

**Brandes Investment Partners**  
**Core Plus Fixed Income Strategy Notes**  
**First Quarter 2024 (January 1 – March 31, 2024)**

The Brandes Core Plus Strategy rose 0.05% net of fees and 0.12% gross of fees, outperforming its benchmark, the Bloomberg U.S. Aggregate Bond Index, which fell 0.78% in the quarter.

<b>Annualized total return as of March 31, 2024</b>	<b>1-year</b>	<b>5-year</b>	<b>10-year</b>
Brandes Core Plus Fixed Income Composite (net)	3.66%	1.15%	1.90%
Brandes Core Plus Fixed Income Composite (gross)	3.93%	1.41%	2.17%
Bloomberg U.S. Aggregate Bond Index	1.70%	0.36%	1.54%

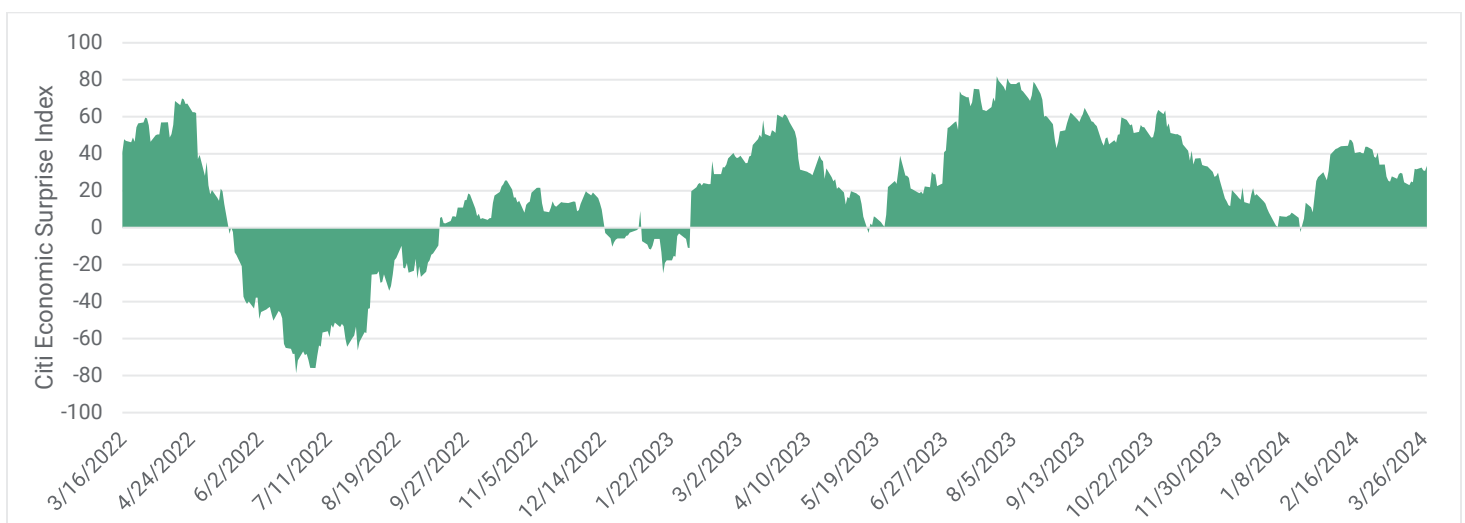
Past performance is not a guarantee of future results. One cannot invest directly in an index. Returns include reinvestment of all dividends and are reduced by any applicable foreign withholding taxes, without provisions for income taxes, if any.

By the standards of the past few years, the start of 2024 has been relatively benign – no global pandemic (2020 & 2021), no beginning of a significant rate hike cycle (2022), and no banking chaos (2023). During the first quarter, equity markets moved higher, credit spreads moved tighter, and interest rates moved upwards as the continued resilience in the U.S. economy forced investors to rethink the timing and number of rates cuts for the coming year.

At the end of 2023, the closely watched median fed dot plot projected three 25bps (basis points) rate cuts in 2024, for a total of 75bps. The market at that time, however, was projecting a total of 175bps in rate cuts. We’ve spoken repeatedly about the disconnect between the market and the Fed (Federal Reserve Bank) on the timing and magnitude of rate cuts. The consistent theme of the past few years has been a market that seems *overly eager* to get rate cuts started.

Complicating the Fed’s ability to feed investor desires for lower rates is economic data that’s not only continued strong, but also has been surprising the market to the upside. Exhibit 1 illustrates the trend in this economic data since the Fed’s first rate hike in March 2022. There has been a consistent string of economic reports surprising the market to the upside (other than a brief blip in early 2023). The first three months of 2024 have seen an acceleration in *upside surprises* in economic data, which has ultimately led the market to price in rate cuts starting later in the year and fewer overall – leading to a rise in U.S Treasury rates during the quarter.

**Exhibit 1. Economic Data Continues to Surprise to the Upside, Complicating the Fed’s Effort to Slow the Economy**

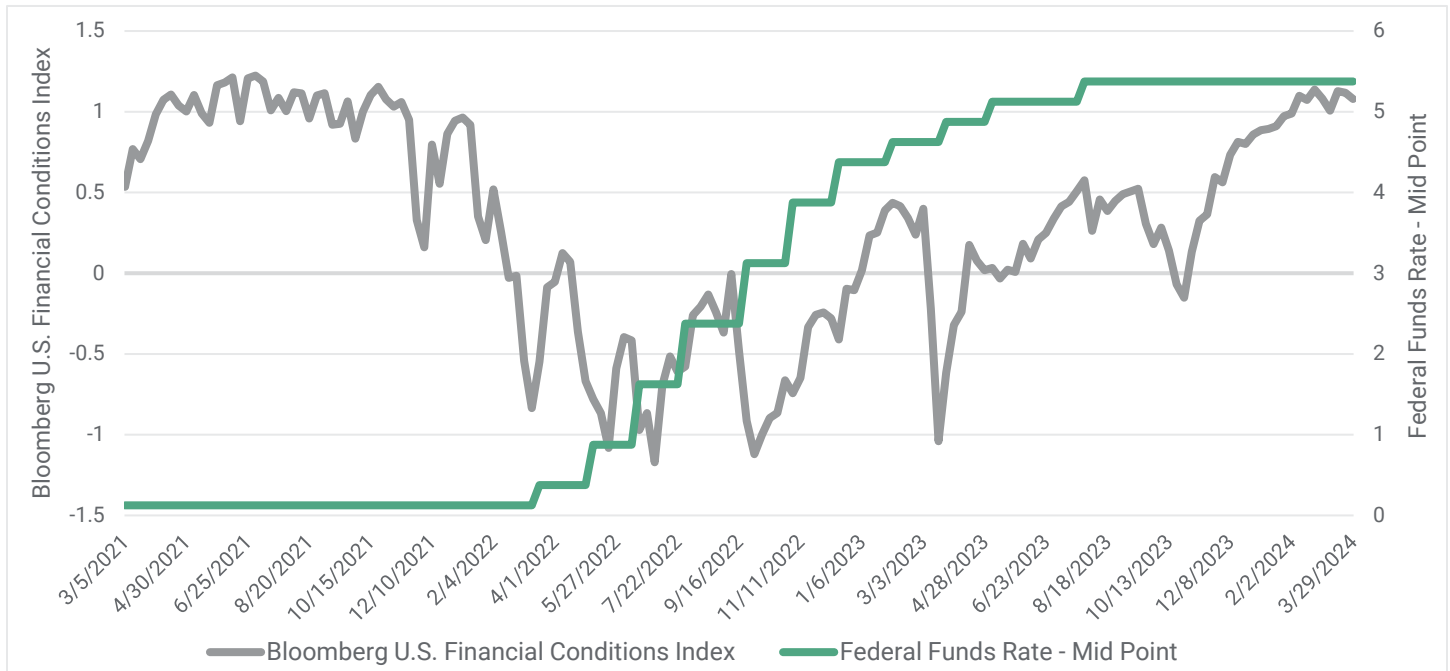


March 16, 2022 to March 28, 2024 | Source: Bloomberg, CitiBank. The US Citigroup Economic Surprise Index represents the difference between official economic results and forecasts. A positive US Citigroup Economic Surprise Index value means economic data releases have been stronger than expected.

We believe that the primary reason that the Fed and investors are eager to see rate cuts as soon as possible is that it seems they are taking as gospel that the current fed funds rate is indeed restrictive. Are we certain, however, that this overwhelming sentiment is correct?

When the Fed began raising rates in March 2022, it expressed a desire to tighten overall financial conditions to tame inflation. An examination of the Bloomberg Financial Conditions Index demonstrates that financial conditions are *easier* than when the Fed began its rate hikes. If financial conditions are easier now, why do many investors still think the current fed funds rate is restrictive and thus keep planning for imminent rate cuts?

**Exhibit 2. Are We Certain the Current Fed Funds Rate Is Restrictive?**



March 5, 2021 to March 29, 2024 | Source: Bloomberg. The Bloomberg U.S. Financial Conditions Index tracks the overall level of financial stress in the U.S. money, bond, and equity markets to help assess the availability and cost of credit. A positive value indicates accommodative financial conditions, while a negative value indicates tighter financial conditions relative to pre-crisis norms. The Federal Funds Rate is a target interest rate set by the central bank in its efforts to influence short-term interest rates as part of its monetary policy strategy.

In an ideal world, there should be little distinction between what a central bank like the Fed should do and what it will do. The Fed seems intent on easing policy despite stubborn inflation data and a clear easing of financial conditions over the past several months. Let’s hope market pressure for lower rates does not push the Fed into policy errors like those made in the 1970s.

**Portfolio Performance**

In the first quarter, the Brandes Core Plus portfolios delivered modestly positive returns and had meaningfully positive relative performance versus their benchmark, the Bloomberg U.S. Aggregate Bond Index.

Corporate bonds provided the largest positive contribution to returns during the quarter. Within corporate bonds, performance during the period was led by corporate bond holdings in information technology (MicroStrategy), utilities (FirstEnergy Corp.), banking (US Bank and Goldman Sachs), and healthcare (Tenet Healthcare).

Term-structure positioning was a positive factor during the quarter. U.S. Treasury yields rose during the period as the market began to reassess both the timing and number of fed funds rate cuts during 2024. Near the end of September 2023, we moved the duration of the portfolios to 90% of the benchmark’s duration – a level that we have maintained throughout the first quarter.

The portfolios' underweight to agency mortgage-backed securities (MBS) aided returns as that sector was one of the few taxable fixed income sectors to post negative returns versus U.S. Treasuries.

Select holdings in services (ADT Inc) and telecom (Telecom Italia) modestly detracted from performance.

Portfolio activity was light during the quarter. The portfolios added a new position in first lien bonds from Univision Communications (8.00% coupon, maturing 8/15/28, rated B1/B+).

Univision Communications is a leading Hispanic media company in the U.S. and Mexico. It operates 36 cable networks and 59 owned or operated television stations. In January 2022, Univision merged with Televisa – its primary content provider – to form a new company TelevisaUnivision.

Given the growth of Spanish speaking population in the U.S. along with Univision's position as the leader in distribution assets and (with the recent merger) content, we view this as among the healthiest categories in broadcasting. Revenues are growing, whereas many firms in the industry are experiencing declining revenue. Cash flow is currently neutral to slightly negative as the company is investing in its direct-to-consumer (DTC) streaming option. We believe that DTC losses have peaked, and that income generated from this initiative will allow the company to grow earnings and cash flow as the service gains scale.

During the quarter we sold our position in MicroStrategy as it reached our estimate of fair value. We also experienced a full call in our holding of Tenet Healthcare.

### **Outlook**

I have a Brandes colleague who accuses me of putting on my *grumpy pants to yell at the clouds* when presenting my opinion of the Fed's litany of largely self-inflected policy errors or my concerns over what we believe are elevated valuations in the current market.

Last quarter I shared the story of how my kids remind me that I am no longer a *young and hip* dad (presuming that I ever was), and now I have colleagues referring to me to as a grumpy old man yelling at clouds - there appears to be a trend forming here.

Consider me curmudgeonly, but I do believe that two important themes that we have highlighted in previous quarters should still guide how we position and manage the portfolios in today's market.

The first theme is our view that while fixed income yields are at attractive levels, valuations are stretched. Yields offered by corporate bonds are near the highest we have seen in nearly 15 years, which has led to considerable optimism about the asset class. As we have explained previously, a closer look indicates that the rise in yield on corporate bonds is largely attributable to the increase in Treasury yields rather than a cheapening of overall credit spreads. The corporate market appears to be *priced for perfection* with credit spreads at or near their tightest levels in several decades. Accordingly, we believe caution is warranted when allocating to the sector.

The second theme is that after nearly seventeen years of unconventional and near-zero rate monetary policy, there exists a paucity of experience and perspective among investors leading to a distorted view of what a *normal* interest rate environment is. I've been part of several conversations where current 10-year U.S. Treasury rate of 4.2% has been referred to as *crippling*. These have mostly been with people who don't seem to realize that in the fifteen-year period leading up to the Global Financial Crisis, the average rate on the 10-year U.S. Treasury was 5.5%.

To many investment professionals who are less than fifteen years into their careers – their perception of *normal* appears to be near zero rates. The market does not seem to give much weight to the notion that the current fed funds rate is not restrictive. That is a risk to monitor as we move forward.

We share some of the optimism as overall yields in the core plus portfolios are the highest they have been since 2009. Our main caution, however, is that we believe it is important to remain disciplined in what one buys. Higher yields are welcome for long-term savers and investors, but a potential burden for companies as they are staring at refinancing upcoming maturities at much higher costs.

The takeaway in our view is that deep, measured, fundamental research is essential as we move forward in an environment where idiosyncratic risks appear to be on the rise. We believe it's critical to be patient in adding to a portfolio: not just know what you own but why you own it.

For a considerable period now, we have attempted to tilt the Brandes Core Plus portfolios into what we believe is a defensive posture to mitigate some of the potential detrimental impact of rising interest rates and widening yield spreads. We believe that this remains a risk. Accordingly, the portfolios continue to favor shorter-maturity corporate bonds and those that we believe exhibit strong, tangible asset coverage. We are managing duration approximately 10% shorter than the portfolios' benchmark. We have a meaningful allocation to U.S. Treasuries and if market uncertainty and volatility continue to cause credit fundamentals to become mispriced relative to our estimates of intrinsic value, then we will look to redeploy some of those Treasury holdings thoughtfully and effectively to take advantage of opportunities.

We remain underweight agency mortgage-backed securities.

As we move forward, we believe prudence dictates that we continue our search for value in a measured and deliberate manner while continuing to tilt the portfolios to what we believe is a relatively defensive posture.

We remain optimistic about the prospects for the Brandes Core Plus Portfolios.

Sincerely,



Timothy M. Doyle, CFA  
Fixed Income Portfolio Manager

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

The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. This index is a total return index which reflects the price changes and interest of each bond in the index.

First lien bonds are senior to all other bonds of an issuer so that first lien bond holders are paid back before all other debt holders. A lien is the legal right of a creditor to seize property from a borrower that has failed to repay the creditor.

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