# Brandes Small Cap Value Fund

## FUND INFORMATION

| | |
|---|---|
| Class I: | BSCMX |
| Class A: | BSCAX |
| Class R6: | BSCRX |

## STRATEGY

The Fund seeks long-term capital appreciation by investing predominantly in U.S. equity securities of small-capitalization companies that the Fund's investment team believes are undervalued relative to their financial strength and upside potential.

## TOP TEN HOLDINGS

(% of assets as of 6/30/2022)

| | |
|---|---|
| Edgewell Personal Care Co | 4.39 |
| NETGEAR Inc | 4.22 |
| Park Aerospace Corp | 4.07 |
| Dril-Quip Inc | 4.03 |
| Moog Inc | 3.88 |
| National Western Life Group Inc | 3.61 |
| Embraer SA | 3.48 |
| Flowserve Corp | 3.46 |
| Hurco Cos Inc | 3.09 |
| National Presto Industries Inc | 3.06 |

Fund holdings are subject to change at any time at the discretion of the investment manager.

The Brandes Small Cap Value Fund declined 10.67% (Class I Shares), outperforming its benchmark, the Russell 2000 Index, which declined 17.20% in the second quarter, and the Russell 2000 Value Index, which fell 15.28%.

## Positive Contributors

Amid strong relative performance for value stocks, holdings across a variety of sectors held up well during the period, led by those in health care, specifically **United Therapeutics** and **Prestige Consumer Healthcare**.

In May, United Therapeutics announced FDA approval of Tyvaso DPI, an inhalation powder for treating pulmonary arterial hypertension and pulmonary hypertension associated with interstitial lung disease to improve exercise ability. The approval was granted without a boxed warning and contraindications. United Therapeutic’s shares were up materially on the news.

Other contributors included technology distributor **Avnet**, software company **N-able** and insurer **American National Group**. A new portfolio addition, homebuilder **M.D.C. Holdings**, also performed well.

From a relative standpoint, our underweights to information technology, communication services and real estate aided returns.

## Performance Detractors

A variety of concerns—from geopolitical risks to inflation and uncertainties about future economic growth—led the markets to decline. As a result, more cyclically oriented companies were some of the weakest performers, along with technology-related companies, which continued to see their valuations compress as interest rates rose.

While most of our health care holdings performed well, **Avadel Pharmaceuticals** was a notable outlier. Avadel’s shares were volatile because the U.S. Food and Drug Administration delayed its approval of Avadel’s narcolepsy drug until next year at the earliest. Meanwhile, cyclical holdings such as regional jet manufacturer **Embraer**, oilfield services company **Dril-Quip**, **Sprott Physical Uranium Trust** and **Dorel Industries** saw their respective shares retreat.

Dril-Quip gave back some of its strong performance from the previous 18 months. Meanwhile, investor frustration over Embraer’s margin guidance, combined with supply-chain issues contributed to its price decline. We believe the market has continued to underappreciate the ongoing cycle recovery across Embraer’s product line; the company’s order backlog has risen above pre-COVID levels. While the market has focused heavily on short-term, one-off margin distortions, Embraer trades at a wide discount to our estimate of its intrinsic value.

## Select Activity in the Quarter

The small cap investment committee added **Scotts Miracle-Gro Company**, M.D.C. Holdings, maternal and infant health company **Utah Medical Products**, and cement company **Buzzi Unicem**. M.D.C Holdings, Utah Medical Products and Buzzi Unicem are companies we know well, having owned them in this portfolio or in other strategies managed by the investment team in the past.

Scotts Miracle-Gro Company (SMG) is the leading manufacturer and marketer of branded consumer lawn and garden products in North America and the exclusive agent of Monsanto for the marketing and distribution of Roundup-branded consumer products in the U.S. and certain other countries. In the mid-1900s, the company became widely known for developing quality lawn fertilizers and grass seeds that led to the creation of a new industry: consumer lawn care. In the 1990s, SMG significantly expanded its product offering by merging with Stern's Miracle-Gro, a leader in water-soluble garden plant foods, by buying the Ortho brand, and by securing the rights to market Monsanto's Roundup brand. Since 2015, the company has made a series of investments to establish a leadership position in hydroponic gardening.

The opportunity to invest in SMG came as the company was updating its fiscal 2022 guidance based on weaker sales outlook and rising input costs. The deterioration in company fundamentals was well known. SMG had already downgraded its original fiscal 2022 earnings per share (EPS) guidance from $8.5-9.0 to $8.0; it subsequently reported that the $8.0 target was likely unattainable. The magnitude of the updated guidance, however, was greater than the market had anticipated, and the new fiscal 2022 EPS target of $4.5-5.0 drove the company's share price lower.

We believe the stock price now reflects the bad news and we think that most of the company's struggles are likely to prove temporary. As of June 30, SMG offered a double-digit earnings yield and a dividend yield of more than 3%, while maintaining market leadership in its industry. That said, our level of conviction and allocation is tempered by the prevailing view that strong demand for lawn and garden products is not mean-reverting and, to a lesser extent, by SMG's high financial leverage-although we believe it is manageable.

We exited our positions in **Kelly Services**, N-able, Avnet, and American National Group.

## Year-to-Date Briefing

The Brandes Small Cap Value Fund declined 10.67% (Class I Shares), outperforming its benchmark, the Russell 2000 Index, which declined 23.43% in the six months ended June 30, 2022, and the Russell 2000 Value Index, which fell 17.31%.

Markets have declined amid unease about inflation and a slowdown in economic growth. As interest rates have risen, technology-related companies have been among the worst performers in the index, along with some cyclically oriented companies based on increasing anxieties about future economic growth. Conversely, more defensive and commodity-oriented companies have performed relatively well. Value stocks have also held up reasonably well in a down market.

Our relative outperformance versus the broad U.S. market (Russell 2000 Index) was due to value exposure as well as select health care, energy and professional services companies. At the individual security level, key drivers were energy investments Dril-Quip, **Helmerich & Payne**, **Chesapeake Energy** and **Halliburton**, health care holding United Therapeutics, and professional services companies **Science Applications International Corp.**, **Resources Connection** and Kelly Services. Notable detractors included Embraer, machinery company **Graham Corporation**, communications equipment producer **NETGEAR** and marine construction company **Orion Group**.

## Current Positioning

Amid widespread declines, value stocks (as measured by the Russell 2000 Value Index) have thus far outperformed the broader market (Russell 2000 Index). Rising inflation and higher interest rates have caused the valuations of many high-flying growth companies to compress. Meanwhile, geopolitical developments exacerbated inflationary trends and increased worries about an economic slowdown, raising the potential for a "stagflationary" environment (low economic growth *and* elevated inflation).

In theory, weaker growth may be a headwind for value stocks, all else being equal. However, as we have mentioned in previous notes, two of the best periods for value versus growth occurred in stagflationary environments during the 1970s and early 2000s. The common factors that led these two periods to result in highly favorable value environments were: markets had been in a state of elevated valuations and the spread between value and growth had been at historically wide levels. The tailwinds for value that were driving relative returns earlier this year still appear evident to us. While valuation spreads between value and growth have begun to narrow from the historically wide gap at the start of the year, they remain among the widest quintile in history, and we therefore continue to feel optimistic about the potential returns for value stocks.

From a positioning standpoint, our largest sector overweights were in industrials and energy, and we continued to find value in health care. We remain markedly underweight in the financials, real estate, and information technology sectors.

As always, we appreciate the trust you have placed in us.

| Average Annual Total Returns (%) as of June 30, 2022 | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Without Load** | 3 Months | YTD | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception 10/1/1997 |
| Class I | -10.67 | -10.67 | -8.39 | 13.58 | 7.16 | 11.73 | 7.41 |
| Class A | -10.65 | -10.70 | -8.55 | 13.31 | 6.84 | 11.44 | 7.14 |
| Class R6 | -10.71 | -10.77 | -8.12 | 11.27 | 5.92 | 11.08 | 7.16 |
| **With Load** | 3 Months | YTD | 1 Year | 3 Years | 5 Years | 10 Years | Since Inception 10/1/1997 |
| Class A | -15.76 | -15.81 | -13.83 | 11.10 | 5.59 | 10.78 | 6.89 |
| Russell 2000 Index | -17.20 | -23.43 | -25.20 | 4.21 | 5.17 | 9.35 | 6.88 |
| Russell 2000 Value Index | -15.28 | -17.31 | -16.28 | 6.18 | 4.89 | 9.05 | 7.69 |

Operating Expenses: Class I: 6.67% (gross), 0.91% (net) Class A: 5.79% (gross), 1.16% (net) Class R6: 6.63% (gross), 0.73% (net)

*Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. All performance is historical and includes reinvestment of dividends and capital gains. Performance data current to the most recent month end may be obtained by calling 1.800.395.3807. Performance data shown with load reflects the Class A maximum sales charge of* ***5.75%.*** *Performance shown without load does not reflect the deduction of the sales load. If reflected, the load would reduce the performance quoted.*

The performance information shown for periods before January 2, 2018 is that of a private investment fund managed by the Advisor (the "Predecessor Fund") prior to the commencement of the Small Cap Fund's operations with policies, guidelines and restrictions that were, in all material respects, equivalent to those of the Small Cap Fund. The Small Cap Fund acquired the assets and assumed the liabilities of the Predecessor Fund on January 2, 2018, and investors in the Predecessor Fund received Class I shares of the Small Cap Fund as part of the reorganization. With respect to Class I and Class R6 shares, the performance information shown reflects the gross expenses of the Predecessor Fund. Class A shares reflect the gross expenses of the Predecessor Fund restated to reflect the Class A sales load and Rule 12b 1 fees.

The Advisor has contractually agreed to limit the operating expenses through January 28, 2023. The Expense Caps may be terminated at any time by the Board of Trustees upon 60 days notice to the Advisor, or by the Advisor with the consent of the Board. Investment performance reflects fee waivers and/or reimbursement of expenses. In the absence of such waivers/reimbursements, total return would be reduced.

Cyclically Oriented Companies: Those following the cycles of an economy through expansion, peak, recession and recovery, including companies that sell items that consumers buy more during a booming economy but spend less on during recession.
Dividend Yield: Dividends per share divided by price per share.
Earnings per share (EPS): The portion of a company's profit allocated to each share of common stock. EPS serves as an indicator of a company's profitability.
Operating Margin: Operating income divided by net sales; used to measure a company's operating efficiency.
Stagflation: Combination of slow economic growth and high inflation.
Yield: Annual income from the investment (dividend, interest, etc.) divided by the current market price of the investment.

The Russell 2000 Index with gross dividends measures the performance of the small cap segment of the U.S. equity universe.

The Russell 2000 Value Index with gross dividends measures performance of the small cap 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.

Diversification does not assure a profit or protect against a loss in a declining market.

**Because the values of the Fund's investments will fluctuate with market conditions, so will the value of your investment in the Fund. You could lose money on your investment in the Fund, or the Fund could underperform other investments. The values of the Fund's investments fluctuate in response to the activities of individual companies and general stock market and economic conditions. Diversification does not assure a profit or protect against a loss in a declining market. It is not possible to invest directly in an index. Stocks of small-sized and mid-sized companies tend to have limited liquidity and usually experience greater price volatility than stocks of larger companies.**

*A mutual fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectuses contain this and other important information about the investment company, and may be obtained by calling 1.800.395.3807 or visiting www.brandesfunds.com. Read carefully before investing.*

The foregoing reflects the thoughts and opinions of Brandes Investment Partners® exclusively and is subject to change without notice.



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