

Brandes Investment Partners
European Equity Strategy Notes
Third Quarter 2024 (1 July – 30 September 2024)

The Brandes European Equity Strategy rose 12.29% (gross of fees), outperforming its benchmark, the MSCI Europe Index, which increased 6.58% in the quarter, and the MSCI Europe Value Index, which appreciated 9.52%.

Positive Contributors

Leading contributors included holdings in health care, notably Spain-based biotechnology firm Grifols, medical equipment companies U.K.-based Smith & Nephew and Netherlands-based Koninklijke Philips, and German health care services company Fresenius SE.

In July, Grifols confirmed that the founding family, which controls 30% of the company, and Brookfield, a multinational Canadian alternative investment fund, are evaluating a potential joint takeover bid for the entire business. The structure and pricing remain unclear, but the market reacted positively to their proposal.

Geographically, holdings in the U.K. were major contributors. Aerospace and defense company Rolls-Royce continued to report improving earnings arising from the recovery in its aerospace end-markets. Other solid U.K.-based performers included consumer staples companies Tesco, J Sainsbury, and Marks and Spencer, as well as home retailer Kingfisher and construction company Balfour Beatty.

Relative to the benchmark, our underweight in technology stocks aided returns as technology-related companies were some of the weakest performers in the MSCI Europe Index.

Performance Detractors

The most notable detractors were in the financials sector. These included Spanish insurance company Linea Directa Aseguradora, and two small-cap banks: Slovenia-based Nova Ljubljanska Banka (NLB) and Austria-based Addiko Bank. Both banks saw their share prices decline after NLB scrapped its takeover offer for Addiko.

Other detractors included Netherlands-based beverage company Heineken Holdings and French luxury goods firm Kering.

Heineken's shares declined after the company took an impairment charge for its stake in China Resources Beer, reflecting a weaker consumer environment in China. Meanwhile, Kering remained under pressure as it worked to revitalise its Gucci business. Although the shares rebounded toward the end of the quarter due to the potential for Chinese stimulus, the increase was not enough to fully offset the earlier decline.

Select Activity in the Quarter

We divested French auto manufacturer Renault, U.K. consumer products company Unilever, and financial brokerage and advisory firm Willis Towers Watson after they reached our estimates of intrinsic value.

We initially bought Ireland-domiciled Willis Towers Watson (WTW) just over a year ago because its share price had underperformed the broader market (MSCI Europe) following its failed merger with Aon. We believed that the company offered an appealing investment opportunity given its reliable cash-flow generation, solid balance sheet, and attractive valuation. We also believed it had the potential to improve its margins closer to its insurance brokerage peers.

During the past year, the company has generated improved growth and has seen margin expansion and increased free-cash-flow generation. While our estimate of WTW's intrinsic value increased, the share price increased more significantly. When it reached our updated intrinsic value estimate, we sold our position.

We used the proceeds from these sales to add to several existing holdings, including recent purchase Infineon, as well as some of the detractors mentioned for the quarter.

Year-to-Date Briefing

The Brandes European Equity Strategy rose 22.50%, outperforming its benchmark, the MSCI Europe Index, which increased 12.77% in the nine months ended 30 September 2024, and the MSCI Europe Value Index, which appreciated 13.81%.

While value outperformance provided a better backdrop for the strategy, it was stock selection across nearly all sectors that drove the relative returns. Investments in financials, industrials, and consumer staples have been the most noteworthy contributors. These were led by Rolls-Royce, Ireland-based consumer staples company Greencore, Italy's Intesa Sanpaolo, and Nova Ljubljanska Banka. Other contributors included communication services firms Magyar Telekom (Hungary) and Millicom International (Luxembourg), as well as medical equipment company Koninklijke Philips.

Several investments in health care detracted from returns, most notably French pharmaceutical Euroapi and Spain's Grifols. Grifols' stock declined (mainly in the first quarter) following a short seller's report that questioned the company's debt, accounting, and corporate governance practices. As mentioned, Grifols' shares did rebound during the third quarter, and we continue to see a meaningful upside potential in owning the company.

Other detractors included Kering and Heineken Holdings, as well as Swiss watchmaker Swatch.

Current Positioning

The Brandes European Equity Strategy holds key overweight positions in consumer staples and communication services, while maintaining significant underweights in technology and industrials. While the strategy remains underweight in industrials, our exposure to that sector increased this year as we have uncovered several new opportunities that we believe have attractive return potential. Our weight to financials has decreased as we have pared and sold some companies that performed well this year and, as a result, their margin of safety (the discount of market price to our estimate of intrinsic value) narrowed. Accordingly, we are now underweight the sector versus the MSCI Europe Index.

Geographically, the portfolio's largest allocations continue to be in France and the United Kingdom. It remains underweight in Switzerland and has no exposure to companies in the Nordic Region. While we maintain our lower weighting to Germany relative to the benchmark, our underweight has narrowed this year with the acquisition of Infineon and Deutsche Post. We believe the differences between the MSCI Europe Index and our strategy make it an excellent complement and diversifier to passive and growth-oriented options.

As of 30 September, value stocks (MSCI Europe Value) continued to trade in the least-expensive decile relative to growth (MSCI Europe Growth) since the inception of the style indices, across various valuation measures, including price/earnings, price/cash flow, and enterprise value/sales. Historically, such discount levels have often signaled attractive subsequent returns for value stocks. We find this encouraging because the Brandes European Equity Strategy—guided by our value philosophy and process—has tended to outperform the value index when it surpassed the benchmark.

Looking ahead, we remain optimistic about the long-term prospects of the companies held in the Brandes European Equity Strategy.

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

The MSCI Europe Index with net dividends captures large and mid cap representation of developed market countries in Europe.

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

The MSCI Europe Growth Index captures large and mid cap securities across developed Europe exhibiting 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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