

# Brandes Emerging Markets Value Fund

## Fund Commentary

Contributions to the MSCI Emerging Markets Index's return have been extremely concentrated year-to-date. The top five performing stocks were IT companies and the IT sector accounted for 40% of index performance. The disproportionate contributions to the index's return highlight, in Brandes LP's view, the importance of being selective when investing in emerging markets. The elevated prices—and valuations—of many emerging market IT businesses were the main reason the Fund has been significantly underweight the sector.

Against this backdrop, the Brandes Emerging Markets Value Fund outperformed its benchmark, the MSCI Emerging Markets Index.

## Positive Contributors

Holdings in Brazil rebounded nicely from the difficulties in the second quarter that were sparked by the corruption allegations against President Michel Temer.

Among the strongest performers were higher-education companies Estacio Participacoes and Kroton Educacional. Brazilian antitrust authorities rejected their proposed merger in late June, effectively ending the nearly year-long uncertainty surrounding the merger plans. The market seemed to appreciate both companies' new, clearer strategic plans in the third quarter, as well as their strong earnings results and business outlooks.

Other positive contributors included jet manufacturer Embraer and food retailer Companhia Brasileira de Distribuicao (CBD). Embraer benefited from higher revenue growth and costs cuts, as well as an improved order pipeline. Additionally, the recent decision by the U.S. Department of Commerce to impose anti-subsidy duties on Embraer's main regional jet competitor, Bombardier, could potentially be an advantage.

Russian holdings also regained footing after a poor start to the year, led by Sberbank and Mobile TeleSystems. Sberbank's shares increased on the back of a strong earnings announcement and a major court victory against Transneft, which removed a significant litigation threat for the company.

Additionally, Hong Kong-based Luk Fook Holdings aided performance. After a couple years of stagnation, the demand for luxury goods from Chinese consumers (Luk Fook's main customers) has grown substantially in recent quarters amid China's improved macroeconomic environment.

## Performance Detractors

Heightened geopolitical tensions between South Korea and North Korea adversely impacted the South Korean equity market. Thus, it is not surprising that the Fund's



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holdings in South Korea were among the main detractors for the quarter.

Auto companies Hyundai Mobis and Hyundai Motor weighed on returns as loss of market share in China and increased incentive costs in the United States hurt their financial results. Other detractors included several holdings in Turkey, Mexican real estate investment trust (REIT) Fibra Uno, as well as China-based cotton yarn manufacturer Weiqiao Textile.

Additionally, the Fund's underweight allocation to the information technology (IT) sector negatively impacted returns relative to the benchmark.

## Select Buy & Sell Activity

The Fund purchased Thailand-based Siam Commercial Bank (SCB).

SCB is Thailand's oldest commercial bank, established in 1904 under a royal charter and listed on the Stock Exchange of Thailand in 1976. The company provides a

full range of financial services, including commercial and retail banking, asset management, auto leasing, securities brokerage and life insurance. SCB has a reputation as a premier retail bank, with one of the best consumer banking franchises in Thailand, and has been focusing on aggressively increasing its share in the small- and medium-sized enterprise (SME) loan market over the past 10 years. Although Thailand's Ministry of Finance owns 23% of SCB, government interference is low because the Kingdom of Thailand has a 24% stake through the Crown Property Bureau.

The Thai banking industry is in the midst of a credit cycle as asset quality started to deteriorate in 2015. SCB's credit quality is more resilient than many of its peers', in Brandes LP's opinion, with less than one-third of its loan book exposed to mortgages and a relatively low percentage of loans to SME. We believe SCB is well equipped to navigate the current credit cycle, given its robust capital adequacy ratios and capital expenditure plan to enhance its mobile banking and IT platforms.

Trading at 10x forward earnings as of September 30, SCB offers a margin of safety, according to Brandes LP's analysis—even after adjusting for further credit deterioration potential over the next few years.

## Current Positioning

While the return of investor optimism and the resulting strong performance of emerging markets equities over the past 18+ months have driven up valuations, Brandes LP has *yet* to witness material improvements in company earnings or returns on equity, leading it to believe there is still ample opportunity in the asset class. Moreover, valuations for emerging markets equities remain attractive compared to those for developed markets (as represented by the MSCI World Index).

Within the asset class, the valuations for value stocks (as represented by the MSCI Emerging Markets Value Index) continue to look attractive to Brandes LP. After a solid performance in the second half of 2016, value stocks meaningfully underperformed growth stocks (as represented by the MSCI Emerging Markets Growth



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Index) by 16% over the last nine months. At quarter end, value stocks traded in line with their 10-year price-to-book average, while growth stocks traded significantly above their 10-year price-to-book average.

While emerging markets' strong performance in the last several quarters can be perceived as good news, a deeper look into the MSCI Emerging Markets Index's performance reveals, in Brandes LP's opinion, how investors may be best served by applying an *active*, opportunity-focused investment approach within the asset class. At Brandes LP, stock selection relies on a careful, bottom-up research, instead of assigning capital based on companies' market-capitalization sizes without regard to business fundamentals, as many passively managed strategies do.

Brandes LP remains optimistic about the prospects for the Brandes Emerging Markets Value Fund and thanks you for your continued trust.

## About Brandes LP

In the 40-plus years since Brandes LP was founded, its goal has remained the same: pursue above-market gains to help investors move closer to their long-term investment objectives. Brandes LP believes that its unwavering commitment to value investing will lead it to attractively priced, fundamentally sound companies worthy of inclusion in the Fund.



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## Contribution Analysis (relative to benchmark)

### LAST QUARTER

INDUSTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Diversified Consumer Services	1.78	Internet Software & Services	-1.64
Wireless Telecom. Services	0.86	Automobiles	-0.63
Food & Staples Retailing	0.55	Equity Real Estate Inv. Trusts	-0.56
Aerospace & Defense	0.51	Real Estate Mgmt & Development	-0.39
Banks	0.51	Textiles, Apparel & Luxury Goods	-0.24

COUNTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Brazil	2.97	China	-2.77
Russia	1.63	South Korea	-0.92
Hong Kong	0.44	Turkey	-0.49
Taiwan	0.36	Mexico	-0.36
Indonesia	0.20	South Africa	-0.12

COMPANY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Estacio Participacoes SA	1.42	Hyundai Motor Co. Ltd. Pref.	-0.47
Sberbank ADR	0.69	KT+G Corp.	-0.31
Companhia Brasileira de Distribuicao P	0.56	KIA Motors Corporation	-0.30
Embraer S.A. ADR	0.50	Fibra Uno Admin. SA ORD	-0.27
Mobile Telesystems	0.48	Emlak Konut Gayrimenkul Yati	-0.27

### LAST 12 MONTHS

INDUSTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Banks	2.35	Internet Software & Services	-3.47
Specialty Retail	1.90	Semicond. & Semicond. Equip.	-1.24
Wireless Telecom. Services	1.86	Household Durables	-1.10
Diversified Consumer Services	1.49	Tech. Hardware, Storage & Periph.	-1.01
Food & Staples Retailing	1.11	Elect. Equip., Instr. & Components	-0.97

COUNTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Brazil	4.46	China	-6.48
Russia	2.67	Taiwan	-1.77
Hong Kong	1.87	South Korea	-1.47
Austria	0.95	India	-1.03
Argentina	0.84	Turkey	-0.56

COMPANY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Estacio Participacoes SA	1.26	Urbi Desarrollos Urbanos SA ORD	-1.16
Companhia Brasileira de Distribuicao P	1.18	Samsung Electronics Ltd.	-0.77
Luk Fook Holdings Intl Ltd ORD	0.97	Emlak Konut Gayrimenkul Yati	-0.76
Sberbank ADR	0.95	Hyundai Mobis	-0.46
Erste Group Bank AG	0.95	KIA Motors Corporation	-0.45



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## Quarterly Additions/Deletions

Additions	Deletions
Siam Commercial Bank	TIM Participacoes SA ADR
	Kasikornbank PCL

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