/reward tradeoff at current valuation levels.

Orion Group gained from strong growth in its marine and concrete segments, while Graham Corp's earnings and revised guidance proved better than market consensus estimates.

Other contributors included security system technology company Arlo Technologies, insurer Mercury General, and Healthcare Services Group.

Performance Detractors

While the portfolio's machinery industry holdings contributed in aggregate, Hurco Companies and Kennametal declined.

Beyond Hurco and Kennametal, there were no material attributes shared by the poor performers. Insurer Crawford & Company, offshore drilling and equipment services provider Dril-Quip, food retailer Ingles Markets, health care equipment company Utah Medical Products and financial services holding company Eagle Bancorp Montana all fell. Crawford & Company posted lower results as a consequence of reduced weather-related business activity, while sales and profitability for Ingles Markets also dipped.

From a relative standpoint, the largest detractor versus the Russell 2000 Index was the exclusion of Super Micro Computer from the portfolio, which was up above 250% year-to-date. Super Micro Computer has prominent place in artificial intelligence (AI), building servers for Nvidia.

Select Activity in the Quarter

The small-cap investment committee initiated positions in gas utilities Northwest Natural Holding and Spire, while selling Eagle Pharmaceuticals.

Regulated natural gas utilities (also referred to as local gas distribution companies or LDCs) traded at a premium over electric utilities until about 2020. The market viewed them as relatively safer investments with solid growth prospects and better supportive mechanisms for the timely recovery of capital expenditures (capex) and purchased energy, while electric utilities were viewed as being potentially obsolete because of competition from renewables. The perceived risk profile of the two utility types switched in 2020, eroding the premium assigned to the gas utilities as the debate about the risk of stranded assets for gas-related infrastructure intensified. This concern seems to be more relevant in public markets. Meanwhile, private market transactions for LDCs are still executed at significant valuation premiums and represent a possible path for value realization if the perceptual gap persists.

Spire Inc., formerly The Laclede Group, was formed in 2000 as the holding company for the Laclede Gas Company based in Missouri. Laclede Gas was founded in 1857 and was listed in 1889. Between 2013 and 2016, the company spent $2.6 billion acquiring three regulated natural gas utilities in Alabama, Missouri, and Mississippi. The company has three reportable business segments: gas utility, gas marketing and midstream. The gas utility segment includes the regulated operations of Spire Missouri, Spire Alabama, Spire Gulf and Spire Mississippi, which serve 1.7 million customers. Other gas-related businesses include unregulated natural gas marketing services and highly contracted midstream activities (pipelines and storage).

Spire earns an above-average (tangible) return on equity and has an earnings per share (EPS) growth profile similar to its peers. The company targets around 6% EPS growth over the medium term underpinned by a robust 10-year capex plan that implies 7%-8% annual rate base growth with good visibility on timely cost recovery. The shares trade at a discount of approximately 10% relative to their peers. This discount may reflect lingering negative perceptions of the regulatory climate in Missouri (68% of rate base) following a cost recovery dispute (since resolved). Other considerations include execution and capital allocation issues outside the regulated utilities and uncertainty about the timing (but not the outcome) for the recovery of its deferred gas purchases. These are based on a volumetric formula and thus tied to customer demand in winter. We believe Spire's utilities have an average or above-average regulatory profile: Alabama and Mississippi are two of the most investor-friendly states in the country, and recent developments in Missouri have significantly improved its regulatory environment. With respect to capital allocation, 97% of Spire's 10-year capex plan is allocated to the regulated utilities, providing good visibility of its earnings growth and returns.

Northwest Natural Holding Company (NW Holdings) is headquartered in Portland, OR. Its primary business is the distribution of natural gas to 800,000 customers in the state, including the Portland metropolitan area, as well as in southwest Washington. The company also engages in other business activities, including a gas storage facility, water utilities and in unregulated, renewable natural gas.

NW Holdings targets about 5% EPS growth for the 2022-27 period and is dependent on continuous rate case filings to sustain a return on equity of around 8%. Like Spire, it trades at a discount relative to its peers. Some of the discount seems justified, given the company's below-average return on equity and low EPS growth potential, but we believe current levels are not too significant. As for shareholder returns, NW Holdings has grown its dividends for 68 years, making it one of only three companies listed on the NYSE with this legacy.

Current Positioning
With minimal portfolio activity, the strategy's allocations from a sector standpoint were largely unchanged. The portfolio maintains its largest weights in industrials, health care and information technology (although an underweight relative to the benchmark). The strategy's most notable underweights are in consumer discretionary, financials, and real estate.

Compared with the Russell 2000 Value Index, we have significantly less exposure to financials and real estate. In our opinion, the differences between the Brandes U.S. Small Cap Value Equity Strategy and the broader U.S. small-cap market continue to make it an attractive complement to other small-cap offerings. Our strategy exhibits lower valuations than the Russell 2000 Index, while offering exposure to companies with what we consider are strong balance sheets, compelling growth prospects, and a history of durable free cash flow generation.

We are optimistic about the potential of value stocks in general and believe the Brandes U.S. Small Cap Value Equity Strategy remains well positioned from a long-term risk/reward perspective.

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

The Russell 2000 Index with gross dividends measures the performance of the small cap segment of the U.S. equity universe.

The Russell 2000 Value Index with gross dividends measures performance of the small cap value segment of the U.S. equity universe. Securities are categorized as growth or value based on their relative book-to-price ratios, historical sales growth, and expected earnings growth.

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

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