

Brandes Investment Partners
Global Small Cap Equity Strategy Notes
Third Quarter 2026 (1 July – 30 September 2026)

The Brandes Global Small Cap Equity Strategy rose 2.95% (gross of fees), outperforming its benchmark, the MSCI ACWI Small Cap Index, which declined 3.17% in the quarter, and the MSCI ACWI Small Cap Value Index, which fell 0.62%.

Positive Contributors

Industrials and health care holdings drove the quarter's relative results. Within industrials, South Korean security services provider S-1 Corporation, U.K.-based staffing firms Michael Page and Hays, and Brazilian regional jet manufacturer Embraer were among the strongest contributors. Michael Page and Hays rebounded sharply as operating results and guidance proved more resilient than expected. Among health care holdings, Germany-based medical equipment firm Draegerwerk was a notable performer, along with Japanese medical diagnostics company Sysmex and pharmaceutical wholesaler Medipal Holdings. Draegerwerk revised its full-year operating margin guidance upward, supported by tariff refunds and robust demand in its safety division, while Sysmex was bolstered by strong recovery in the Americas.

Geographically, the strategy benefited from holdings in the U.K. and emerging markets. In addition to the aforementioned U.K. staffing firms, paper and forest products company Mondi and real estate management business LSL Property Services performed well.

Performance Detractors

While our industrials allocation helped returns in aggregate, select holdings declined, including engineering business Orion Group, machinery company Graham, and aerospace and defence companies Park Aerospace and Hexcel. Orion Group's profitability was affected by marine-project startup delays and lower equipment utilisation, while Graham experienced longer decision cycles for large energy and process projects due to geopolitical uncertainty. We maintain our allocation in both companies as we believe the current risk-reward trade-off is favourable.

Other detractors included U.K. broadcaster ITV and U.S.-based chemicals company Scotts Miracle-Gro and pizza restaurant chain Papa John's International. ITV's first-half results and advertising outlook fell short of market expectations, while investors assessed the economics of the proposed sale of its Media & Entertainment segment. Papa John's remained under significant pressure as the company suspended its quarterly dividend in August to prioritise investments in a longer-than-anticipated transformation strategy. Scotts Miracle-Gro continued to be adversely affected by increased freight and commodity costs, which pressured gross margins. We added to our position in Scotts Miracle-Gro based on the weakness.

Select Activity in the Quarter

We initiated a position in Switzerland-based luxury goods company Swatch while fully exiting U.S. oil and gas business World Kinect.

Swatch Group is the world's largest watchmaker and is vertically integrated across the watchmaking value chain. Its portfolio spans nearly all price points, from Swatch and Tissot to Longines, Omega, Blancpain, and Breguet, with Omega serving as its largest brand and primary profit driver. The company also participates in ultra-high-end jewellery through Harry Winston. Swatch is controlled and managed by the founding Hayek family, which holds majority voting control despite owning a minority economic interest. We believe the company's collection of established brands, vertically integrated manufacturing capabilities, and long-term family ownership represent valuable competitive attributes.

The opportunity to invest emerged after deterioration in profitability caused by softer demand in China, adverse currency movements, and fixed-cost deleveraging. Revenue in China declined amid subdued consumer confidence, broader weakness across the watch industry, and Swatch's decision to reduce third-party distribution in the country. At the same time, the company's Swiss franc-denominated cost base and largely non-Swiss franc revenue base have made the strengthening franc a meaningful headwind, as price increases lagged the currency pressure. These factors have driven profitability to historically low levels and weighed on the share price. However, results outside mainland China have proven more resilient, and recent developments signal the potential for operating leverage if revenue growth returns.

We believe Swatch is undervalued relative to its normalised earnings potential and underlying assets. Key risks include prolonged weakness in China, currency headwinds, a relatively inflexible cost structure, suboptimal capital allocation, and governance concerns. Nevertheless, the company's valuable brands, strong balance sheet, asset backing, and potential for earnings normalisation support an attractive risk-reward profile.

Year-to-Date Briefing

The Brandes Global Small Cap Equity Strategy rose 9.47%, underperforming its benchmark, the MSCI ACWI Small Cap Index, which appreciated 12.43% year-to-date, and the MSCI ACWI Small Cap Value Index, which rose 11.11%.

Holdings in industrials and communications services were strong drivers of return. These included machinery companies Kennametal, Graham, and Aalberts, aerospace and defence business Moog, and Millicom International and Magyar Telekom in communications services. Select consumer and health care companies also performed well, including flooring business Mohawk Industries, German medical device company Draegerwerk, and U.S.-based Edgewell Personal Care.

Information technology accounted for nearly 50% of the benchmark's gains, making our underweight position a significant detractor from relative performance. Additionally, our technology holdings are concentrated in companies facing elevated concerns about AI-driven disruption, including IT services provider Globant and software company Open Text, which also weighed on returns.

Outside of technology, other detractors included Montana Aerospace, Papa John's International, blood plasma company Grifols, and beverages business C&C Group.

Current Positioning

As market returns have become increasingly concentrated in a small number of AI-related companies, we believe the index-agnostic Brandes Global Small Cap Equity Strategy offers meaningful diversification from prevailing market exposures.

Our largest allocations remain in industrials, health care, consumer staples, and consumer discretionary. Conversely, we maintain lower exposure to technology, financials, and real estate. Geographically, the portfolio continues to have meaningful exposure to companies in the U.K., Hong Kong, Canada, and emerging markets, while holding a meaningful underweight position in the U.S., which accounts for over 50% of the benchmark. In our view, the portfolio's positioning continues to reflect opportunities for which near-term uncertainty has created a disconnect between price and long-term fundamentals.

Looking ahead, we believe the current environment remains particularly attractive for disciplined value investors. Market enthusiasm continues to be concentrated in a narrow group of AI-related companies, often with limited regard for valuation. While the long-term potential of AI is significant, history suggests periods of extreme optimism can create opportunities for active investors to uncover appealing investments elsewhere in the market. We believe that is the case today.

Across the portfolio, we are finding companies that appear overlooked by investors despite having what we see as strong competitive positions, durable cash-flow generation, and compelling valuations. These include businesses that can benefit from technological change rather than be disadvantaged by it. In our view, the portfolio's differentiated exposures can provide investors with meaningful diversification potential and make it a good complement to passive and growth-oriented approaches. The portfolio also offers what we consider a more attractive aggregate valuation profile than the benchmark, while maintaining focus on long-term return potential. We remain encouraged by the prospects for value stocks and the risk-reward trade-off of our holdings.

For term definitions, please refer to <https://www.brandes.com/emea/termdefinitions>.

For index definitions, please refer to <https://www.brandes.com/emea/benchmark-definitions>.

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