

# Brandes Global Small Cap Equity Fund

## Fund Commentary

During the quarter, a question that Brandes LP was quite often asked was how the U.S. trade negotiations have impacted its portfolios. In this regard, Brandes LP has been closely monitoring the situation and has revisited the valuations of all holdings that can potentially be affected by President Trump's steel and aluminum tariffs, either directly (e.g., steelmakers) or indirectly (e.g., auto companies). Brandes LP concluded that no adjustments to intrinsic value estimates were necessary at this point.

Amid the constant stream of macroeconomic and geopolitical news, Brandes LP continues to pursue attractive businesses with stock prices below its estimates of their intrinsic value. Brandes LP believes uncertainties help drive prices of fundamentally sound companies below what they are truly worth.

The Brandes Global Small Cap Equity Fund underperformed its benchmark, the S&P Developed Small Cap Index in the first quarter.

## Positive Contributors

Portfolio holdings in the Aerospace & Defense, Leisure Products and Equity Real Estate Investment Trusts (REITs) industries were contributors to performance.

From a country perspective, holdings in Brazil, Spain and Greece positively contributed to performance.

The largest individual contributor to performance was Brazilian jet manufacturer Embraer.

Embraer continued to have constructive dialogue with Boeing about a potential business combination. Newswires have been suggesting that the companies could combine their commercial airline units, but it remains unknown if — and exactly how — this might happen.

## Performance Detractors

The most significant detractors were holdings in the United States and the United Kingdom. Specifically, domestically oriented companies, such as retailers Rent-A-Center and Debenhams, as well as facilities management company Mitie Group, weighed on performance.

Debenhams' share price fell after management issued another profit warning early in the year. The U.K. retailer cited weak Christmas results as the driver behind the decline in its year-end sales and the weaker-than-expected 2017 profits.

U.S.-based gasoline engine company Briggs & Stratton and health care services company Owens & Minor also hurt returns, along with U.K.-based money and passports printer De La Rue.

De La Rue, which has been around for 200 years, saw its shares slide toward the end of the quarter following the sudden departure of its chief financial officer and an unexplained profit warning. The stock took another tumble a few days later after the U.K. government decided to award the contract for manufacturing post-Brexit British passports to De La Rue's foreign rival. Brandes LP believes the market has overreacted to the news about De La Rue's contract loss and it continues to see upside potential in the company as it resolves its excess capacity issue.

Other detractors included India-based utility Reliance Infrastructure.



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## Current Positioning

As part of Brandes LP's commitment to long-term investing, it strives to be proactively engaged with its investment holdings to help improve corporate governance and increase returns on capital. During the first quarter, this commitment was exemplified by Brandes LP's involvement with Embraer.

In light of Embraer's acquisition/partnership negotiations with Boeing, Brandes LP has been in communications with Embraer and a few of its other important shareholders. Brandes LP has been long-term investors in Embraer, with its history of investing in the company dating back to 2001. Over the past few months, Brandes LP informed Embraer's board of directors and executive management team about the framework of its investment thesis that led to its large investment in the company. Specifically, Brandes LP shared its view that:

- Embraer's fundamental business value as a stand-alone entity remains undervalued even at the higher stock price at the time of our communication.
- The business combination with Boeing has the potential to unlock a lot of additional value for many of Embraer's stakeholders, including the Brazilian taxpayers, labour unions, management, shareholders, and particularly for Boeing.

Given the political nature of the decision and its importance to the various stakeholders, Brandes LP made it clear that it is critical for Embraer's board and management team to fulfill their mandate to protect shareholders' best interests. Brandes LP emphasized the importance for appropriate compensation to Embraer's shareholders — not only for the company's assets, but also for a portion of the potential synergies that will accrue to Boeing should the deal move forward. Brandes LP indicated that should these conditions not be met, it would be fully prepared to vote against the transaction and lobby its fellow shareholders to do the same.

As of March 31, the Fund's largest overweight positions were in the United Kingdom and Japan, while its largest underweight was in the United States. On a sector basis, the Fund maintained significant overweights in consumer staples and discretionary, specifically the food & staples retailing industry, and key underweights in technology, financials and materials.

Brandes LP remains committed to building and holding value portfolios for its clients in all market conditions.

## 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	
	%		%
Equity Real Estate Inv. Trusts (REITs)	0.66	Multiline Retail	-0.67
Leisure Products	0.39	Commercial Services & Supplies	-0.60
Aerospace & Defense	0.36	Health Care Equip. & Supplies	-0.32
Food & Staples Retailing	0.24	Machinery	-0.30
Beverages	0.13	Banks	-0.27

### COUNTRY

Top 5 Contributors		Top 5 Detractors	
	%		%
Brazil	0.44	United States	-2.72
Spain	0.22	United Kingdom	-1.16
Greece	0.19	India	-0.27
Australia	0.17	Belgium	-0.17
Hong Kong	0.13	Japan	-0.10

### COMPANY

Top 5 Contributors		Top 5 Detractors	
	%		%
Embraer SA ORD	0.43	Debenhams PLC ORD	-0.67
Sankyo Co Ltd	0.40	Reliance Infrastructure Ltd.	-0.40
Lar Espana	0.23	Edgewell Personal Care Co.	-0.31
Draegerwerk AG	0.15	Rent-A-Center Inc.	-0.31
Popular Inc.	0.14	De La Rue plc	-0.26

### LAST 12 MONTHS

INDUSTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Household Durables	1.04	Multiline Retail	-1.19
Equity Real Estate Inv. Trusts (REITs)	1.02	Oil, Gas & Consumable Fuels	-0.96
Health Care Equip. & Supplies	0.45	Commercial Services & Supplies	-0.94
Aerospace & Defense	0.39	Banks	-0.74
Diversified Telecom. Services	0.23	Machinery	-0.70

### COUNTRY

Top 5 Contributors		Top 5 Detractors	
	%		%
Greece	0.55	United States	-5.10
Brazil	0.53	United Kingdom	-3.21
Argentina	0.32	Japan	-1.32
Spain	0.31	Germany	-0.74
Canada	0.26	France	-0.65

### COMPANY

Top 5 Contributors		Top 5 Detractors	
	%		%
Beazer Homes USA Inc.	0.92	Debenhams PLC ORD	-1.19
Invacare Corp	0.86	Chesapeake Energy Corp	-0.81
Embraer SA ORD	0.75	Babcock & Wilcox Enterpr	-0.63
Lar Espana	0.57	Countrywide PLC	-0.59
NIIT Technologies Corp.	0.39	C&C Group Plc	-0.50





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