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Brandes Investment Partners
U.S. Small Cap Value Equity Strategy Notes
First Quarter 2026 (1 January – 31 March 2026)

The Brandes U.S. Small Cap Value Equity Strategy returned 8.48% (gross of fees), outperforming its benchmark, the Russell 2000 Index, which rose 0.89%, and the Russell 2000 Value Index, which gained 4.96%.

Positive Contributors
Holdings in the industrials sector drove performance, led by machinery companies Kennametal and Graham Corporation, as well as aerospace and defence businesses Moog and Park Aerospace.

Kennametal significantly raised its guidance for fiscal year 2026 and is expected to be a key beneficiary of the material increase in tungsten prices, providing a potential positive tailwind to its margins. Park Aerospace benefited from surging demand for its missile defence materials. It also reported strong earnings.

Consumer staples businesses Ingles Markets and Edgewell Personal Care also performed well. Ingles Markets continued to recover from operating challenges during previous years; it announced noteworthy year-over-year profitability growth. Meanwhile, Edgewell completed the sale of its feminine care business for $340 million. The proceeds strengthened its balance sheet, which investors viewed favourably.

Performance Detractors
Detractors included a few technology-related holdings, which were pressured by heightened concerns about perceived disruption from artificial intelligence (AI) and broader macroeconomic uncertainty.

IT services companies Globant and Amdocs declined as investors reassessed the potential impact of generative AI on traditional IT services models, particularly in application development and consulting. Software company OpenText also detracted from performance. Investor concerns centred on the durability of legacy enterprise software models amid rapid advances in AI-enabled information management tools. While OpenText continued to generate substantial recurring revenue from its mission-critical software, uncertainty regarding integration execution and AI-related disruption weighed on sentiment. In our view, the market has overstated near-term disruption risks, while discounting the strength of OpenText's installed base and customer switching costs, causing the company's shares to trade at what we consider appealing valuations.

Other detractors included pizza retailer Papa John's International and laser eye surgery company Lensar. In March, Lensar and Alcon announced they were abandoning Alcon's proposed acquisition of Lensar after the FTC moved to block the transaction on antitrust grounds.

Select Activity in the Quarter
We took advantage of the market volatility to initiate a number of positions. New buys included beverages company Molson Coors, food products businesses Ingredion and Lamb Weston, IT services company Amdocs, software business NICE, containers and packaging company Winpak, and flooring business Mohawk Industries. Meanwhile, we exited positions in apparel company Gildan Activewear, Eagle Bancorp Montana, National Presto, Healthcare Services Group, and Sealed Air.

Mohawk Industries is the world's largest flooring manufacturer. With a leading position on ceramic tile, carpet, laminate, vinyl and stone products, the company serves residential remodelling, new construction and commercial markets. Its global manufacturing and distribution footprint provides substantial scale advantages, broad product reach and cost efficiency across cycles.

The market is currently focused on near-term headwinds facing Mohawk, including slowing home-remodelling demand, elevated input costs and margin pressure after an unusually strong post-COVID rebound.
While cycle risks are still elevated, the company benefits, in our opinion, from a strong balance sheet and a free-cash-flow profile that has stayed positive throughout this period. Additionally, management owns a meaningful equity stake and has shown a willingness to deploy capital opportunistically through share repurchases and acquisitions during times of industry stress.

In our view, Mohawk trades at a valuation that can withstand a prolonged downturn scenario. Based on our assessment of normalized earnings power and balance sheet strength, we believe its shares offer an attractive margin of safety and favourable long-term return potential.

NICE Ltd. is a Contact Centre-as-a-Service (CCaaS) provider, maintaining dual headquarters in Israel and the United States, with a customer base that is predominantly in the U.S. NICE has evolved alongside changing technology and customer requirements. Historically, the company provided software and services to help enterprises manage on-premise customer contact centres. In this capacity, NICE was one of several software and hardware vendors offering tools to staff, manage, measure and evaluate call centre operations. The company was particularly strong in workforce engagement management (WEM) software, a critical component for effective contact centre operations.

In recent years, CCaaS offerings have been increasingly adopted because they lower total cost of ownership, better integrate customer service channels and leverage automation, including AI. All of this enables a superior customer experience that can be applied to other areas of a business. NICE responded to this shift by acquiring a leading CCaaS provider, inContact, in 2016. This acquisition gave NICE a nearly complete CCaaS solution, and as cloud-based offerings grew at the expense of on-premise systems, NICE benefited from higher revenue per licensed seat. The market rewarded this industry-leading position with strong valuation multiples.

However, in 2025 rapid advances in AI capability and adoption began to cloud NICE's outlook. On one hand, improving AI functionality has accelerated the shift toward CCaaS solutions and away from on-premise deployments. On the other, the pace of change has intensified competition among CCaaS providers and has driven increased investment to incorporate advanced AI features. NICE has indicated that this heightened investment, including the approximately $1-billion acquisition of Cognigy, will put pressure on its earnings over the next year. This uncertainty contributed to a sharp correction in the share price, pushing it to multi-year lows and compressing valuation multiples to near all-time lows.

While it is impossible to predict definitive winners and losers in the AI arms race, NICE remains favourably positioned as an established incumbent in the CCaaS market with a well-capitalized balance sheet. AI-enhanced contact centre functionality could meaningfully expand the overall market size over time. We will continue to monitor the competitive landscape for evidence of NICE's performance in navigating this transition. For the patient, long-term investor, the current opportunity in NICE appears attractive.

Current Positioning

While our allocation to companies in industrials continues to be the largest weighting from a sector perspective, we have materially reduced our allocation, trimming positions that have performed well and selling off National Presto and Healthcare Services Group. Following the additions of Ingredion, Molson Coors, and Lamb Weston, our allocation to consumer staples has increased substantially. Along with industrials and materials, it continues to be one of our largest overweight's. The strategy's most notable underweights are in financials, health care and real estate. Compared to the Russell 2000 Value Index, we have less exposure to financials and real estate.

In our opinion, the differences between the Brandes U.S. Small Cap Value Equity Strategy and the broader U.S. small-cap market continue to make it an attractive complement to other small-cap offerings. Our strategy exhibits lower valuations than the Russell 2000 Index, while offering exposure to companies that we believe have strong balance sheets, compelling growth prospects and a history of durable free-cash-flow generation.

We are optimistic about the potential of value stocks in general and believe the Brandes U.S. Small Cap Value Equity Strategy remains well positioned from a long-term risk/reward perspective.

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