

Brandes Investment Partners
International Small Cap Equity Strategy Notes
Third Quarter 2024 (July 1 – September 30, 2024)

The Brandes International Small Cap Equity Strategy returned 9.76% net of fees and 10.00% gross of fees, outperforming its benchmark, the MSCI ACWI ex USA Small Cap Index, which gained 8.90% in the quarter, and the MSCI ACWI ex USA Small Cap Value Index, which was up 9.36%.

Annualized total return as of September 30, 2024	1-year	5-year	10-year
Brandes International Small Cap Equity Composite (net)	44.36%	17.15%	8.18%
Brandes International Small Cap Equity Composite (gross)	45.61%	18.18%	9.14%
MSCI ACWI ex USA Small Cap Index	23.25%	8.20%	6.07%

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.

Positive Contributors

Notable contributors included holdings in industrials and health care.

Brazil-based regional jet manufacturer Embraer and U.K.-based aerospace and defense company Rolls-Royce reported improved earnings amid a strong demand in their aerospace end markets. Embraer also received a settlement from Boeing for the latter company’s unsuccessful takeover bid, while its stock benefited from its recent inclusion in the MSCI Emerging Markets Index.

Within health care, leading contributors included Japanese health care testing services company H.U. Group and Kissei Pharmaceuticals, as well as Spain-based biotechnology firm Grifols.

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

Geographically, holdings in the U.K. helped performance. Besides Rolls-Royce, consumer staples companies J Sainsbury and Marks & Spencer also lifted returns, along with capital markets company St. James’s Place.

Performance Detractors

While much of the Japanese market rebounded following its August decline—which was driven by the sudden volatility in the Japanese yen, Bank of Japan rate rises, and earnings concerns—it was not the case for our Japanese financials holdings. Hachijuni Bank and Oita Bank declined, and our underweight to the country detracted from relative returns.

Select consumer discretionary holdings also performed poorly, specifically Canadian Dorel Industries and newly added U.K.-based Burberry Group. Other detractors included South Korean food products company Binggrae, Hong Kong’s PAX Global Technology, and Austria-based Addiko Bank.

Select Activity in the Quarter

The small-cap investment committee initiated positions in Swiss machinery business Bystronic, Indonesian noodle company Indofood, and U.K. luxury goods firm Burberry.

With a rich history dating back to 1856, Burberry primarily sells apparel and accessories. The company went public for the second time in 2002 after nearly five decades under the U.K. retail conglomerate Gus. Since its re-listing, Burberry has been refining its business model to focus on elevating the brand.

When Gus spun off Burberry, more than half of its revenue came from the wholesale channel. After investing in its retail channel roll-out, almost 80% of the company's revenue is now from direct-to-consumer sales, either through its stores or online—aligning it more closely with its luxury peers. This shift from wholesale to direct retail has been positive for Burberry, as it has allowed the company to better control its brand image, including customer experience and pricing. In addition to the retail channel expansion, Burberry has streamlined its product offerings, concentrating on categories where it has a distinct legacy and brand appeal. Despite a management turnover in 2022, Burberry's core strategy has remained largely unchanged.

In the past few years, the luxury goods industry has lagged the broader global market (MSCI ACWI ex USA Small Cap) as concerns about Asia's economic prospects have dampened the outlook for many companies in the industry, including Burberry.

Asia Pacific accounts for more than 40% of Burberry's revenue, with China accounting for about half of that. This is typical for players in the industry as Asia Pacific represents the largest luxury goods market in the world. Recently, a weak Japanese yen and a sluggish Chinese economy have created a challenging environment for luxury goods businesses. However, while the luxury market is sensitive to macroeconomic changes, history suggests that the top luxury brands can still accrue value even during times of low economic growth. For example, it is estimated that the luxury goods market in Japan has continued to grow over the past 15 years even as the Japanese economy contracted (in U.S. dollar terms).

We believe Burberry's issues are temporary in nature and have created a compelling entry point (its stock has declined by over 60% in the past 18 months) for an investment in a company with heritage brand value, resilient financial performance amid topline cyclicality, and a strong balance sheet.

Besides the new purchases, the investment committee built out a full position in Mexico-based Grupo Bolsa Mexicana de Valores (BMV Group), which we initially added to the portfolio toward the end of the second quarter.

BMV Group operates the Mexican Stock Exchange and other cash, listed derivatives, and over-the-counter markets for various asset classes. Founded in 1894, BMV is now the second-largest stock exchange in Latin America. It is the only fully verticalized operation that offers integrated trading and post-trading solutions for multiple asset classes, including equities, fixed income, derivatives, and exchange-traded funds. Additionally, the company provides custody, clearing, and settlement facilities, as well as data products for the local and international financial community.

Mexico's national election in early June led to a sell-off in the country's financial market and a depreciation of the peso. This heightened political uncertainty, combined with perceived limited growth prospects, competition threats, and concerns about high real interest rates in Mexico, has weighed on BMV's outlook. However, we believe that the company's current challenges have been more than reflected in its share price. We appreciate BMV's healthy balance sheet and its history of paying dividends and repurchasing shares, as well as the fact that its business has a franchise that is difficult to replicate. Additionally, the company has been investing to upgrade its technology infrastructure and has grown revenues and profits above inflation despite facing currency, competition, and domestic trading volume headwinds. At its current valuations, BMV represents an attractive value opportunity to us.

Other portfolio activity included the full sales of light-duty engine manufacturer China Yuchai, Swiss pumping equipment business Sulzer, aerospace and defense company Heroux-Devtek, and U.K. retailer Marks & Spencer.

Year-to-Date Briefing

The Brandes International Small Cap Equity Strategy returned 27.13% net of fees and 28.13% gross of fees, outperforming its benchmark, the MSCI ACWI ex USA Small Cap Index, which gained 11.93% in the nine months ended September 30, 2024, and the MSCI ACWI ex USA Small Cap Value Index, which was up 12.70%.

Stock selection across multiple sectors drove returns. Standout performers included aerospace and defense companies Embraer, Heroux-Devtek, and Rolls-Royce, as well as bank holdings AIB Group and Nova Ljubljanska Banka. Food products business Greencore Group and apparel company Yue Yuen Industrial also helped returns, as did telecom services

providers Magyar Telekom and Millicom International Cellular. Geographically, holdings in Hong Kong, the United Kingdom, Ireland, and Brazil were solid contributors.

Our lack of exposure to India hurt relative returns. At the stock level, several positions in health care declined, notably Spanish biotech firm Grifols and France-based pharmaceutical firm Euroapi. Other detractors included real estate investment trust Fibra Uno and homebuilder Consorcio ARA, which are both based in Mexico.

Current Positioning

The portfolio positioning from a country and sector standpoint was largely unchanged during the quarter. The strategy maintains large allocations to industrials, consumer staples, health care, and financials, while holding underweights in technology, materials, real estate, and consumer discretionary. Geographically, the portfolio continues to have significant exposure to companies in Japan (although underweight relative to the benchmark), the U.K., Ireland, Hong Kong, and emerging markets, while maintaining underweights in Australia, India, and Taiwan.

Stock selection across sectors and countries continued to drive the strategy's outperformance relative to the benchmark this year. Going forward, we remain optimistic about the portfolio's holdings composition and the risk/reward tradeoff it offers.

For term definitions: <https://www.brandes.com/termdefinitions>

The MSCI ACWI ex USA Small Cap Index with net dividends captures small-cap representation across developed and emerging markets excluding the United States.

The MSCI ACWI ex USA Small Cap Value Index captures small-cap securities across developed and emerging markets excluding the United States, exhibiting overall value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield.

The MSCI Emerging Markets Index captures large and mid cap representation of emerging market countries.

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