

# Brandes Global Small Cap Equity Fund

## Fund Commentary

Amid the market's strong appreciation and the difficult environment for value, Brandes LP's portfolio positioning continues to reflect its commitment to the value investing philosophy. While this positioning resulted in underperformance versus the benchmark for the year, it highlights Brandes LP's focus on long-term company fundamentals, as opposed to short-term market trends.

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

## Positive Contributors

A diverse set of companies lifted absolute returns, led by Brazilian jet manufacturer Embraer, U.S.-based gas engine manufacturer Briggs & Stratton and Japanese food-related company Toyo Suisan Kaisha.

Embraer's shares jumped in December following news that Boeing has been in takeover talks with the company. The deal would strengthen Boeing's position in the regional jet market and help counter a recent move by Airbus, which announced a joint venture with Embraer's

competitor, Bombardier, in October. Boeing, Embraer and the Brazilian government have been working through potential control scenarios and regulatory issues. The government has a "golden share" in Embraer that gives it veto power over such a transaction.

Other positive contributors included South Korean gas utility company Samchully and India-based electric utilities company Reliance Infrastructure. Reliance Infrastructure saw its performance bounce back in December after announcing the sale of its Mumbai power generation and distribution business, helping reduce its debt.

## Performance Detractors

From a country perspective, exposure to the United Kingdom was the main relative performance detractor as holdings significantly underperformed the benchmark's U.K. constituents.

Notable detractors were multiline retailer Debenhams, grocer Wm Morrison and facilities management company Mitie. All three are domestically oriented businesses

which continue to face numerous headwinds in the United Kingdom, including persisting uncertainties related to Brexit (i.e., the United Kingdom's decision to leave the European Union).

Mitie's share price slid due to news that the company could not sell its property management business at an adequate price, thus keeping its debt elevated in a weakening market.

Additionally, German medical equipment firm Draegerwerk weighed on relative returns, as it gave back some of its strong returns from earlier in the year.

The Fund's underweight to the U.S. also detracted from relative performance.

## Select Buy & Sell Activity

The Small-Cap Investment Committee purchased shares of Canadian electronics manufacturing services (EMS) company Celestica.

The world's fifth-largest EMS provider by revenue, Celestica competes in an industry with generally little



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differentiation and intense competition among players. However, the company has been gradually transitioning away from the highly competitive and low-margin consumer-technology assembly business, toward the lower-volume but more customized medical and industrial business lines that offer higher margins and returns on capital.

Recent market pessimism surrounding Celestica's short-term program delays and inventory outages in one of the company's business segments led to a share-price decline. However, the company is engaged in a material restructuring program aimed at reducing costs and increasing profitability toward peer levels.

While some of the headwinds facing Celestica's communications and server/storage business are structural, Brandes LP believes the company's new business mix and restructuring program should allow it to generate reasonable revenue growth and returns on invested capital over the longer term. Brandes LP also appreciates Celestica's strong balance sheet, with net cash accounting for approximately 20% of its market capitalization. Additionally, over the last seven years, management has aggressively implemented a share-buyback initiative, reducing the share count by over 35%. With the stock trading at less than 10x earnings at the

time of the Fund's purchase, Brandes LP took advantage of the market's focus on short-term issues and difficulties surrounding the restructuring to initiate a position in what it considers a transitioning company with an appealing long-term upside potential.

## Current Positioning

As of December 31, the Fund's largest overweight positions were in the United Kingdom and the consumer staples sector, specifically food & staples retailing. Key underweight positions were in the United States, as well as in technology and materials.

Additionally, Brazil continued to represent another area where Brandes LP has found what it considers attractive value potential, with the country making up more than a third of the Fund's emerging markets exposure at year end.

While absolute performance was strong across world markets this year, Brandes LP continues to believe that the most attractive investment opportunities are largely outside the United States. Additionally, Brandes LP believes attractive valuations for value stocks in non-U.S. markets may bode well for future returns.

The Fund continues to be composed of companies that Brandes LP believes are undervalued relative to its estimates of their true worth. Regardless of the markets' direction in 2018, Brandes LP will remain true to its mission to seek mispriced securities worthy of inclusion in client portfolios.

## 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	
	%		%
Food Products	0.30	Multiline Retail	-0.54
Aerospace & Defense	0.21	Commercial Services & Supplies	-0.54
Machinery	0.19	Oil, Gas & Consumable Fuels	-0.39
Household Durables	0.18	Specialty Retail	-0.29
Real Estate Mgmt & Development	0.18	Health Care Prov. & Services	-0.28

COUNTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
India	0.49	United States	-2.67
Japan	0.28	United Kingdom	-1.08
China	0.17	Germany	-0.29
Spain	0.13	Australia	-0.27
Greece	0.13	South Korea	-0.23

COMPANY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Toyo Suisan Kaisha Ltd	0.34	Debenhams PLC ORD	-0.54
Reliance Infrastructure Ltd.	0.32	MITIE Group PLC	-0.54
Embraer S.A. ADR	0.27	Owens & Minor Inc	-0.24
Invacare Corp	0.27	Wm. Morrison Supermarkets PLC	-0.19
Briggs & Stratton Corp.	0.25	Chesapeake Corp.	-0.19

### LAST 12 MONTHS

INDUSTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Household Durables	0.88	Real Estate Mgmt & Development	-1.11
Equity Real Estate Inv. Trusts (REITs)	0.82	Beverages	-0.97
Health Care Equip. & Supplies	0.51	Chemicals	-0.87
Paper & Forest Products	0.44	Biotechnology	-0.82
Energy Equip. & Services	0.35	Capital Markets	-0.73

COUNTRY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Brazil	0.73	United States	-4.52
India	0.69	United Kingdom	-2.22
Greece	0.50	Japan	-0.97
Argentina	0.31	Switzerland	-0.87
Spain	0.27	Germany	-0.86

COMPANY			
Top 5 Contributors		Top 5 Detractors	
	%		%
Beazer Homes USA Inc.	0.84	Countrywide PLC	-0.76
M.D.C. Holdings Inc.	0.65	Chesapeake Corp.	-0.76
Embraer S.A. ADR	0.62	Babcock & Wilcox Enterpr	-0.63
Invacare Corp	0.60	C&C Group Plc	-0.60
Norbord Inc.	0.53	Debenhams PLC ORD	-0.59



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## Quarterly Additions/Deletions

Additions	Deletions
Lotte Confectionery Co. Ltd.	China Yuchai Int'l Ltd.
Owens & Minor Inc	Desarrolladora Homex SA promissory note 1.00% Oct23/22
Resources Connection Inc.	Desarrolladora Homex SAB ORD
World Fuel Services Corp	Nortel Inversora SA Pref.
Edgewell Personal Care Co	Chesapeake Energy Corp 6.125% Feb 15/21
Societe BIC SA	Invacare Corp
Taylor Morrison Home Corp	San-In Godo Bank Ltd.
Telit Communications PLC	Sanki Engineering Co. Ltd.
Celestica Inc.	
Kyushu Financial Group Inc	
POPULAR INC	



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