Market Overview

So much for summer market doldrums. During the third quarter, the market had plenty of headlines for investors to keep tabs on while they enjoyed their summer. Key themes that the market had to grapple with over the past three months included: additional tariffs on Chinese imports, protests in Hong Kong, an attack on Saudi oil production, another U.S. Federal Reserve rate cut, a new European Central Bank stimulus package, and finally a Presidential impeachment inquiry.

August was particularly volatile, highlighted by President Trump’s threat of a 10% tariff on $300 billion of Chinese imports, increasing to 25% over time. The threat was moderately walked back, but a 15% tariff on $110 billion of Chinese goods took effect on September 1.

The increased trade rhetoric caused a sharp sell-off in equity markets and sharply lower interest rates during August. The 10-year U.S. Treasury rate declined 0.52% in August—the largest monthly decline since January 2015 and the sixth largest monthly decline in the past 15 years. The 10-year U.S. Treasury rate ended the quarter at 1.67%, implying a negative real yield (i.e., the yield adjusted for inflation).

The Fed’s preferred measure of inflation is the Commerce Department’s core Personal Consumption Expenditure (PCE) index. The latest reading on the index of 1.8% indicates that inflation is running below the Fed’s 2% target.1 However, a number of other inflation measures suggest that core PCE may be understated. The Labor Department’s core Consumer Price Index (CPI) index latest reading was 2.4%.2 The main difference between the two indices is the greater weight placed on housing by the CPI. The Gross Domestic Product price index most recent reading was also 2.4%.3 The Atlanta Fed’s sticky price CPI—a weighted basket of CPI items that change price relatively slowly—showed core prices up 2.6% from a year earlier. Meanwhile, the Dallas Fed’s trimmed mean inflation rate, which tosses out the biggest positive and negative monthly price movers, rose 2% in August.

Speaking of inflation, the market anticipates that inflation will effectively remain dormant for the next decade. At the end of the quarter, the market was foreseeing a 1.52% inflation rate for the next 10 years.4 As seen in Exhibit 1 (next page), only two periods during the past 100 years have occurred when the rolling 10-year inflation rate average was below current expectations. The first was in the Great Depression; the second, in the early 1960s.
The 1960s is an interesting parallel to consider. During the early part of that decade, the unemployment rate dropped to 3.5% from 7% with little initial impact on wages or prices. However, in the latter half inflation rose sharply. This severe increase was attributed to increased fiscal spending to fund the conflict in Vietnam and new entitlement programs in Medicaid and Medicare. While there are no new large-scale fiscal stimulus programs today, the U.S. government has a higher deficit to GDP ratio than in the 60s.

The other factor that influenced the rapid rise in inflation was political pressure on the Fed to keep rates low to reduce the cost of financing the Vietnam War. This pressure may have contributed to the Fed ultimately falling behind the inflation curve. *Good thing there is no political pressure on the Fed today.*

The point of the cited example is not to suggest that inflation is poised to rapidly accelerate as it did in the 1940s or 1970s. Rather, it is to highlight one of the most prevalent cognitive errors in the investment world and everyday life: *recency bias*, or the human tendency to overemphasize more recent data. Inflation and interest rates have been low for a considerable period of time; therefore, the market has effectively extrapolated that low inflation and interest rates will continue indefinitely. We do not have a forecast of when inflation will ultimately trend higher or interest rates will begin to move up. But believing that the inflation rate will remain 1.5% for the next decade certainly gives us pause.

**Fund Performance**

The Brandes Core Plus Fixed Income Fund advanced 1.24% (Class I Shares), underperforming its benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index, which rose 2.27% in the third quarter of 2019.

Relative performance was hurt by corporate bond investments in energy and telecommunications.

With energy, unease about a global slowdown and an oversupply of oil and natural gas caused underperformance for the entire sector. More specifically, bonds from *Chesapeake Energy* and *Range Resources* detracted from returns as the market expressed its concerns about debt levels from energy companies operating in the high-yield space.

The short-term sentiment, particularly regarding natural gas, has been decidedly negative, primarily as a result of abundant supply. However, the longer-term fundamentals are more positive. Based on our analysis, natural gas is capturing 70% of energy needs from coal plant retirements versus 30% for renewables. Export capacity is increasing; liquefied natural gas export terminals are coming online, and a new pipeline recently placed into service will increase export capacity to Mexico. Finally, investor demands for more capital discipline should serve to restrain volume growth.
During the quarter, Chesapeake engaged in two transactions that saw debt holders voluntarily swap $733 million in debt for common equity. During the past few years, Chesapeake has opportunistically extended debt maturities to lengthen their runway during a downturn; it has now turned its focus on debt reduction through equity swaps and possible asset sales. Chesapeake has been shifting their product mix toward higher margin oil, which should aid cash flow going forward.

In the telecommunications sector, Frontier Communications detracted from returns. Earlier this year, the company took positive steps to address balance sheet returns, including buying $56 million of its debt in the open market below par value and issuing $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. Frontier also announced an asset sale for $1.35 billion, with proceeds earmarked for additional debt reduction when the transaction closes.

Frontier continues to generate positive free cash flow and with the transactions highlighted above, has a visible path to paying down its maturities for the next three years (we own bonds with a scheduled maturity in 2021). However, its bond prices, continued to move lower in the quarter because a number of investors who own longer-maturity Frontier debt began agitating for the company to undertake a more comprehensive debt restructuring as the path to repay debt maturing in 2023 and beyond is far less certain.

Given the sharp decline in interest rates, the Fund’s duration positioning toward the lower end of our duration-controlled band also detracted from returns.

Finally, the Fund’s defensive positioning in corporate bonds hurt relative performance. We have been favoring shorter maturity corporate bonds—the duration of our corporate bond exposure is under three years—with credit spreads at or near the tightest levels relative to U.S. Treasuries in decades. During the quarter, Intermediate maturity corporate bonds modestly outperformed shorter maturity corporates. Year-to-date, the outperformance is quite stark as 7- to 10-year maturities delivered over 350bps more in return versus U.S. Treasury securities than corporate bonds with 1- to 3-year maturities.

The Fund received positive contributions from Pilgrim’s Pride Corp, and select holdings in banking (JPMorgan and U.S. Bank).

We continued to increase our weight in agency mortgage-backed securities (MBS), as their performance lagged the broader market. The increase in overall market volatility and continued runoff of the Fed’s balance sheet agency MBS holdings, at about $200 billion over the past 12 months, caused yield spreads in the agency MBS market to widen to their highest levels in more than five years in August.

While we remain underweight agency MBS, we will consider additional purchases if recent weakness persists.

**Outlook**

Toward the end of the quarter, U.S. economic data reports have been mixed. Economic reports about consumer spending—which represents about two-thirds of the economy—have been largely positive. Manufacturing reports, however, have begun to show more weakness—understandable against the uncertainty of the ongoing trade war. The market has reacted by calling for additional rate cuts from the Fed, pricing in a 70% probability of at least one additional cut before year end.

A question worth contemplating is whether further interest rate cuts are actually stimulative? Low or negative rates are generally thought to be negative for the banking industry; therefore, shouldn’t a policy that is negative for the banking system also likely be bad for the overall economy? Also, with historically low rates and seemingly limitless demand for bonds, are the price and availability of credit not an issue? Would another 25bps or 50bps in interest rate cuts unlock an abundance of pent up demand for credit?

Additionally, one of the unintended consequences of lower rates is that we are seeing a rise in the personal savings rate. The U.S. personal savings rate is more than double what it was heading into the global financial crisis when the Fed funds rate was over 5%.  The thought is that consumers are boosting their savings rate to offset the lower interest income. So rather than stimulating consumers to borrow more cheaply and to spend more, we are starting to see evidence that they are socking away more of their earnings.
Boston Fed President Eric Rosengren dissented at the most recent Fed meeting and expressed a view consistent with ours:

“While risks clearly exist related to trade and geopolitical concerns, lowering rates to address uncertainty is not costless. In my view, there are clearly risks of headwinds hitting the economy, but the stance of monetary policy is already accommodative. There are also risks of tailwinds and costs to monetary policy being too accommodative. Additional accommodation is not needed for an economy where labor markets are already tight – and further risks inflating the prices of riskier assets, and encouraging households and firms to take on what may be too much leverage.”

There are certainly concerns in the markets that while employment and consumer reports are strong, business confidence and manufacturing reports are slowing. Moreover, the potential for a protracted trade war and politicians distracted by impeachment theatre remain ongoing concerns.

In our view, market technicals continue to drive valuations over credit fundamentals. Yield spreads on most taxable fixed-income assets remain close to the tightest levels in some time. Credit spreads per unit of leverage suggest that caution is warranted.

In this environment, the Brandes Core Plus Fixed Income Fund favors shorter maturity corporate bonds and those that, in our view, exhibit strong, tangible asset coverage. Although we added to our position during the quarter, we remain underweight agency MBS and we’ve been 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.

As always, thank you for your business and continued trust.

---

1 Source: Bureau of Economic Analysis, Bloomberg; data as of 8/31/19.
2 Source: Bureau of Economic Analysis, Bloomberg; data as of 8/31/19.
3 Source: Bureau of Economic Analysis, Bloomberg; data as of 6/30/19.
4 Source: Bloomberg as of 9/30/19.
5 Source: Bloomberg World Interest Rate Probability, 9/30/19.
6 Source: Bureau of Economic Analysis, Bloomberg; data as of 8/31/19.
**Average Annual Total Returns (%) as of September 30, 2019**

<table>
<thead>
<tr>
<th></th>
<th>Without Load</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3 Months</td>
<td>YTD</td>
<td>1 Year</td>
<td>3 Years</td>
<td>5 Years</td>
<td>10 Years</td>
<td>Since Inception 12/28/2007</td>
<td></td>
</tr>
<tr>
<td>Class I</td>
<td>1.24</td>
<td>6.64</td>
<td>6.85</td>
<td>2.18</td>
<td>2.79</td>
<td>4.60</td>
<td>3.83</td>
<td></td>
</tr>
<tr>
<td>Class A</td>
<td>1.08</td>
<td>6.52</td>
<td>6.56</td>
<td>1.87</td>
<td>2.53</td>
<td>4.29</td>
<td>3.54</td>
<td></td>
</tr>
<tr>
<td>Class R6</td>
<td>1.33</td>
<td>7.13</td>
<td>7.40</td>
<td>2.70</td>
<td>3.13</td>
<td>4.80</td>
<td>4.01</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>With Load</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3 Months</td>
<td>YTD</td>
<td>1 Year</td>
<td>3 Years</td>
<td>5 Years</td>
<td>10 Years</td>
<td>Since Inception 12/28/2007</td>
<td></td>
</tr>
<tr>
<td>Class A</td>
<td>-2.75</td>
<td>2.56</td>
<td>2.61</td>
<td>0.56</td>
<td>1.75</td>
<td>3.89</td>
<td>3.20</td>
<td></td>
</tr>
<tr>
<td>Bloomberg Barclays U.S. Aggregate Bond Index</td>
<td>2.27</td>
<td>8.52</td>
<td>10.30</td>
<td>2.92</td>
<td>3.38</td>
<td>3.75</td>
<td>4.15</td>
<td></td>
</tr>
</tbody>
</table>

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.

Basis Point: Equal to 1/100th of 1%.

Credit Spread: The difference in yield between two bonds of similar maturity but different credit quality.

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.

Par: The face value at which a bond will be redeemed at maturity.

U.S. Personal Savings as a percent of disposable income. Household saving (sometimes referred to as personal saving) is defined as household disposable income less household consumption.

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

Yield Spread: The difference in yield from a Treasury security and another debt security of the same maturity.

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.

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. 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.

The foregoing reflects the thoughts and opinions of Brandes Investment Partners® exclusively and is subject to change without notice.

Brandes Investment Partners® is a registered trademark of Brandes Investment Partners, L.P. in the United States and Canada.

Brandes Core Plus Fixed Income Fund is distributed by ALPS Distributors, Inc.

BI001066 1/31/20