

Brandes Investment Partners
Global Small Cap Equity Strategy Notes
First Quarter 2025 (1 January – 31 March 2025)

The Brandes Global Small Cap Equity Strategy returned 5.98% (gross of fees), outperforming its benchmark, the MSCI ACWI Small Cap Index, which was down 3.97% in the quarter. The MSCI ACWI Small Cap Value Index fell 1.91%.

Positive Contributors

Holdings in the aerospace and defence industry continued to drive returns, led by Brazilian regional jet manufacturer Embraer, U.K.-based Rolls-Royce, and Switzerland-based Montana Aerospace. Both Rolls-Royce and Embraer appreciated substantially over the past few years as their end-markets recovered, leading to better-than-expected earnings with higher volumes and enhanced margins. Rolls-Royce upgraded its fiscal-year guidance and announced a share buyback as its balance sheet strengthened on the back of healthy cash-flow generation. Meanwhile, Embraer secured several new wins against competitors in its defence business. This, coupled with an expanding order backlog for regional jets, has further boosted market confidence in the company's prospects.

Communication services holdings also lifted returns, notably Hungary's Magyar Telekom and Luxembourg-domiciled Millicom International, which operates in Latin America. Magyar reported earnings results that exceeded market expectations and announced an increase in its dividend.

Other strong performers included German medical equipment manufacturer Draegerwerk, U.S. energy equipment and services business Innovex International, and France-based cement company Vicat. Draegerwerk benefited from an improved outlook, while Vicat showed strong financial results and progress on various strategic initiatives.

Performance Detractors

Information technology was the worst-performing sector in the benchmark, and our holdings in the sector (i.e., U.S.-based Netgear and Arlo Technologies, Hong Kong-based PAX Global Technology) declined as well.

Other material detractors included investments in consumer discretionary and consumer staples, including U.K.-based grocer J Sainsbury, Ireland-based beverage firm C&C Group, and U.S. domiciled Hanesbrands.

Hanesbrands' share price retreated due to disappointing quarterly results and the departure of its CEO. Meanwhile, shares of C&C Group fell amid a weaker hospitality industry in the U.K., a key market for the company. The firm also faced market scepticism about the timing of its turnaround and the initial implementation of its strategic plan to simplify the business and improve its brand.

Select industrial holdings also performed poorly, specifically machinery companies Graham and L.B. Foster, and construction and engineering business Orion Group. Both Graham Holdings and Orion Group declined after announcing that their revenue and full-year guidance had missed analyst expectations.

Select Activity in the Quarter

We initiated a position in U.S.-based metalworking and maintenance company MSC Industrial Direct and South Korean Hankook Tire & Technology, while divesting positions in Ireland-based food products company Greencore Group, U.S.-based Phibro Animal Health, and U.K. financial services firm St. James Place.

Hankook Tire & Technology is the largest tire producer in Korea and the seventh largest in the world. Almost all of Hankook's tires are for passenger and light-duty vehicles. Historically, Hankook has been a second-tier player in the industry, producing good quality tires that sell at a discount to the products of first-tier players. In the last few years, Hankook has been able to modestly increase its market share in both the original equipment and replacement markets.

Hankook's shares traded down over the past year, largely due to capital allocation concerns. A longtime shareholder of auto components supplier Hanon Systems, Hankook increased its previously 20%-stake at a significant premium (approximately 60%) to Hanon's share price in 2024. While we agree that the transaction was value destructive, we believe the market has overreacted to the news and undervalued the earnings power of the business.

We appreciate that Hankook maintains a strong, net-cash balance sheet subsequent to the Hanon Systems transaction. Additionally, the majority of demand for Hankook's tires is for replacement tires versus new vehicle tires, which, although somewhat cyclical in nature, positions Hankook more defensively. The company has also been making investments to gain market share in the U.S. and Europe, and it has a competitive offering in electric vehicle (EV) tires. EVs require more advanced tires, which are sold at a premium and can have a shorter replacement cycle. At its current valuation, Hankook offers a compelling investment opportunity to us.

Current Positioning

The strategy maintains large allocations to industrials, consumer staples, and health care, while holding underweights in technology, materials, real estate, and consumer discretionary. Geographically, the portfolio continues to have meaningful exposure to companies in the U.K., Spain, Ireland, Hong Kong, and emerging markets, and a notable underweight to the United States. In our opinion, the differences between the Brandes Global Small Cap Equity Strategy and the MSCI ACWI Small Cap Index make it an attractive complement to other small-cap offerings, especially those that are growth-oriented or passively managed.

While value leadership (MSCI ACWI Small Cap Value vs. MSCI ACWI Small Cap) did provide a tailwind for the strategy over the past year, it was our stock selection across sectors and countries that has primarily driven outperformance. Going forward, we remain optimistic about the portfolio's holdings composition and the risk/reward trade-off it offers.

For term definitions: <https://www.brandes.com/termdefinitions>

The MSCI ACWI Small Cap Index with net dividends captures small cap representation across developed and emerging markets countries.

The MSCI ACWI Small Cap Value Index captures small cap securities across developed and emerging markets countries exhibiting overall value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

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