Brandes U.S. Equity Fund

Fund Commentary

A continuing trend and significant headwind to relative performance this year has been value stocks' underperformance versus growth stocks, as measured by the Russell 1000 Value Index and the Russell 1000 Growth Index. After posting strong returns in the second half of 2016, value stocks have lagged growth stocks thus far in 2017 by more than 11%. This underperformance can largely be attributed to the strong performance of the technology sector, where the Fund maintained an underweight position, and most notably just five companies: Apple, Facebook, Microsoft, Amazon, and Alphabet which together have driven nearly a quarter of the S&P 500's return.

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

Positive Contributors

Notable positive contributors included several financial holdings, led by Citigroup, PNC Financial and State Street, which appreciated following improved earnings results and guidance, in part due to the potential benefit from higher interest rates.

Several holdings that reported strong earnings saw their share prices advance. These included retailers Aaron's, oil company Chevron, as well as technology firms Cognizant and Microsoft. Pharmaceutical firm Pfizer and biotechnology company Gilead Sciences also boosted absolute returns.

Performance Detractors

The most significant detractors included several of the Fund's health care holdings that reported weaker earnings during the quarter, including drug distributors McKesson and Cardinal Health, as well as hospital operator HCA Healthcare. Drug distributors have experienced some temporarily elevated pricing competition as well as revenue pressure from declines in generic drug prices. Historically, however, the occasional competitive or pricing flare-ups have been resolved due to the industry's oligopolistic nature (three players of roughly equivalent size control most of the distribution), and the distributors should continue to benefit from an ageing population and newly compressed valuations.

Select Buy & Sell Activity

The Fund initiated positions in Omnicom and Advance Auto Parts while divesting its position in Aaron's after it appreciated strongly and reached Brandes LP's estimate of intrinsic value.

Omnicom is one of the three largest global ad agency holding companies by revenue. Its brands include DDB Worldwide, BBDO Worldwide and TBWA Worldwide.

In Brandes LP's opinion, the business model of ad agencies is attractive and resilient amid changing economic conditions, given their variable-cost nature and technological neutrality (i.e., generally limited disruption from how ads are viewed). Over the past year,

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organic revenue growth for the ad agency industry has slowed, in part due to tough comparisons with 2016, a year that saw elevated ad spending related to the Summer Olympics in Brazil and the U.S. presidential elections. In addition, consumer packaged goods (CPG) companies, historically the largest advertisers, pulled back on their advertising budgets given concerns over digital ad placements (association with unseemly material) and efforts to improve their margins. However, digital platforms (Facebook, Google, etc.) are addressing the placement concerns, and CPG companies are suffering from slowing revenue growth that comes in part from advertising pullbacks.

These concerns, which Brandes LP views as short term in nature and overdone in magnitude, have created several potentially undervalued and attractive investment opportunities.

Among large, publicly listed ad agency holding companies, Brandes LP believes Omnicom has the best operational track record, with consistent organic growth, steady margins, a solid balance sheet and a history of attractive returns on invested capital. Brandes LP is attracted to the company's strong business model, healthy cash flows and steady pace of shareholders returns. Moreover, the stock's recent underperformance has led to an appealing valuation, in Brandes LP's opinion. The company trades at 14x forward earnings as of September 30, offers a 2.9% dividend yield and has returned over 100% of its net income to shareholders through dividends and stock buybacks over the past decade. While the shares remained under pressure during the quarter, Brandes LP believes Omnicom provides an attractive long-term risk/reward tradeoff at its current price.

Advance Auto Parts (AAP) is one of the four largest vendors in the $100 billion automotive aftermarket, with more than 5,000 stores and 50 distribution centers across the United States. AAP's subsidiaries include Carquest, AutoPart International and Worldpac. AAP operates both in commercial services (Do-It-For-Me or "DIFM"), which make up roughly two-thirds of the automotive aftermarket, and retail services (Do-It-Yourself or "DIY").

AAP saw its share price decline almost 50% this year as the market has become concerned about the company's slowing growth, declining margins and increased competition from Wal-Mart and Amazon. Brandes LP acknowledges the increased threats to AAP's business but believes the company also faces some cyclical issues and company-specific challenges that it has the potential to overcome. While the industry faces increased competition from new entrants, it is likely that this has been exacerbated by a cyclical downturn in the number of vehicles that are 7-10 years old (the sweet spot for aftermarket parts demand) due to weak vehicle sales during the 2007-2009 financial crisis.

Additionally, the company has several significant cost-cutting initiatives, including improvement of its supply chain. In Brandes LP's view, these measures should help AAP increase its margins, which are currently significantly below peers. Brandes LP also appreciates that the company has a higher mix of DIFM business (roughly 60% of sales), which is more resilient to new online competition than its DIY counterparts.

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Amid the negative market sentiment, Brandes LP believes the AAP represents an attractive investment opportunity given its defensive positioning, cyclically depressed end-market demand, and its potential to navigate company-specific challenges.

Current Positioning

At quarter end, the Brandes U.S. Equity Fund exhibited more attractive valuations, in Brandes LP's opinion, than the S&P 500 Index.

As of September 30, the Fund's largest relative overweight positions were in the financials and health care sectors. The most significant underweights were in industrials, consumer discretionary, and information technology.

The Fund's allocation to the technology sector has declined this year as Brandes LP has pared or sold several positions that have appreciated to their intrinsic values, and as the sector has become increasingly popular. Conversely, Brandes LP has uncovered more potential value opportunities in the health care sector, where the Fund's allocation has increased to over 19% as of September 30 compared to over 14% for the S&P 500 Index. While the Fund maintained a significant exposure to pharmaceuticals, the main increase has been to health care service companies, such as drug distributor Cardinal Health and hospital operator HCA Healthcare. In general, the health care industry has been out of favor as the market has been preoccupied with faster growing industries and it has been concerned about the potential Affordable Care Act (ACA) repeal or retrenchment. While an ACA repeal currently looks less likely, at the time of investment Brandes LP quantified the impact of any potential ACA repeal, and found several opportunities created by market overreaction.

As always, Brandes LP anchors their allocation decisions on a fundamental, bottom-up investment approach focused on seeking the most attractive value.

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	%
Tobacco	0.21	Health Care Prov. & Services	-0.86
Specialty Retail	0.19	Semicond. & Semicond. Equip.	-0.33
Food Products	0.16	Oil, Gas & Consumable Fuels	-0.26
Industrial Conglomerates	0.15	Diversified Financial Services	-0.21
Banks	0.13	Aerospace & Defense	-0.21

COMPANY

Top 5 Contributors	%	Top 5 Detractors	%
Aaron's Inc	0.14	McKesson Corp	-0.32
Citigroup Inc.	0.14	World Fuel Services Corp	-0.23
Chevron Corp.	0.10	M.D.C. Holdings Inc.	-0.20
Cognizant Tech Solutions	0.10	HCA Holdings Inc.	-0.18
Advance Auto Parts, Inc.	0.09	Cardinal Health Inc.	-0.15

LAST 12 MONTHS

INDUSTRY

Top 5 Contributors	%	Top 5 Detractors	%
Banks	4.37	Aerospace & Defense	-0.75
Capital Markets	0.73	Semicond. & Semicond. Equip.	-0.67
Specialty Retail	0.50	Health Care Prov. & Services	-0.67
Household Durables	0.46	Internet Software & Services	-0.66
Elect. Equip., Instr. & Components	0.36	Chemicals	-0.37

COMPANY

Top 5 Contributors	%	Top 5 Detractors	%
Bank of America Corp	1.01	Apache Corporation	-0.35
Citigroup Inc.	0.94	Express Scripts Holding Co	-0.32
State Street Corporation	0.81	HCA Holdings Inc.	-0.20
Western Digital Corp.	0.79	World Fuel Services Corp	-0.18
PNC Financial Services Group	0.78	Cardinal Health Inc.	-0.15

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Quarterly Additions/Deletions

Additions	Deletions
Omnicom Group	Aaron's Inc
Advance Auto Parts Inc	

BRANDES INVESTMENT PARTNERS on the BRIDGEHOUSE Independent Platform

Brandes U.S. Equity Fund

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