

U.S. Value Equity Strategy Notes First Quarter 2024 (1 January – 31 March 2024)

The Brandes U.S. Value Equity Strategy rose 12.06% (gross of fees) in the quarter, outperforming its benchmark, the Russell 1000 Value Index, which increased 8.99%.

Positive Contributors

Stock selection across sectors drove outperformance, led by holdings in financials and health care.

Our bank holdings continued their solid run from the fourth quarter of 2023, representing one of the best performers from an industry standpoint. During the quarter, large money centre banks appreciated more than regional banks overall as concerns regarding the latter's heightened exposure to commercial real estate dampened investor sentiment. Accordingly, our overweight and allocation to money centre banks, such as Citigroup and Wells Fargo, contributed positively to returns.

Within health care, top performers included distributors McKesson and Cardinal Health, as well as health care services providers HCA Healthcare and Cigna. Although the sector underperformed the overall benchmark, the solid performance of several of our health care holdings more than offset the negative impact from our overweight allocation.

Several technology holdings were also strong contributors, notably semiconductor-related companies such as Applied Materials and Micron Technology. Apart from the start of a recovery in the semiconductor market, these holdings benefited from investor optimism surrounding the growing structural demand for semiconductor content, fuelled by the proliferation of artificial intelligence (AI) applications. In addition to Applied Materials and Micron, technology manufacturing firm Flex rose on the back of the spinoff of its solar equipment business, Nextracker, as well as the ongoing improvements in its operating results.

Performance Detractors

With no holdings experiencing significant share-price declines, detractors were primarily companies that remained relatively flat or did not do as well as the overall benchmark. These included several positions in health care, which represented one of the weaker performers within the Russell 1000 Value Index. Notable detractors were Lab Corp, Sanofi, and Pfizer.

Technology firms Cognizant and OpenText also weighed on performance, along with communication services company Comcast.

Within the benchmark, energy (especially the oil and gas industry) was among the best-performing sectors in the quarter. Although our three holdings (i.e., Chevron, Halliburton, World Kinect) appreciated, our underweight to the sector hurt relative performance. Our underweight was mainly due to our lack of holding in ExxonMobil, which accounted for over 2% of the benchmark at quarter end.

Select Activity in the Quarter

We took advantage of the continued optimism in the technology sector by divesting its holding in Applied Materials after it reached our estimate of its intrinsic value.

We initially purchased Applied Materials, the world's largest supplier of wafer fabrication equipment for semiconductor production, when its shares declined in 2018 due to concerns surrounding semiconductor capital expenditures (capex) spending. At the time, while the market focused on the industry's near-term downturn, we believed Applied Materials was well positioned to benefit from increased silicon intensity over the medium term. Given the trend of increasing semiconductor content per device, coupled with growing complexity of semiconductor design and manufacturing process, we looked to capitalize on what we deemed a structural growth opportunity at a bargain price. Additionally, we saw potential upside from China's investments in its domestic semiconductor industry, which could further boost equipment demand.

In 2020 and 2021, the semiconductor shortage and increased industry spending drove up Applied Materials' share price, leading us to strategically reduce our exposure. Then in 2022, when technology stocks, particularly semiconductor-related ones, experienced a pullback due to a cyclical downturn reminiscent of the conditions during our initial investment in 2018, we added to our position. Over the past 18 months, the shares surged as the market increasingly favoured semiconductor-related companies amid prospects of rising demand driven by AI. Consequently, we opted to divest our position as we no longer consider the stock materially discounted.

Current Positioning

The portfolio maintains overweight positions in financials, health care, and communication services, while retaining key underweights in utilities and real estate, with no holdings in these sectors. Additionally, it remains significantly underweight in consumer staples, with only one holding in the sector (food product company Ingredion), compared to the benchmark's nearly 8% allocation.

Value stocks underperformed growth stocks this quarter (Russell 1000 Value vs. Russell 1000 Growth), mainly due to the strong run of the technology sector. Despite value underperformance, however, our strategy did better than the broader Russell 1000 Index, driven primarily by the notable performance of our financials and health care holdings, as discussed earlier.

Given the widening valuation gap between value and growth stocks over the past year, we are increasingly optimistic about the return potential for value stocks. Following the performance of the growth index (MSCI USA Growth), which was largely fuelled by a select few tech-related names, value stocks (MSCI USA Value) are now trading at the largest decile discount relative to growth stocks since the inception of the style indices. This valuation disparity is evident across various metrics, such as price/earnings, price/cash flow, and enterprise value/sales. Historically, such valuation differentials have often signalled compelling subsequent returns for value stocks over longer-term horizons. Notably, our portfolio, guided by our value philosophy and process, has tended to outperform the benchmark when value stocks outperform the Russell 1000.

Looking ahead, we remain optimistic about the prospects of our holdings. As of 31 March 2024, the Brandes U.S. Value Equity Strategy trades at more appealing valuation levels than the benchmark, in our opinion, while also offering more attractive long-term growth characteristics.

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

The Russell 1000 Index with gross dividends measures performance of the large cap segment of the U.S. equity universe.

The Russell 1000 Value Index with gross dividends measures performance of the large cap value segment of the U.S. equity universe. Securities are categorized as growth or value based on their relative book-to-price ratios, historical sales growth, and expected earnings growth.

The Russell 1000 Growth Index with gross dividends measures performance of the large cap growth segment of the U.S. equity universe. Securities are categorized as growth or value based on their relative book-to-price ratios, historical sales growth, and expected earnings growth.

The MSCI USA Value Index captures large and mid cap U.S. securities exhibiting overall value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

The MSCI USA Growth Index captures large and mid cap U.S. securities exhibiting overall 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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