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

The Brandes Global Small-Mid Cap Equity Strategy rose 6.09% (gross of fees), outperforming its benchmark, the MSCI ACWI SMID Cap Index, which declined 1.71%.

Positive Contributors

Stock selection across a variety of sectors drove returns: the two most significant contributors were in financials and industrials. The most prominent contributor was Brazil-based regional jet manufacturer Embraer. Embraer has maintained its impressive streak, announcing 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.

Our overweight to and stock selection in the banking industry also drove returns, led by Greece-based Piraeus Financial, Italian Credito Emiliano, and Ireland-based AIB Group. European banks overall have performed well this year. Their performance has been spurred by better-than-expected earnings growth plus an improved economic environment. These conditions have prompted increased demand for loans and improved market optimism, resulting in rising valuations.

Other contributors included telecom company Magyar Telekom in Hungary, construction materials company Buzzi in Italy, and German medical equipment manufacturer Draegerwerk. Magyar saw its share price rise after reporting earnings results that were ahead of market expectations and announcing a dividend increase.

Performance Detractors

Information technology was the worst-performing sector in the benchmark, and several of our holdings declined, led by Hong Kong-based PAX Global Technology and U.S.-based network equipment company NETGEAR.

Other detractors included investments in consumer discretionary and consumer staples, including Ireland-based beverage firm C&C Group, U.S.-based Edgewell Personal Care, U.K-based Burberry Group, Indonesia-based PT Gudang Garam and Hong Kong-based Yue Yuen Industrial. Shares of C&C Group fell amid a weaker hospitality industry in the U.K., a key market for the company. It 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 Activity

We sold Fuji Media from the portfolios.

Fuji Media was first added in 2016. The company is the fourth-largest for-profit, national, over-the-air television broadcaster in Japan. At the time, the company's core broadcasting business was struggling: It had fallen to fourth place from first in ratings. Fuji Media also had little streaming presence and was facing a slow decline in its core business given the secular shift to internet-based competitors. The company's corporate governance was also poor. Fuji Media had net financial assets that equated to almost 75% of its market capitalization when we initially invested. The company paid a modest dividend (3.1% yield in early 2016) and had not made a material share repurchase in its history to that point. To address its shortcomings in the television market, Fuji Media began to deploy capital into real estate development—an endeavour unlikely to prove fruitful for shareholders. In summary, the company was poorly positioned and poorly managed; however, its price was still right.

When we added Fuji Media, the share price was trading at about half of its book value and its free cash flow yield was approximately 8%. Over the next several years, Fuji Media's progress to achieving its full potential was lacklustre, and it continued to trail its peers in ratings. Dividends grew slowly, ~2.3% annually, despite the company's overcapitalization. However, it did complete two share repurchase programs equating to roughly 10% of its market cap.

As 2022 wrapped up, the Tokyo Stock Exchange announced initiatives to motivate companies with market caps *less than* book value to address what is deemed an oddity in developed markets outside of Japan. Fuji Media's efforts to react had little immediate impact, although it could have contributed to the most recent share repurchases.

Unfortunately, a Fuji Media television celebrity's reprehensible conduct seems to have been a catalyst for change. In December, a news story accused a recognized Fuji Media TV personality of sexual misconduct. Advertisers quickly withdrew, senior managers resigned, and an independent investigation was launched. Fuji committed to improve its corporate governance and over a month, the share price rose by more than 80%. The company's discount to book value closed to less than 20% in the share price surge. We believe it is possible for the company to close the valuation gap completely, but the required steps are challenging to execute and are not assured. For this reason, we sold the position.

A recent addition to the small-mid cap portfolios is Qorvo. The company is a leading supplier of radio frequency front-end (RFFE) components used primarily in smartphones. Qorvo holds the third-largest market share globally behind Qualcomm and Skyworks. The long-term trend in the RFFE industry is increasing content per phone as new, faster cellular networks are rolled out. The industry has benefited greatly from the increasing adoption of smartphones globally, as well as the increased RFFE content per phone. However, the period of high growth and high margins appears to have ended: both declined materially in fiscal 2023. Another poor earnings announcement from Qorvo last October caused a one-day share price decline of more than 25% as the market hope for a quick recovery seemed misplaced.

Qorvo faces several challenges. Global demand has shifted to lower priced, entry level phones. Not only is there less content per phone for these basic alternatives, but there is also far more competition as the components are older and more commoditized. Compounding the issue for Qorvo compared with peers is its greater exposure to Android models in emerging markets. Low-cost RFFE suppliers in China have been gaining share as phone manufacturers cut costs to attract price-conscious buyers. The declining demand for premium smartphones has also slowed the 5G rollout in many markets, further delaying recovery in RFFE content.

In 2021, Qorvo and its peers were valued as if competition or softening demand were not imminent. Over the year, that proved false and Qorvo's share price was halved. After declining by about 70% from its all-time high, Qorvo appears to offer compelling value to an investor with a long enough time horizon. The company's balance sheet is strong and its investment in research and development will likely allow it to continue to differentiate itself against more commoditized peers. The timing of the recovery is uncertain but at current valuation levels, we believe long-term investors can afford to be patient.

Current Positioning

The strategy holds key overweight positions versus the benchmark in the consumer staples and health care sectors. Meanwhile, we remain underweight in typically cyclical sectors, such as consumer discretionary and industrials. We also have an underweight in perceived "safe havens," such as utilities.

Geographically, we continue to find value opportunities outside the United States, especially in the United Kingdom, Japan and emerging markets. The portfolio remains materially underweight versus the benchmark's allocation to the United States.

Global small-mid cap equities continue to represent, in our opinion, fertile ground for fundamentally solid businesses trading at a discount to their estimated intrinsic values. Within the asset class, value stocks (MSCI World SMID Cap Value) continue to trade in the highest quartile of discount levels to the broader market (MSCI World SMID Cap) on a variety of valuation metrics, including forward price/earnings, price/cash flows, and enterprise value/sales.

We believe that paying extremely close attention to valuations enables us to choose opportunities that others may miss. From our perspective, selectivity and a laser focus on margin of safety remain paramount in any and all market environments. We are enthusiastic about the potentially undervalued companies we are finding and the diversification offered by the Brandes Global Small-Mid Cap Equity Strategy.

Term definitions: https://www.brandes.com/termdefinitions

The margin of safety for any security is the discount of market price to our estimate of intrinsic value.

The MSCI ACWI SMID Cap Index with net dividends captures mid and small cap representation across developed and emerging market countries.

The MSCI World SMID Cap Index captures mid and small cap representation of developed market countries.

The MSCI World SMID Cap Value Index with net dividends captures small 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.

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