

U.S. Small Cap Value Equity Strategy Notes Second Quarter 2024 (1 April– 30 June 2024)

The Brandes U.S. Small Cap Value Equity Strategy declined 3.34% (gross of fees), slightly underperforming its benchmark, the Russell 2000 Index, which fell 3.28% in the quarter. The Russell 2000 Value Index was down 3.64%.

Positive Contributors

Top contributors included holdings in the health care sector, most notably Phibro Animal Health, United Therapeutics, and LENSAR.

United Therapeutics continued its robust start to 2024 with strong demand for Tyvaso DPI, a dry-powder inhaler for treating pulmonary arterial hypertension. Meanwhile, Phibro Animal Health announced a pending agreement to acquire Zoetis's medicated feed additive franchise and some additional livestock assets for \$350 million. Phibro's management views the acquisition as offering meaningful earnings-per-share accretion and an opportunity to expand the company's offerings into new markets. The market regarded this deal, plus Phibro's strong earnings announcement, favorably.

Other contributors included machinery company Graham Corporation, construction and engineering business Orion Group, consumer products company Edgewell Personal Care, and aerospace and defense firm Moog Inc.

Performance Detractors

Notable detractors were in the energy and industrials sectors, specifically Park Aerospace and Spirit AeroSystems, machinery businesses L.B. Foster and Hurco Companies, Healthcare Services Group, and energy equipment and services company Dril-Quip.

Hurco declined after announcing suspension of its quarterly dividend as it works to enhance its financial flexibility. Meanwhile, Spirit AeroSystems' performance was volatile due to its manufacturing of the 737 Max jet fuselage, which has become the focus of intense attention since a door plug blowout on an Alaska Airlines airplane earlier this year. With a change in the risk profile altering the risk/reward tradeoff, we sold our position in Spirit in the quarter.

Other detractors included health care company Pediatrix Medical Group and apparel business Hanesbrands.

Select Activity in the Quarter

We initiated positions in packaging and performance-based materials business Sealed Air Corporation and professional services company Resources Connection.

A team at Deloitte, led by the current Chair Donald Murray, founded Resources Connection in 1996. The company operated as a part of Deloitte until 1999 when the founding team completed a management-led buyout, and it went public in 2000. Resources Connection provides its clients with experienced consultants under a temporary staffing model, usually for non-recurring, specialized projects. The company offers support in finance and accounting, risk management, internal audit, information management, human resources, supply chain management, and actuarial and legal services. Approximately 80% of Resources Connection's revenue is generated in North America, 12% in Europe, and the remainder throughout Asia. About half of its business is in providing finance and accounting services.

During the past year, shares of Resources Connection have traded down more than 30%, creating what we view as an attractive investment opportunity. We believe the market underappreciates the company's free-cash-flow generation capabilities—it has generated positive free cash flow every year since its IPO—and high incremental return capability given the asset-light nature of its enterprise. Known as the low-cost provider to the Big Four accounting firms, Resources Connection serves a well-diversified client base that includes many of the Fortune 100 companies. The company also has a strong net-cash balance sheet, which should help offset the cyclical nature of its business.

Besides the new purchases, other portfolio activity included the aforementioned divestment of Spirit AeroSystems.

Year-to-Date Briefing

The Brandes U.S. Small Cap Value Equity Strategy returned 9.03% (gross of fees), outperforming its benchmark, the Russell 2000 Index, which gained 1.73% in the six months ended 30 June 2024, as well as the Russell 2000 Value Index, which was down 0.85%.

Holdings in the industrials, materials, and health care sectors drove returns. At the holding level, leading performers included aerospace and defense company Embraer, machinery business Graham Corporation, construction and engineering company Orion Group, security system technology business Arlo Technologies, and Phibro Animal Health.

Positions in the energy and consumer staples sectors were notable decliners, specifically energy equipment business Dril-Quip and Ingles Markets. Other detractors included insurer Crawford & Company, Utah Medical Products, and machinery business Hurco Companies.

Current Positioning

The strategy's allocations from a sector standpoint remain largely unchanged. The portfolio maintains its largest weights in the industrials, health care and information technology sectors (although underweight relative to the benchmark in information technology and health care). The strategy's most notable underweights are in consumer discretionary, financials, and real estate.

Compared to the Russell 2000 Value Index, we have significantly 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 with what we consider 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.

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

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 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.

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

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