

Brandes Emerging Markets Value Fund

Fund Commentary

In the fourth quarter, the Brandes Emerging Markets Value Fund outperformed its benchmark, the MSCI Emerging Markets Index.

Positive Contributors

Holdings in Brazil led performance as the election of right-wing presidential candidate Jair Bolsonaro bolstered the country's stock market. Bolsonaro, a departure from the left-wing Workers' Party that had dominated Brazilian politics since 2002, has vowed to deal with Brazil's fiscal woes and reduce structural impediments to economic growth. Noteworthy contributors included oil & gas firms Petrobras and Petrobras Distribuidora, electric utility Companhia Paranaense de Energia (Copel) and regional jet manufacturer Embraer.

Indonesia-based PT Bank Rakyat Indonesia and China-based Bosideng also aided returns. Over the past year, Bosideng has reshaped its down apparel brand by targeting younger customers, collaborating with top designers and launching high-profile fashion shows. Furthermore, the company has benefited—at least in the short term—from the increasing tension between China and Canada, aggravated by the early December arrest of Huawei Technologies' chief financial officer. Following the arrest, a

subset of Chinese customers have boycotted Canadian products, including those by Canada Goose (one of Bosideng's main rivals), in favour of domestic brands such as Bosideng.

Other positive contributors included Russian food retailer X5 Retail Group, South Korean security services provider S-1 and Philippine real-estate developer Megaworld, which posted strong results on the back of improving demand for its residential projects. Additionally, the Fund's underweight to China helped relative returns.

Performance Detractors

Holdings in Mexico fell amid concerns about possible antibusiness policies of newly inaugurated President Andrés Manuel Lopez Obrador (AMLO). In late October, Mexico's currency and bonds declined after AMLO cancelled a \$13 billion airport project, igniting worries of a less investment-friendly environment. A November proposal to cap banking fees intensified market concerns. Notable detractors included cement company Cemex, as well as real estate investment trusts Fibra Uno and Fibra Macquarie Mexico. Generally, the Fund has added to its positions on the share-price weakness.

Shares of Taiwanese AsusTek Computer declined due to a poor earnings report, driven mainly by greater price competition in the United States and Europe, concerns over the U.S.-China tariff dispute and margin compression in the component and handset segments. Brandes LP believes these issues are temporary and cyclical, and more than accounted for in the share price, which was less than book value per share as of December 31. With approximately 70% of its market value in cash and equity holdings, AsusTek has a solid asset backing to weather its shorter-term challenges, based on Brandes LP's analysis.

Meanwhile, Indonesian telecom services provider XL Axiata continued to struggle with underwhelming data service revenue, likely due to an inability to adjust pricing. Additional detractors included bank holdings, led by Russia's Sberbank, Colombia-based Grupo Aval and Thailand-based Siam Commercial Bank.

Select Buy & Sell Activity

The Emerging Markets Investment Committee initiated a position in Flex Ltd., one of the world's largest electronics

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manufacturing services (EMS) providers, second only to Hon Hai of Taiwan/China. Headquartered in Singapore, Flex provides manufacturing and supply services globally.

Investor sentiment toward Flex has been extremely negative, with the stock down over 50% in 2018. In its May 2018 earnings release, the company announced some order pushouts and continued delays in its high-profile contract with Nike. The stock dropped further in the fourth quarter, when the company announced profitability and capacity issues in its consumer business (~15% of profits), the amicable termination of its relationship with Nike and the unexpected retirement of its highly regarded CEO.

Brandes LP believes Flex represents an appealing opportunity, even after taking into consideration the inherent risks. Unlike some of its Asian peers or smaller U.S. competitors, Flex, with 100 sites and over 200,000 employees in 30 countries, has 80% of its manufacturing footprint in low-cost regions. Given the current tariff concerns with China, many original equipment manufacturers (EMS providers' customers) have been looking to reposition their supply chains, and have recognized that they may have become too dependent on China even if the tariff threat dissipates. Flex has more manufacturing facilities in Southeast Asia, Eastern Europe and Mexico compared to its peers, with some unused capacity in these locations.

Furthermore, Flex has been de-emphasizing its commodity electronics work and focusing more on its higher-margin medical, auto and industrial businesses. It has also diversified beyond just contract manufacturing, moving toward a “sketch-to-scale” model where it provides design, supply-chain logistics, manufacturing and then reverse-logistics. The combination of these moves should elevate differentiation and switching costs—and potentially margins, although Brandes LP recognizes the magnitude of any uplift will be limited given some of its competitors are moving in the same direction.

Brandes LP has owned Flex several times, and the company has demonstrated the ability to improve its margins to more normalized (higher) levels when it has incurred operational or execution problems that Brandes LP deemed fixable or that appeared to be more than accounted for in the share price. Brandes LP feels that is the situation with Flex today, and at 7x earnings the market seems to be overemphasizing the addressable issues impacting a small part of its business over the next couple of quarters, while underappreciating the longer-term positioning of its more meaningful businesses.

Given the strong appreciation in the Brazilian market, the Fund trimmed its exposure to a number of holdings there, including the full sale of Petrobras Distribuidora (BR).

BR, which was carved out of Petrobras through an equity offering in December 2017, is the largest fuel and lubricant

supplier in Brazil. BR's business is highly influenced by Brazil's political environment and its stock responded very favourably to the outcome of the national election. Brandes LP sold its position as the share price appreciated to our estimate of its intrinsic value.

Current Positioning

Brandes LP is optimistic about the outlook for emerging markets and believes the market focus on macro-economic issues (e.g., trade disputes, national elections, currency interactions) during much of 2018 has created significant opportunity for long-terminded and discerning fundamental investors.

As Brandes LP noted last quarter, it has increased its weighting to China, adding four new companies and nearly doubling its allocation over the year. Brandes LP has also taken advantage of market weaknesses to increase its exposure to businesses in South Korea and Mexico.

Brazil remained the largest country overweight, although the Fund's weighting declined after it divested a few holdings that appreciated to Brandes LP's estimates of intrinsic value during the second half of the year. Relative to the benchmark, the Fund maintained a higher allocation to the consumer discretionary sector and a lower exposure to information technology.

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In Brandes LP's opinion, emerging markets equities exhibit very appealing valuations—from both an absolute and a relative perspective. As of December 31, the MSCI Emerging Markets Index traded near its five-year lows and at 35% to 50% discount to U.S. equities (as represented by the S&P 500 Index) based on major valuation metrics (e.g., price-to-earnings, price-to-book, price-to-cash flow).

Brandes LP is enthusiastic about the potentially undervalued companies it is finding within the asset class, and believes the Brandes Emerging Markets Value Fund remains well positioned for the long term.

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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Brandes Emerging Markets Value Fund

Contribution Analysis (relative to benchmark)

LAST QUARTER

| INDUSTRY | | | |
|------------------------------------|------|--|-------|
| Top 5 Contributors | | Top 5 Detractors | |
| | % | | % |
| Oil, Gas & Consumable Fuels | 1.04 | Construction Materials | -0.87 |
| Electric Utilities | 0.88 | Equity Real Estate Inv. Trusts (REITs) | -0.69 |
| Textiles, Apparel & Luxury Goods | 0.71 | Wireless Telecom. Services | -0.64 |
| Aerospace & Defense | 0.68 | Diversified Financial Services | -0.35 |
| Internet & Direct Marketing Retail | 0.64 | Banks | -0.35 |

| COUNTRY | | | |
|--------------------|------|------------------|-------|
| Top 5 Contributors | | Top 5 Detractors | |
| | % | | % |
| China | 2.36 | Mexico | -1.28 |
| Brazil | 1.80 | India | -0.56 |
| South Korea | 1.21 | Malaysia | -0.36 |
| Taiwan | 0.81 | Hong Kong | -0.27 |
| Turkey | 0.29 | Colombia | -0.23 |

| COMPANY | | | |
|---|------|-----------------------------------|-------|
| Top 5 Contributors | | Top 5 Detractors | |
| | % | | % |
| Embraer S.A. | 0.69 | Cemex SA de CV ADR | -0.97 |
| Companhia Paranaense de Energia | 0.67 | XL Axiata Tbk PT ORD | -0.45 |
| PT Bank Rakyat Indonesia (Persero) Tbk Cl | 0.58 | Genting Malaysia Bhd ORD | -0.37 |
| Petroleo Brasileiro SA Pfd | 0.51 | Asustek Computer Inc | -0.31 |
| Bosideng Intl. Hldgs. Ltd. | 0.46 | Fideicomiso PLA Admin. Industrial | -0.28 |

LAST 12 MONTHS

| INDUSTRY | | | |
|------------------------------------|------|--|-------|
| Top 5 Contributors | | Top 5 Detractors | |
| | % | | % |
| Interactive Media & Svcs. | 1.38 | Banks | -1.84 |
| Internet & Direct Marketing Retail | 0.97 | Equity Real Estate Inv. Trusts (REITs) | -1.55 |
| Oil, Gas & Consumable Fuels | 0.87 | Construction Materials | -0.81 |
| Textiles, Apparel & Luxury Goods | 0.84 | Diversified Consumer Services | -0.76 |
| Elect. Equip., Instr. & Components | 0.80 | Diversified Financial Services | -0.62 |

| COUNTRY | | | |
|--------------------|------|------------------|-------|
| Top 5 Contributors | | Top 5 Detractors | |
| | % | | % |
| China | 5.02 | Turkey | -2.92 |
| Russia | 1.37 | Mexico | -1.24 |
| South Africa | 1.14 | Argentina | -1.00 |
| South Korea | 0.99 | United Kingdom | -0.83 |
| Chile | 0.18 | Malaysia | -0.70 |

| COMPANY | | | |
|---|------|------------------------------|-------|
| Top 5 Contributors | | Top 5 Detractors | |
| | % | | % |
| Bosideng Intl. Hldgs. Ltd. | 1.12 | Turkiye Vakiflar Bank | -1.19 |
| Petroleo Brasileiro SA Pfd | 0.82 | Emlak Konut Gayrimenkul Yatı | -1.16 |
| Lukoil ADR | 0.77 | YPF SA ADR | -1.00 |
| PT Bank Rakyat Indonesia (Persero) Tbk Cl | 0.63 | Cemex SA de CV ADR | -0.93 |
| Tech Mahindra Ltd | 0.59 | Reliance Infrastructure Ltd. | -0.83 |

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Quarterly Additions/Deletions

| Additions | Deletions |
|------------------------|-----------------|
| Enel Chile ORD | Infosys |
| Copa Holdings SA Cl. A | Petrobras Distr |
| Flextronics Intl. Ltd. | |
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