The Case for Value in a Well-Diversified Portfolio

Dear Clients and Friends,

Regular readers of our quarterly letters will know that we routinely return to a broad theme—that we believe value exposure warrants a meaningful position in a well-diversified portfolio. We have maintained this conviction even after value stocks had underperformed their growth counterparts for well over a decade (MSCI World Value vs. MSCI World Growth). Events in 2021 supported our position, with value generally doing well. In our past letters, we have pointed out that when value stocks outperformed growth stocks or the general market, our portfolios tended to do even better.

As we embark on a new year, we invite you to reflect on where we have been—and where we might be headed. Investors who loaded up on growth stocks 10+ years ago—or simply switched to purely passively managed, index-tracking products—likely have enjoyed solid performance while a value-centric approach trailed. Over this period, many markets have been buoyed by record low interest rates, unprecedented and coordinated action by central banks around the world, and enthusiasm for leading technology companies.

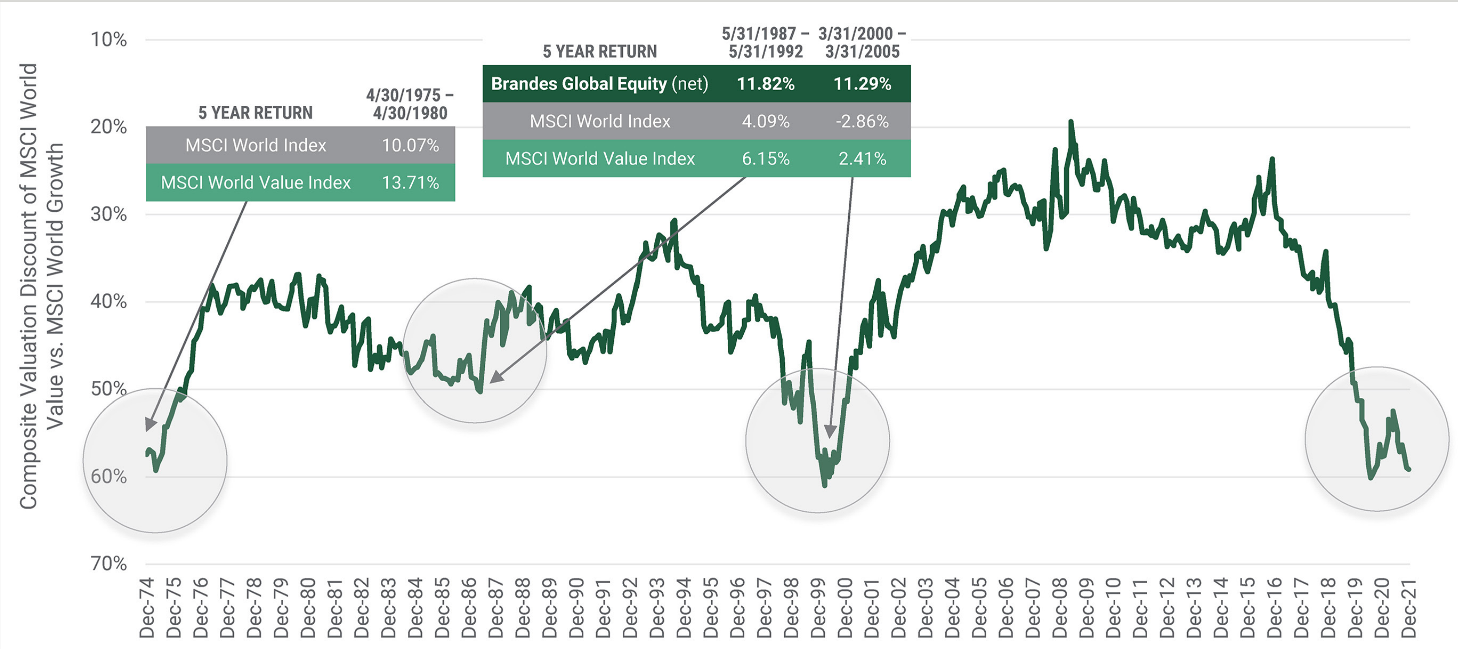
Amid these dynamics, we pose a couple of questions: do you think the next five or 10 years will look exactly like the past? If so, what's your conviction level? If you are 100% certain nothing will change, you probably won't want to change the allocations in your portfolio. Instead, you might prefer to allow growth allocations to run, continue to add to a handful of strong-performing stocks, and remain concentrated in the United States.

In previous letters, we have noted that over the past several years, many capital allocators have allowed their allocation to value and to companies outside of the United States to drift lower. No one can say for certain when the optimal time will be to reverse those allocations. However, the potential for rising interest rates and inflationary pressures may indicate that 2022 represents a compelling time to consider a higher allocation to value stocks.

We firmly believe that the price investors pay for any security *relative to its underlying worth* drives long-term returns. This belief is the essence of value investing. And right now, as can be seen in the chart below, the valuation levels for value versus growth are about as attractive as we've seen in 20 years. We also show that after such periods of outsized dispersion between value and growth, value outperformed the general market.

Global Value Stocks Relative Valuations

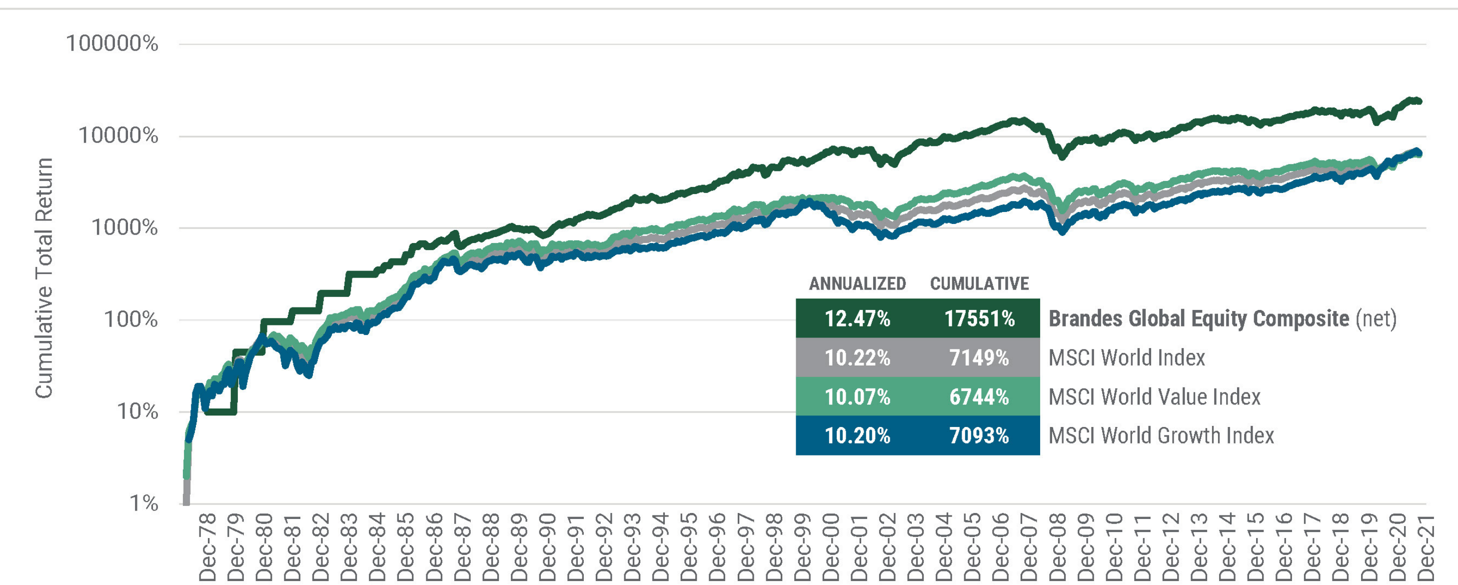
Valuation Relative to Growth Stocks vs. History



DECEMBER 31, 1974 TO DECEMBER 31, 2021 | Source: MSCI via FactSet. All returns annualized. Past performance is not a guarantee of future results. For each fundamental ratio (Price/Book, Price/Earnings, Price/Cash Flow, Forward Price/Earnings, Enterprise Value/Sales, Enterprise Value/Earnings Before Interest, Taxes, Depreciation, and Amortization), we calculate the average ratio of the MSCI World Value Index and divide it by the average ratio of the MSCI World Growth Index to determine the relative valuation. Aggregate valuation discounted based upon the average of each individual metric's valuation discount of the value index relative to growth. Please note that all indices are unmanaged and are not available for direct investment. Brandes performance is net of management fees. Please see the accompanying GIPS® report. The hypothetical examples are for illustrative purposes only. They do not represent the performance of any specific investments. Actual results will vary.

History tells us that there tends to be a cyclicality to equity markets, and the same has been true for the returns of various investment approaches. Since 1978, the Brandes Global Equity Strategy clearly demonstrates this cyclicality. Yet, despite the ups and downs, as can be seen from the chart below, this strategy posted annualized outperformance of 225 basis points net of fees over that period, with even greater outperformance versus the value and growth indices.

Cumulative Growth %



DECEMBER 31, 1977 (COMPOSITE INCEPTION) TO DECEMBER 31, 2021 | Source: Brandes, MSCI. Cumulative total return – net of management fees. This hypothetical example is for illustrative purposes only. It does not represent the performance of any particular investment. Actual results may vary. Past performance is not a guarantee of future results. It is not possible to invest directly in an index. Please see the accompanying GIPS® report. The inception date for the MSCI World Growth and Value Indices is December 8, 1997. Data shown prior to this date is the result of backtesting performed by MSCI. There may be frequent material differences between backtested and actual performance. Length of investment period not typical for most investors.

Crises come and go, markets correct, markets grow, governments around the world act unpredictably, and investor sentiment changes like the wind. Trying to predict what will happen next is, in our opinion, a futile exercise. However, in our experience, a sensible investment approach, applied consistently, has historically rewarded the patient investor over the long term. Therefore, our view is the same today as it has been in the past and will likely be in years to come—stay invested, rebalance consistently, and consider a meaningful allocation to value as part of a diversified portfolio.

We wish you and your loved ones a healthy and prosperous 2022.

Brandes Investment Partners

Global Equity GIPS® Report available here.

Basis Point: 1/100 of 1%.

Enterprise Value: Market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents.

EV/Sales: Enterprise value divided by sales.

Forward Price/Earnings: Price per share divided by earnings per share expected over the next 12 months or next fiscal year.

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

Price/Cash Flow: Price per share divided by cash flow per share.

Price/Earnings: Price per share divided by earnings per share.

The MSCI World Index with net dividends captures large and mid cap representation of developed markets. **The MSCI World Value Index** captures large 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. **The MSCI World Growth Index** captures large and mid cap securities across developed market countries exhibiting 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.

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