Brandes U.S. Equity Fund

Fund Commentary

The U.S. equity market moved broadly higher in the fourth quarter, closing an eventful 2016 punctuated by Donald Trump's victory in the U.S. presidential election. U.S. stocks remained on an upward trajectory for much of 2016, boosted further in the fourth quarter by expectations that the President-elect's policies would fuel growth and inflation. In a widely expected move, the U.S. Federal Reserve raised interest rates in December for the second time since the financial crisis.

The sustained U.S. market rise continued to drive equity valuations higher. As of December 1, 2016, the S&P 500 Index traded at a cyclically adjusted price-to-earnings (CAPE) ratio of 28.3x. This reflected a 12% premium to the quarter-century median CAPE ratio.

Against this backdrop, the Brandes U.S. Equity Fund outperformed its benchmark, the S&P 500 Index.

Positive Contributors

The most significant performance contributors were the Fund's bank holdings, including Bank of America, Citigroup, Wells Fargo and PNC Financial Services.

After posting negative performance in the first half of the year, these banks began regaining lost ground in the third quarter, and collectively rose over 20% (in U.S. dollar terms) in the fourth quarter as the market started to anticipate a generally better operating environment for banks in the years ahead.

Brandes LP believes that despite the significant recent rally in their share prices, the Fund's U.S. bank holdings continue to offer an attractive investment opportunity. At quarter end, they traded at low multiples of forward earnings and book value. Additionally, in Brandes LP's view, they have offered more attractive yields than areas of the market that investors have traditionally flocked to as yield plays. Unlike many other yield plays, several U.S. banks have grown earnings in the last five years and have had a higher total shareholder yield (buybacks and dividends), with a much more sustainable and attractive payout ratio.

Other positive contributors included gas engine manufacturer Briggs & Stratton, electronics firm Avnet and computer data storage company Western Digital.

Performance Detractors

The most significant return detractors were positions in the healthcare sector, led by medical equipment manufacturer Varian, drug distributor McKesson, as well as pharmaceutical firms Merck and Pfizer. Several of these pharmaceutical- related companies declined in the fourth quarter on concerns about potentially lower drug prices.

McKesson's shares have fallen out of favor over the past year due to earnings growth concerns and the loss of some customers following an industry consolidation. In its most recent quarterly report, McKesson said it expects earnings to decline due to increased pricing pressure from one of its competitors attempting to take market share. While this may impact earnings in the short term, Brandes LP believes that over the longer term, the drug distribution market will have fairly rational pricing due to its oligopolistic structure, which discourages prolonged aggressive pricing. The negative impact from a potential Affordable Care Act repeal should be minimal, while the drug distributors should continue to benefit from the aging population.

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Other detractors included furniture and electronics rent-to-own company Rent-A-Center and software firm Verint.

The Fund's cash position served as the largest detractor from relative returns. The sustained U.S. market rise has created a challenging environment to find many companies exhibiting attractive valuations, in Brandes LP's view. As always, Brandes LP continues to diligently seek out undervalued investment opportunities but is also mindful of not stretching or overpaying for assets, which in its opinion would increase risk. Therefore, this has led to the increased cash weighting. This cash position provides "dry powder" to take advantage of potential individual valuation dislocations as they arise.

Select Buy & Sell Activity

In a fairly light period for Fund activity, Brandes LP divested the Fund's positions in information technology distributor Ingram Micro and semiconductor company Xilinx.

Brandes LP initially purchased Xilinx, the world's largest field programmable gate array (FPGA) company, nearly two years ago after its share price declined on market concerns of a near-term semiconductor downturn and weakened spending in one of Xilinx's key end markets. Despite these concerns, Brandes LP believed the company offered a number of positive attributes:

- The company had a strong competitive position in an attractively growing market, controlling roughly 50% of the FPGA market for more than a decade, which enabled the company to earn strong returns on capital and generate free cash flow.
- The company had a healthy balance sheet and had an attractive capital return history, raising its dividend fivefold since 2005 and repurchasing 22% of its shares over the past decade.
- Its shares offered an attractive discount to Brandes LP's estimate of its long-term intrinsic value.

In the last two years, Xilinx generated strong returns on capital, while its main competitor was acquired by Intel at a significant premium to Xilinx's valuation. As a result, Xilinx's stock price appreciated as speculation increased about a potential takeover given: 1) Xilinx's strong market share in products (FPGAs) that will be increasingly used in various computer acceleration applications, namely in the data center, artificial intelligence and automotive end markets, and 2) a highly active M&A environment in the semiconductor market. As a result, the company's share price appreciated above Brandes LP's estimate of intrinsic value and it divested the Fund's position.

Ingram Micro, a Fund holding for several years, has enjoyed strong share-price appreciation over the last few years. The company was acquired by a Chinese investment company in early 2016 at a significant premium to its recent share price and the acquisition closed in the fourth quarter.

Brandes LP initially purchased Ingram Micro as it felt the company was underappreciated by the market. At the time of purchase, Ingram Micro traded below tangible book value and at 10x earnings, and had a strong balance sheet and cash flow. Additionally, as a distributor, Ingram Micro's business was less dependent on technological shifts and innovation than other industry players, such as manufacturers, in Brandes LP's view.

Along with several other technology companies the Fund held at the time, and many it still holds today, Brandes LP felt Ingram Micro was a good example of what it called a "boring" technology company. Brandes LP believes this term helped define technology businesses trading at attractive valuations, exhibiting attractive economics and strong competitive positions, but not exclusively focused on the new and exciting areas of the technology landscape. As a result, these companies were underappreciated and

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largely ignored by the market's sell side and many technology investors at the time. Given the strong economics of these businesses that were priced at attractive valuations, Brandes LP believed they would offer appealing long-term returns.

To the extent these "boring" technology businesses continued to modestly grow their value by generating strong returns on capital and returning capital to shareholders, Brandes LP felt the market would eventually appreciate their worth. With Ingram Micro, as is frequently the case in value investing, the valuation discount was eventually closed via an acquisition by another company.

Current Positioning

At year end, the Fund continued to exhibit more attractive valuations than the S&P 500 Index based on price to book, price to earnings and price to cash flow.

As of December 31, the Fund's largest overweight positions were in financials and healthcare. Over the last several years, Brandes LP have increasingly found value in a variety of U.S. financials, most notably several money center and regional banks, as they underperformed the broader market. After a poor start to 2016, several of the Fund's holdings appreciated quite significantly in the second half, closing the year with strong contributions to performance. While the market finally seems to recognize that the period of low loan growth, capital retention and low interest rates won't last forever, Brandes LP believes more appreciation potential exists. Additionally, Brandes LP has started to find more value opportunities in the healthcare sector, an area that has lagged the overall market and where, perhaps unsurprisingly, the Fund weighting increased throughout 2016. While the market is concerned about the negative impact on profitability from drug price reform and possible repeal/replacement of the Affordable Care Act, Brandes LP feels in several cases the impact on individual stock prices has been overdone.

The Fund's underweight positions were in industrials, consumer discretionary, consumer staples and materials. In the past, it has been particularly challenging for Brandes LP to find value in consumer staples. Many companies in the sector are regarded as "less risky" and have above-average yields, which typically garner investor preference in a yield-starved environment, such as the current one. This preference has led to expensive valuations for many companies in the sector, including those with declining earnings and limited growth prospects, in Brandes LP's view. As a result, the Fund has been significantly underweight consumer staples, a position that benefited performance in the fourth quarter, especially as many of the so-called "safe" companies declined while the overall market appreciated.

Looking ahead to 2017 and beyond, Brandes LP remains optimistic about the prospects for the Brandes U.S. Equity Fund. Against the seemingly ever-present backdrop of geopolitical and macroeconomic uncertainties, Brandes LP believes its Graham-and-Dodd value approach, focused on seeking mispriced opportunities, should work well over the long term, leading it to attractively priced, fundamentally sound companies worthy of inclusion in the Fund.

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

LAST QUARTER

INDUSTRY

Top 5 Contributors	%	Top 5 Detractors	%
Banks	3.84	Semicond. & Semicond. Equip.	-0.12
Elect. Equip., Instr. & Components	0.76	Media	-0.09
Capital Markets	0.52	Health Care Prov. & Services	-0.06
Machinery	0.37	Communications Equipment	-0.05
Tech. Hardware, Storage & Periph.	0.22	Food & Staples Retailing	-0.05

COMPANY

Top 5 Contributors	%	Top 5 Detractors	%
Bank of America Corp.	0.86	Varian Medical Systems Inc	-0.19
BB&T Corp.	0.69	McKesson Corp	-0.10
Citigroup Inc.	0.59	Verint Systems	-0.07
PNC Financial Services Group	0.59	Rent-A-Center Inc.	-0.07
Briggs & Stratton Corp.	0.49	Pfizer Inc.	-0.03

LAST 12 MONTHS

INDUSTRY

Top 5 Contributors	%	Top 5 Detractors	%
Banks	3.19	Semicond. & Semicond. Equip.	-0.49
Elect. Equip., Instr. & Components	2.36	Health Care Prov. & Services	-0.37
Oil, Gas & Consumable Fuels	2.32	Insurance	-0.24
Pharmaceuticals	1.05	Software	-0.21
Machinery	0.67	Tobacco	-0.09

COMPANY

Top 5 Contributors	%	Top 5 Detractors	%
Briggs & Stratton Corp.	1.06	Express Scripts Holding Co	-0.78
Bank of America Corp.	0.99	Chesapeake Energy Corp.	-0.65
BB&T Corp.	0.92	Verint Systems	-0.35
Apache Corporation	0.85	Rent-A-Center Inc.	-0.28
Corning Inc.	0.67	American International Group	-0.07

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Quarterly Additions/Deletions

Additions	Deletions
Laboratory Corp of Amer Holdings	Xilinx Inc
U.S. Bancorp	Ingram Micro Inc. Cl. A

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