BRANDES INVESTMENT PARTNERS

Turmoil and Opportunities in Brazil

JANUARY 2016

Brazil's economic and political saga over the last several months has put the country's image in a negative spotlight and its equity market under pressure. But having invested in emerging markets for more than 30 years, Brandes knows that "crises" are part and parcel of investing in this developing region of the world. Over the past couple of years alone, there have been several events that triggered panic in emerging markets—from taper tantrum[1] concerns that mainly affected the Fragile Five[2] in late 2013 and the Russia/Ukraine geopolitical crisis that started in 2014, to the Greek debt crisis earlier this year and more recently, the turmoil in Brazil.

A Series of Events Led to Selloff in Brazil

With Brazil's economy contracting for three consecutive quarters, the president's approval rating falling nearly to the country's rate of inflation and its sovereign credit rating downgraded to below investment grade by both Standard & Poor's and Fitch, it is not surprising that Brazilian equities have been extremely out of favor among many investors.[3] The "Car Wash" investigation into the corruption at state-owned oil giant Petrobras, which has led to the arrests of a number of government and business officials, has marred the reputation of Brazil's corporate sector. Potential impact from China's slowdown also adds concerns about the prospects of Brazilian companies. Furthermore, Brazil's private-sector debt growth in recent years ignites worries over whether businesses can pay off their liabilities as they come due and whether banks can manage the ramifications of the current economic difficulties.

As of November 30, 2015, the MSCI Brazil Index lost approximately 38% (in U.S. dollar term) on a year-to-date basis, while the real fell by over 31% against the U.S. dollar, making it one of the worst-performing currencies this year.[4]

"Brazil is experiencing not only a hard time economically, but is also living through a period of disillusionment and anger on the political front. During my visit there, I saw signs of this in everyday conversations, in primetime news and front-page newspaper articles," says Gerardo Zamorano, CFA, Director of Investments at Brandes Investments Partners who visited the country in mid-August.

The challenges facing Brazil have driven investor sentiment to its lowest level since the Global Financial Crisis of 2008-2009. Additionally, consumer and business confidence in the country have fallen to record lows.

China Impact on Brazil: Overblown?

China <2.5% of Brazil's GDP

While Brazil is a resource-rich country and has benefited from its trading relationship with China for over more than a decade, exports to China accounted for less than 2.5% of Brazil's 2014 gross domestic product (GDP). While that amount is still meaningful and China's slowdown has other indirect influences on the Brazilian economy, the perceived risk from the slowdown is—in Brandes' opinion—somewhat overblown. Moreover, Brandes has largely avoided large Brazilian materials companies, one of the areas most affected by the slowdown. Note that the materials sector represented the third-largest weighting (10%) in the MSCI Brazil Index as of September 30, 2015.

[1] Equity and bond selloff in 2013 that was triggered by a suggestion by then Federal Reserve Chairman Ben Bernanke that an imminent reduction in the Fed's bond purchases was possible.
[2] A term coined by Morgan Stanley in late 2013; refers to five emerging countries (Turkey, Brazil, India, South Africa and Indonesia) whose economies were heavily dependent on foreign investments.
[3] Source: *The Wall Street Journal* "Brazil GDP Slips for Third-Consecutive Quarter," published December 1, 2015 (Brazil's GDP contracted in Q1-Q3 2015); Bloomberg "Brazil Credit Rating Cut to Junk by S&P Amid Budget Strain," published September 9, 2015; The Wall Street Journal "Fitch Downgrades Brazil to Junk, With Negative Outlook", published December 16, 2015.
[4] Source: FactSet as of November 30, 2015.

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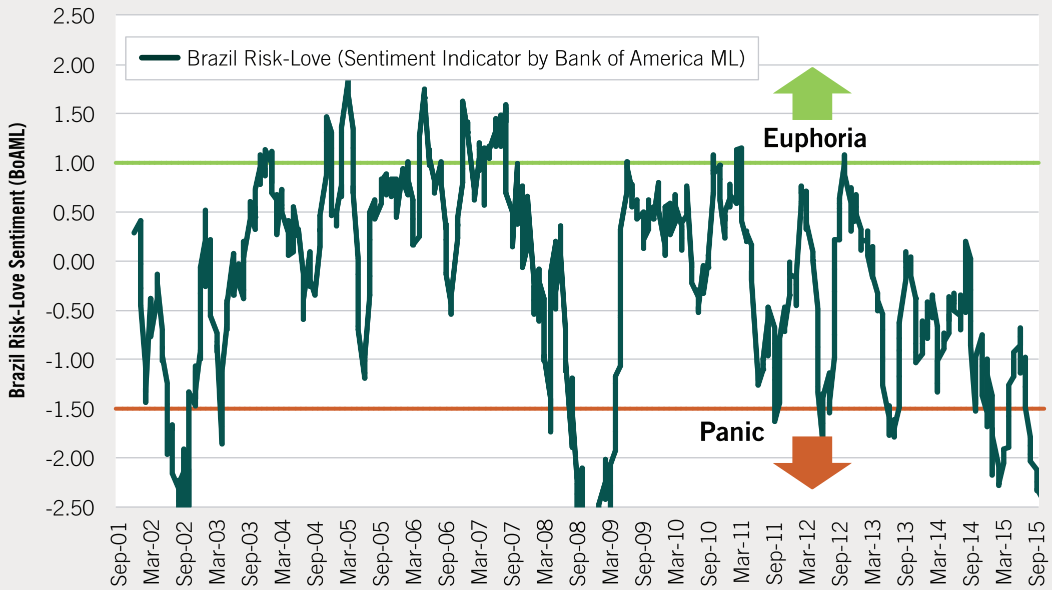
Volatility, as measured by standard deviation, has tended to decrease materially over longer periods.

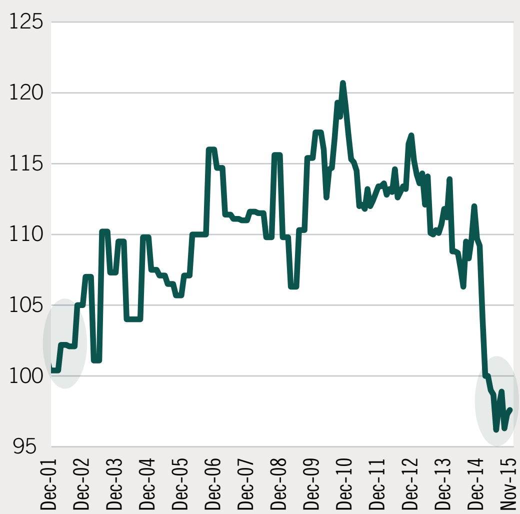
Exhibit 1: Investor Sentiment Reached "Panic Zone"; Consumer and Business Confidence Dropped



Source: BofA Merrill Lynch Global Research as of 9/30/2015. Risk-Love is a sentiment indicator used to measure the mood of consensus. Factors such as turnover to market cap, volatility, put call ratio, CDS spreads, IPO issuance as proportion of market cap are used to construct this metric. Each factor is normalized and then combined to form the Risk-Love indicator.

Brazilian Consumer Confidence at Record Lows

Lower than in the Latin American Crisis



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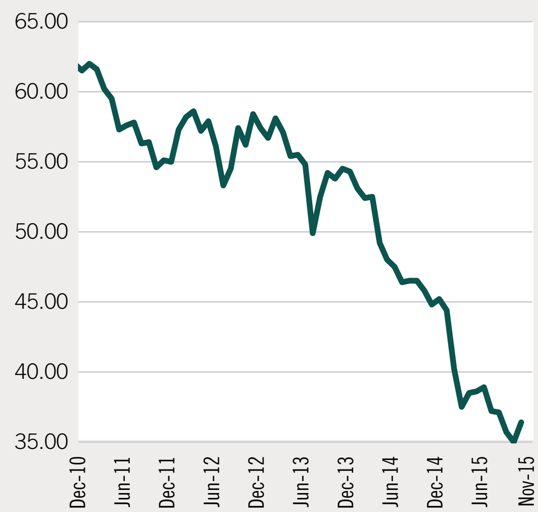


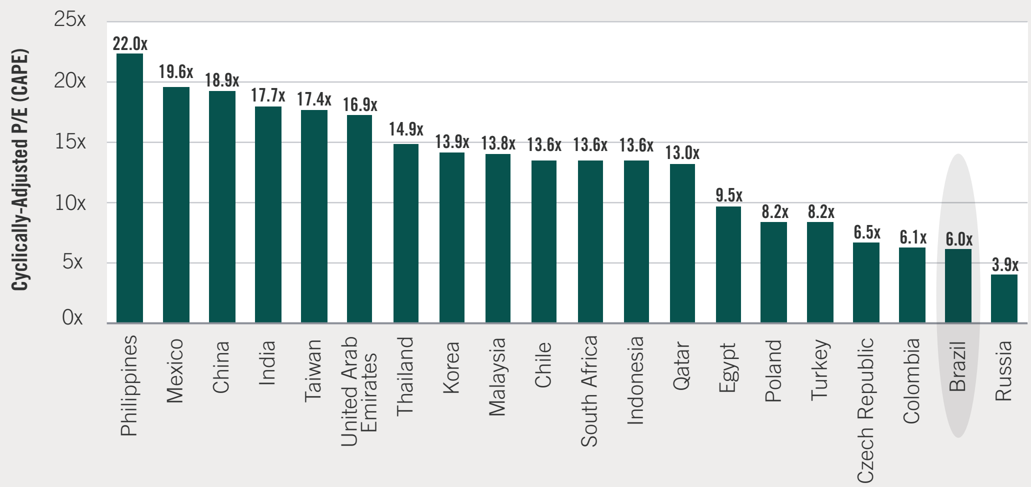
Source: FactSet as of November 30, 2015. Consumer confidence is based on Brazil's National Index of Consumer Expectation, which focuses on consumers' current financial situation and on expectation about inflation, unemployment, wages and major purchases for the next 6 months. Business confidence is based on Brazil's Industrial Entrepreneur Confidence Index, which measures the current situation of businesses and its future prospects.

When Adversities Bring Opportunities

Although things may look dire at the macroeconomic level, Brandes' experience shows it is often during difficult times—when behavioral biases creep in and short-term risk aversion overcomes rational investment decision—that attractive investment opportunities present themselves. Exhibit 2 shows that the Brazilian equity market traded at an appealing valuation, with its cyclically adjusted price-to-earnings ratio (CAPE) lower than that of many other emerging markets.

Exhibit 2: Bargains in Brazil?

Brazil's CAPE Among the Lowest in Emerging Markets



Source: Morgan Stanley as of 11/30/2015. Universe captures 98% of market cap and free-float adjusted market cap in each country. Past performance is not a guarantee of future results. Cyclically-Adjusted Price-to-Earnings (CAPE): A valuation measure, generally applied to broad equity indices, that uses real

Amid the recent unfavorable performance for Brazilian equities, it is interesting to highlight that the past two crises prior to the current one were followed by strong three-year annualized returns for the MSCI Brazil Index.

Exhibit 3: Prior Crises Followed by Strong Subsequent Three-Year Annualized Returns

	Calendar-Year Returns		Subsequent 3-Yr. Annualized Returns	
	MSCI Brazil	MSCI EM	MSCI Brazil	MSCI EM
2002 Latin American Crisis	-30.7%	-6.0%	66.4%	38.4%
2008 Global Financial Crisis	-56.1%	-53.2%	24.2%	20.4%
Year-To-Date Nov. 30, 2015 Current Turmoil	-38.1%	-12.7%	?	?

Source: FactSet as of 11/30/2015. Past performance is not a guarantee of future results. Please note that all indices are unmanaged and not available for direct investment. MSCI EM stands for MSCI Emerging Markets Index.

Moreover, the valuation spreads among emerging markets in Exhibit 2 reinstate Brandes' beliefs that they are not homogenous and that investors may be better served by not taking a "one-size-fits-all" approach to the asset class. And while a valuation for a specific country or asset class may provide a good indicator on the overall investor sentiment, Brandes understands that each company reacts to macroeconomic events differently. This is why in Brandes' pursuit of long-term alpha, they focus on fundamentals instead of short-term factors. The Brandes process entails a bottom-up approach to analyzing how businesses are affected by company-specific as well as non-company specific factors.

Getting Comfortable with Brazilian Businesses

While many investors seem to paint all Brazilian companies with the same brush, Brandes' opportunity-focused investment process has enabled them to identify businesses whose shares trade materially below their estimates of their true worth. In some cases, they have observed how fears about Brazil's macro environment can overshadow companies whose majority of operations or sales are actually generated outside Brazil, and thus may benefit from a weaker currency. In other cases, Brandes has seen how the market's "short-termism" has pressured companies' share prices despite their positive attributes—providing a good entry point for an investment, in their opinion.

"The current situation in Brazil reminds me of the one we experienced in 2002. At that time, economic crisis in Argentina and uncertainty surrounding the presidential election in Brazil led to a selloff in these markets. Contrary to market consensus, we were heavily weighted toward companies in Argentina, Brazil and Mexico," comments Mr. Zamorano. **"Even though these investments detracted from our near-term performance in 2002, we were pleased with the impact they had on longer-term results."**

As of November 30, 2015, the Brandes Global Equity Fund, Brandes International Equity Fund and Brandes Emerging Markets Value Fund held meaningful allocations to companies based in Brazil.[5] However, Brandes believes the valuation of their investments there are not predicated on the impact of President Dilma Rousseff's potential impeachment, whether the GDP will contract further or whether the Brazilian real will stabilize. With each valuation and investment, Brandes thoroughly examines and adjusts for the quality of a company's balance sheet, its ability to handle its maturity schedule, and the impact of macroeconomic conditions, such as the private-sector loan growth.

Exhibit 4: Weighting to Brazilian Companies[5]

Brandes Global Equity Fund	3.5%
Brandes International Equity Fund	7.2%
Brandes Emerging Markets Value Fund	19.1%

In Brandes' view, Brazilian holdings are fairly well diversified—ranging from highly-regulated entities to industrial and consumer-oriented companies. One trait that all of these businesses share: Brandes believes they offer a compelling risk/reward tradeoff.

Exhibit 5: Brandes' Holdings in Brazil

Source: Brandes Investment Partners L.P. as of November 30, 2015. Securities mentioned herein are not to be construed as a recommendation to buy or sell.

[5] Source: Brandes Investment Partners as of November 30, 2015.

Looking Beyond the Turmoil: Brandes' Quest for Value in Brazil

In summary, the recent economic and political turmoil in Brazil appears to have caused many investors to overlook fundamentals at the company level. As disciplined value investors, Brandes remain cognizant of the challenges facing the country and analyze them in the context of their effects on Brandes' intrinsic value estimates for their individual holdings.

Brandes' diligent analysis shows that the rampant investor fear in Brazil has resulted in a number of appealing long-term value opportunities.

Brandes' diligent analysis shows that the rampant investor fear in Brazil has resulted in a number of appealing long-term value opportunities. This conviction is reflected in their meaningful allocations to select Brazil-based companies within the Brandes Global Equity Fund, Brandes International Equity Fund and Brandes Emerging Markets Value Fund. Amid the dynamic nature of markets and investor behavior, Brandes believes that company fundamentals, while seemingly obscured by the market's preoccupation with volatility, will eventually gain investor recognition. They hold the view that selectivity—and a focus on margin of safety—remain paramount in any market environment.

Margin of Safety: The margin of safety for any security is defined as the discount of its market price to what the firm believes is the intrinsic value of that security.

Alpha: A measure of performance based on the excess return of an investment relative to the return of a benchmark index.

Diversification does not assure a profit of protect against loss in a declining market.

The MSCI Brazil Index is designed to measure the performance of the large and mid cap segments of the Brazilian market. With 66 constituents, the index covers about 85% of the Brazilian equity universe. The MSCI Emerging Markets Index with gross dividends measures equity market performance of emerging markets. MSCI has not approved, reviewed or produced this report, makes no express or implied warranties or representations and is not liable whatsoever for any data in the report. You may not redistribute the MSCI data or use it as a basis for other indices or investment products.

International and emerging markets investing is subject to certain risks such as currency fluctuation and social and political changes, differences in financial reporting standards and less stringent regulation of securities markets which may result in greater share price volatility; such risks are increased when investing in emerging markets. Additional risks associated with emerging markets investing include smaller-sized markets, liquidity risks, and less established legal, political, social, and business systems to support securities markets. Some emerging markets countries may have fixed or managed currencies that are not free-floating against the U.S. dollar. Certain of these currencies have experienced, and may experience in the future, substantial fluctuations or a steady devaluation relative to the U.S. dollar. Stocks of small companies usually experience more volatility than mid and large sized companies.

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