*Quarterly Commentary*

# BRANDES CORE PLUS FIXED INCOME FUND

MARCH 31, 2019

### FUND INFORMATION

| | |
|---|---|
| Class I: | BCPIX |
| Class A: | BCPAX |
| Class R6: | BCPRX |

### STRATEGY

The Fund seeks to maximize long-term total return, consisting of both current income and capital appreciation.

### TEN LARGEST CORPORATE ISSUERS

(% of assets as of 3/31/2019)

| | |
|---|---|
| ADT Corp | 2.17 |
| JPMorgan Chase & Co | 2.03 |
| Range Resources Corp | 2.03 |
| Citibank NA | 2.02 |
| AT&T Inc | 2.02 |
| Tenet Healthcare Corp | 1.77 |
| Chesapeake Energy Corp | 1.56 |
| Wells Fargo & Co | 1.42 |
| Chevron Corp | 1.41 |
| Kinder Morgan Inc/DE | 1.35 |

Fund holdings are subject to change at any time at the discretion of the investment manager.

## Market Overview

The Federal Reserve surprised the markets with a shift to a decidedly *dovish* monetary posture. After four interest-rate hikes in 2018, the market was prepared for fewer rate hikes in 2019. However, following its late-March meeting, the Fed indicated that the fed funds rate is likely to remain unchanged in 2019 and forecast the likelihood of a single rate hike in 2020.

Consequently, the bond and equity markets cheered the Fed's policy shift, with all taxable fixed-income asset classes registering positive returns and the S&P 500 Index posting its best quarterly return in a decade.

Market sentiment turned markedly. A late-November Bloomberg poll found nearly all respondents forecasting at least one fed funds rate *hike* in 2019. But by the end of the quarter, a majority predicted at least one fed funds rate *cut* this year.[1]

The other notable—perhaps *concerning* is a better word—observation from the March Fed meeting is that the central bank now believes its monetary policy is back to normal. By any historical benchmark, however, the Fed's monetary policy remains highly stimulative. As of March 31, the current real fed funds rate, which is the rate adjusted for inflation, was at approximately 0.25%, a sharp drop compared to the 40-year real fed funds rate average of 2%. Consider that at the end of the Fed's last tightening cycle in 2006, the real rate was 2.75%.

Additionally, the Fed announced that it would stop shrinking its balance sheet at the end of September, which at quarter end stood at about $3.5 trillion (about $3 trillion above the pre-financial crisis level). Perhaps this is the *new normal* for Fed policy?

What should give investors pause, in our view, is that a low nominal and real fed funds rate, not to mention a massive balance sheet, could limit the Fed's ability to respond to the next crisis.

On the fiscal side, the state of affairs is no less concerning.

The U.S. Government budget deficit and debt continue to grow to unprecedented levels. The average annual budget deficit over the past decade has been $872 billion. For context, the average annual budget deficit over the previous 50 years was $104 billion. Currently, the total U.S. public debt outstanding stands at an all-time high of $22 trillion, with interest payments averaging more than $1 billion per day.

Moreover, as a percentage of U.S. gross domestic product, the federal debt had exceeded 100% as of January 2018.[2]

The market has not only seemingly paid little attention to the federal debt explosion over the past decade, but the new economic theory *du jour*—Modern Monetary Theory—posits that government deficits don't matter at all. Time will tell if this theory is also the *new normal*.

As somewhat of an aside, but indicative of many investors' sanguine view of debt levels and market risks, Greece returned to the public markets in the first quarter and was able to issue a €2.5-billion 10-year bond at a yield of 3.90%. This represented the first 10-year bond offering since before the 2011-2012 Greek debt crisis.

## Fund Performance

The Brandes Core Plus Fixed Income Fund (Class I Shares) advanced 3.13%, outperforming its benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index, which rose 2.94% in the first quarter of 2019.

Relative performance was led by corporate bond holdings in telecommunications and energy.

Within telecommunications, **Frontier Communications** primarily boosted returns. The company posted revenue that showed some stabilization after a continued pattern of subscriber losses following the company's large acquisition of Verizon assets in California, Texas and Florida in 2016.

The company also took positive steps to address balance sheet concerns. First, it purchased $56 million of its debt in the open market below par value during the quarter. Second, Frontier was able to issue $1.65 billion first-lien bonds maturing in 2027. Proceeds from the issuance were used to refinance a term loan set to mature in 2021. This issuance helps lengthen the company's runway to build on its operational stabilization. Importantly, with the refinancing, there are a total of $316 million in bonds set to mature before the September 2021 term-loan maturity. Given that the company is generating positive free cash flow, bond prices reacted favorably during the quarter.

Within energy, performance was led by **Chesapeake Energy** and **Range Resources**. Both companies reported positive fourth quarter earnings that beat expectations, but the bonds' performance was more likely a correction from the fourth-quarter decline, which felt more like technical selling than anything fundamentally related to the credit profile.

Select holdings in banking and metals and mining hurt returns.

**JPMorgan** and **Wells Fargo** detracted from performance as their bond prices were little changed in a market where rates fell and thus, bond prices broadly increased. Both securities are perpetual floating rate notes with coupons that reset over 3-month LIBOR each quarter. LIBOR rates fell during the first quarter, meaning these two securities could potentially see their coupons reset downwards next quarter. However, JPMorgan and Wells Fargo still offer attractive coupons even at modestly lower rates and remain long-term core holdings.

Given the sharp rally in rates downwards, the Fund's duration positioning toward the lower end of our duration-controlled band also detracted from returns.

Activity was limited as we struggled to find value opportunities due to the strong performance of risk assets. We added a new position in **Ford Motor Credit** (8.125% coupon, maturing January 2020, rated Baa3/BBB) and **Goldman Sachs** (3.00% coupon, maturing April 2022, rated A3/BBB+). These purchases are consistent with our recent theme of favoring shorter-maturity corporate bonds until a more attractive value proposition returns to the market.

## Outlook

The risk party that has been raging for more or less a decade now received a new shot of adrenaline courtesy of the Fed in the first quarter. In December 2018, Fed Chairman Jerome Powell described the central bank's balance sheet wind-down as on "autopilot." As markets threw a tantrum toward year end, Powell not only walked back that comment in early January of 2019, but the Fed also made a decidedly dovish pivot at its March meeting.

Bond and stock markets have grown to love accommodative central banks and appear to be sanguine about rising fiscal debt levels. The current markets remind us of the old *Wayne's World* quote: "Party on Wayne. Party on Garth."

Maybe we are old fashioned or a bit curmudgeonly, but we feel it's difficult to believe Fed policy is currently *normal* and that debt levels *don't matter*. Therefore, we continue to bias the Fund in what we believe is a defensive manner.

In this environment, the Brandes Core Plus Fixed Income Fund continues to favor shorter-maturity corporate bonds and those that exhibit strong, tangible asset coverage, in our view. We are underweight agency mortgage-backed securities and managing duration toward the shorter end of our duration-controlled range. We have a higher allocation to U.S. Treasuries that we will look to redeploy thoughtfully and efficiently—if and when market uncertainty and volatility cause credit fundamentals to become *mispriced* from our estimates of intrinsic value.

[1] Source: Bloomberg World Interest Rate Probability
[2] Source: Federal Reserve Bank of St. Louis; as of 1/7/2018

| Average Annual Total Returns (%) as of March 31, 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Without Load** | 3 Months | YTD | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception 12/28/2007 |
| Class I | 3.13 | 3.13 | 3.58 | 2.46 | 2.41 | 5.61 | 3.70 |
| Class A | 3.11 | 3.11 | 3.26 | 2.13 | 2.12 | 5.29 | 3.40 |
| Class R6 | 3.38 | 3.38 | 4.40 | 2.91 | 2.71 | 5.79 | 3.86 |
| **With Load** | 3 Months | YTD | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception 12/28/2007 |
| Class A | -0.73 | -0.73 | -0.62 | 0.83 | 1.34 | 4.88 | 3.04 |
| Bloomberg Barclays U.S. Aggregate Bond Index | 2.94 | 2.94 | 4.48 | 2.03 | 2.74 | 3.77 | 3.85 |

Operating Expenses: Class I: 0.68% (gross), 0.50% (net) Class A: 0.87% (gross), 0.70% (net) Class R6:0.63% (gross), 0.35% (net)

*Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. All performance is historical and includes reinvestment of dividends and capital gains. Performance data current to the most recent month end may be obtained by calling 1.800.395.3807. Performance of A Shares without load does not reflect maximum sales charge of 3.75%. If reflected, the load would reduce the performance quoted.*

Class I shares commenced operation on December 28, 2007. Class S shares never commenced operations. They were re-designated as Class A shares and commenced operations on January 31, 2013. Performance shown prior to the inception of Class A shares on January 31, 2013, reflects the performance of Class I shares, restated to reflect Class A sales loads and expenses.

The Advisor has contractually agreed to limit the operating expenses through January 31, 2020. The Expense Caps may be terminated at any time by the Board of Trustees upon 60 days notice to the Advisor, or by the Advisor with the consent of the Board. Investment performance reflects fee waivers and/or reimbursement of expenses. In the absence of such waivers/reimbursements, total return would be reduced.

Asset Coverage: A company's ability to cover debt obligations with its assets after all liabilities have been satisfied. Source: Investopedia.com
Duration: The weighted maturity of a fixed-income investment's cash flows, used in the estimation of the price sensitivity of fixed-income securities for a given change in interest rates.
Fed Funds Futures: Financial contracts representing market opinion of where the daily official federal funds rate will be at the time of the contract expiry.
Federal Funds Rate: The interest rate at which a depository institution lends funds maintained at the Federal Reserve to another depository institution overnight.
Floating Rate Notes: Debt instruments that do not have a fixed rate of interest over the life of the instruments.
Free Cash Flow: Total cash flow from operations less capital expenditures.
LIBOR: The London Interbank Offered Rate is basic rate of interest used in lending between banks on the London interbank market and also used as a reference for setting the interest rate on other loans.
Modern Monetary Theory: A macroeconomic framework suggesting that sovereign governments can print all the money they need irrespective of the deficits they incur. Source: Investopedia.com
Yield: Annual income from the investment (dividend, interest, etc.) divided by the current market price of the investment.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. This index is a total return index which reflects the price changes and interest of each bond in the index.
The S&P 500 Index with gross dividends measures equity performance of 500

All fund securities except for those labeled "Not Rated" and "Other" have been rated by a Nationally Recognized Statistical Rating Organization such as Moody's, Standard & Poor's or Fitch. Quality ratings typically range from "AAA" (highest grade) to "D" (lowest). When a bond is rated by more than one organization, Brandes uses the highest rating available. Credit quality ratings pertain to the underlying securities of the fund and not to the fund itself.

**Because the values of the Fund's investments will fluctuate with market conditions, so will the value of your investment in the Fund. You could lose money on your investment in the Fund, or the Fund could underperform other investments. The values of the Fund's investments fluctuate in response to the activities of individual companies and general stock market and economic conditions. In addition, the performance of foreign securities depends on the political and economic environments and other overall economic conditions in the countries where the Fund invests. Emerging country markets involve greater risk and volatility than more developed markets. Some emerging markets countries may have fixed or managed currencies that are not free-floating against the U.S. dollar. Certain of these currencies have experienced, and may experience in the future, substantial fluctuations or a steady devaluation relative to the U.S. dollar. It is not possible to invest directly in an index.**

**As with most fixed income funds, the income on and value of your shares in the Fund will fluctuate along with interest rates. When interest rates rise, the market prices of the debt securities the Fund owns usually decline. When interest rates fall, the prices of these securities usually increase. Generally, the longer the Fund's average portfolio maturity and the lower the average quality of its portfolio, the greater the price fluctuation. The price of any security owned by the Fund may also fall in response to events affecting the issuer of the security, such as its ability to continue to make principal and interest payments or its credit rating. Below investment grade debt securities are speculative and involve a greater risk of default and price change due to changes in the issuer's creditworthiness. The market prices of these debt securities may fluctuate more than the market prices of investment grade debt securities and may decline significantly in periods of general economic difficulty.**

*A mutual fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectuses contain this and other important information about the investment company, and may be obtained by calling 1.800.395.3807 or visiting www.brandesfunds.com. Read carefully before investing.*

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