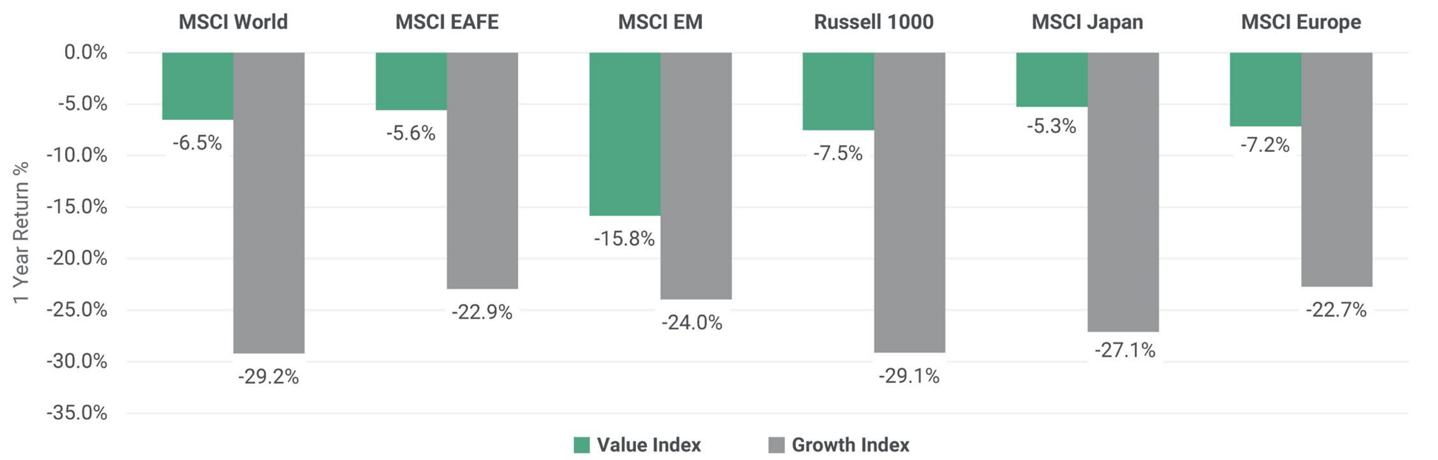
The State of Value Investing

Dear Clients and Friends,

As we embark on the new year, it’s reassuring to see that the value run that started a little over two years ago continued through 2022. Over the past year, value stocks have outpaced their growth counterparts across various markets, as shown in the chart below.

Recent Value Run

1-Year Value vs. Growth Index Performance



Value Index Performance Relative to Growth	MSCI World	MSCI EAFE	MSCI EM	Russell 1000	MSCI Japan	MSCI Europe
	22.7%	17.4%	8.1%	21.6%	21.8%	15.6%

For the 12 months ending December 31, 2022 | Source: Brandes, FactSet, MSCI, Russell. Past performance is not a guarantee of future results. It is not possible to invest directly in an index.

The value run is one answer to the question that some investors had during the previous decade, “is value investing dead?” We dedicated a lot of ink on our past quarterly letters defending the value investment approach, cautioning investors not to abandon value and consider always maintaining an appropriate allocation to the style. We believe the fundamental concept of value investing has always—and will always—remain relevant, regardless of the value/growth cycles.

Value Investing

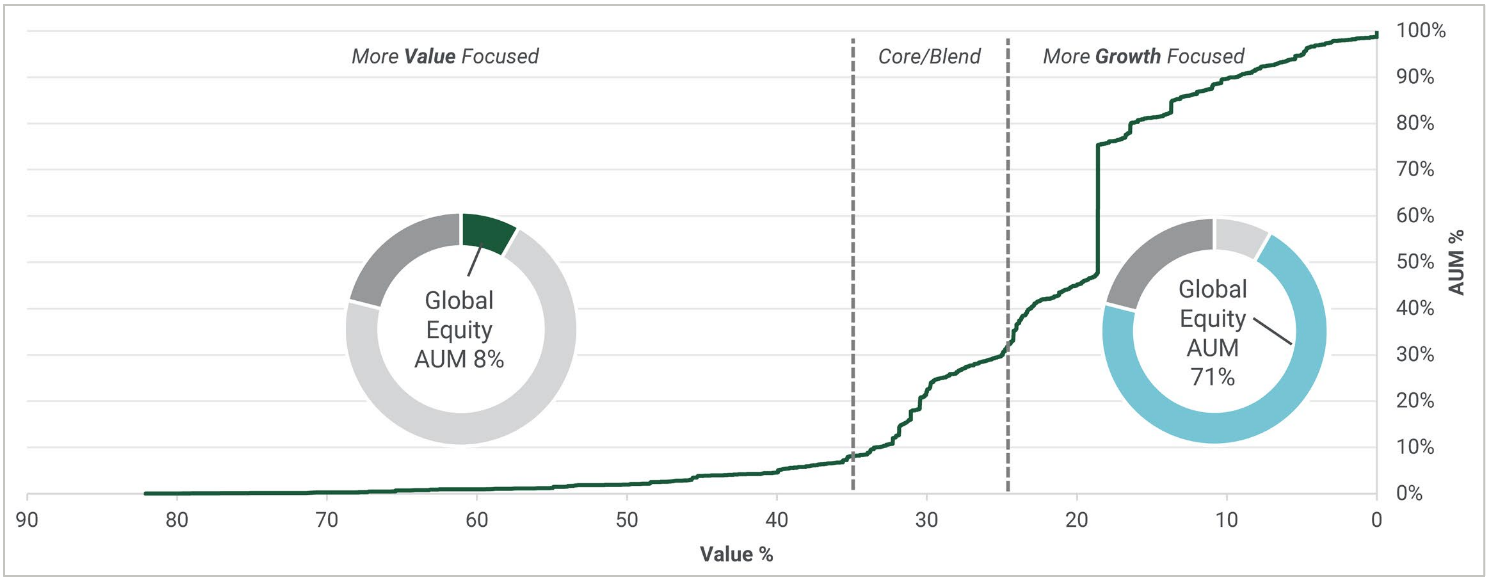
The Brandes organization was founded in 1974 with the express purpose of applying a value investing approach to global financial markets. While the way we implement that approach has evolved over the intervening 49 years, the core principles never change. A value investing approach seeks to take a business-like approach in establishing a long-term fundamental value of a company. We purchase securities when we believe they are sufficiently undervalued by the market due to temporary challenges or market overreactions. Since there are no guarantees when it comes to investing in the stock market, seeking to purchase a company at a discount creates a powerful concept called "margin of safety" (the discount of a security's market price to its estimated intrinsic value). The concept of margin of safety was coined by Benjamin Graham, considered the father of value investing. In his seminal book, The Intelligent Investor, Graham wrote *"[T]he function of the margin of safety is, in essence, that of rendering unnecessary an accurate estimate of the future. If the margin is a large one, then it is enough to assume that future earnings will not fall far below those of the past in order for an investor to feel sufficiently protected against the vicissitudes of time."*

While value investing can cycle in and out of favor, its efficacy over the long term merits attention, in our opinion. When you compare the Fama/French U.S. market value and growth parts of the total market between 1927 and 2021, on average, value has outperformed its growth counterpart by 4.1% each year.[1]

It's a fact that for much of the previous decade, growth stocks handily beat value stocks. But just as trees don't grow to the sky, the conditions that are favorable to one style don't persist forever. However, when one style dominates for an extended period of time, some investors are prone to certain behavioral biases. For example, extrapolation bias refers to a tendency to expect the current environment to continue. This is often mentioned when a gambler enjoying a run of good luck (albeit entirely random) extrapolates his recent success and doubles down, confusing the string of good luck with random events. In the context of value investing, many in the investment world exhibited extrapolation bias. In some of our previous letters, we wondered where all the value managers had gone. The chart below shows that value-focused funds now make up only a sliver of large-cap global equity assets under management (AUM).

Where Have All the Value Managers Gone?

Allocated by Style (Value vs. Growth)



As of December 31, 2022 | Source: Morningstar Global Open End Funds and ETFs in the Global Equity Large Cap Category and >$100mn AUM. Net Value Exposure as defined by Morningstar. >35% defined as Value Focused and <25% as Growth Focused.

This chart shows that a significant majority of the AUM in the Morningstar Global Equity Large Cap category have portfolios more tilted to companies with growth characteristics (71%) than to value characteristics (8%).

It was created by evaluating the open-end and exchange-traded funds in the Global Equity Large Cap Category with at least $100 million in AUM. Each portfolio was classified based on exposure to the value style (as defined by Morningstar), with greater than 35% exposure defined as “more value focused”, 25%-35% core/blend-focused, and less than 25% “more growth focused.”

The dark green line denotes the % of AUM (y-axis) across the value exposure spectrum (x-axis), moving from the most “value” (left side of the x-axis) to least value (right side of the y-axis).

Of course, not all investors abandoned value investing entirely, yet many struggled to remain invested with the value style over the past decade. As legendary investor the late Sir John A. Templeton once remarked about the four most dangerous words in the world of investing: “this time is different.” Adopting such a mindset or falling prey to confirmation bias (such as we're in a "new normal") to explain recent stock price movements can cause investors to give up on an otherwise sensible allocation approach.

Over the past several years, the most common question we received from investors was “what are the catalysts for value investing to make a resurgence.” We provided examples of catalysts but were quick to caution investors that we had no way of knowing whether or when an event would happen to cause these catalysts to take hold. Instead, we often urged investors to have an appropriate allocation to value for when some of these catalysts would take hold. While we knew it was very likely that eventually interest rates would rise and the rate of inflation would increase (and create a potentially more favorable environment for value investing), we did not know when this would happen or what would be the exact cause.

While we feel vindicated by the resurgence of the value investing style and the recent outperformance of most Brandes strategies (see table on next page, Brandes Strategies with Excess Return vs. Benchmark), we continue to caution investors to remain diversified with their investments.

Annualized total return as of December 31, 2022	**1-Year**	**5-Year**	**10-Year**
Brandes International Equity Composite	-7.89	1.36	4.84
MSCI EAFE Index	-14.45	1.54	4.67
Brandes Global Equity Composite	-5.25	4.69	7.58
MSCI World Index	-18.14	6.14	8.85
Brandes Emerging Markets Equity Composite	-14.01	-2.45	1.03
MSCI Emerging Markets Index	-20.09	-1.40	1.44
Brandes Global Small Cap Equity Composite	-6.95	2.18	7.18
S&P Developed SmallCap Index	-18.71	3.07	7.90
Brandes U.S. Value Equity Composite	-2.18	9.10	12.14
Russell 1000 Value Index	-7.54	6.67	10.29
Brandes International Small Cap Equity Composite	-7.96	0.08	5.23
S&P Developed Ex-US SmallCap Index	-21.81	-0.42	5.46
Brandes Japan Equity Composite	-1.16	-1.36	6.27
MSCI Japan Index	-16.65	0.23	5.55
Brandes European Equity Composite	-9.84	1.37	5.23
MSCI Europe Index	-15.06	1.87	4.58
Brandes Global Small-Mid Cap Equity Composite	-4.75	2.20	8.07
MSCI World SMID Cap Index	-18.93	3.74	8.11
Brandes Emerging Markets Value Equity Composite	-15.91	-4.05	0.90*
MSCI Emerging Markets Index	-20.09	-1.40	1.44

Brandes Strategies with Excess Return vs. Benchmark

Strategy	1-Year excess return as of 12/31/2022	Annualized excess return since 10/31/2020**
Brandes International Equity	6.6%	7.4%
Brandes Global Equity	12.9%	11.4%
Brandes Emerging Markets Equity	6.1%	10.3%
Brandes Global Small Cap Equity	11.8%	13.6%
Brandes U.S. Value Equity ***	5.4%	5.8%
Brandes International Small Cap Equity	13.9%	14.0%
Brandes Japan Equity	15.5%	3.5%
Brandes European Equity	5.2%	6.1%
Brandes Global Small-Mid Cap Equity	14.2%	9.1%
Brandes Emerging Markets Value Equity	4.2%	6.5%

Sources: Brandes, MSCI, S&P, Russell. Total return net of management fees. Outperforming a benchmark is not an indication of a positive absolute return. Returns include reinvestment of all dividends and are reduced by any applicable foreign withholding taxes, without provisions for income taxes, if any. Periods of greater than one year have been annualized.
*Performance since inception (January 31, 2015)
**10/31/2020 is what we consider the start of the shift in the value/growth cycle
***Benchmark is Russell 1000 Value while all others are not style specific

Our client letters over the past several years have focused on defending the entire value investing style and we have tried to make top-down arguments in support of the style. However, as a fundamental investor, we build portfolios from the bottom up, one company at a time. We value companies with a business-like mindset taking into account the material issues impacting the business. Having insight into how we think about business valuations is key to understanding Brandes and our value investing approach. To illustrate this, we have profiled below two companies currently held in a number of our strategies.

Fiserv Inc. (NASDAQ FISV) – currently held in the following strategies: Global Equity, U.S. Value Equity, Enhanced Income

Fiserv is a leading provider of financial technology services for merchants worldwide, including governments and companies, as well as financial institutions such as banks and credit unions. After its 2019 merger with First Data, a leading payment processing company, Fiserv holds a strong market position in each of its three key business segments, which comprise of:

- *Merchant acceptance*—provides merchants with a wide range of products and services, including the means to accept payments through equipment, underwriting and transaction processing. This segment includes Fiserv's high growth Clover product offering for small- and medium-sized businesses. Clover boasts a gross payment volume similar to its competitor, Square.

- *Financial technology*—provides financial institutions with technology solutions, such as back-end payment processing, to run their businesses.

- *Payments and network*—provides products and services, such as outsourced information technology software, to process digital payment transactions.

We first purchased Fiserv as its price declined in 2021. The company's share price continued to retreat in early 2022 due to several factors, including increasing competition in the merchant acceptance space and the overhang from KKR's sale of its ownership stake (private equity firm KKR held a major portion of First Data). We added to our position in Fiserv amid the share-price decline as we believed it traded at an attractive valuation relative to its favorable economics and long-term secular tailwinds. As banks increasingly outsource their payment transactions (including debit- and credit-card processing) and consumers progressively shift from cash to card payment, Fiserv could—in our opinion—benefit from these trends. We also believe the company has the potential to improve its operating margin and free cash flows as it continues its integration with First Data, and to strengthen its earnings per share growth once it resumes its share buyback program. Prior to the First Data merger, Fiserv had used its strong free cash flow generation to repurchase 30% of its shares outstanding over an eight-year period.

While competition will likely remain intense given the long-term secular tailwinds of the industry, we believe that Fiserv's strong relationships with large banks and merchants, as well as with smaller businesses through its Clover product offering, put the company in a strong competitive position. At its current valuation, Fiserv represents an attractive risk/reward tradeoff to us.

Sanofi SA (SNY) – currently held in the following strategies: Global Equity, International Equity, European Equity, U.S. Value Equity, Global Opportunities Value, Global Balanced, Enhanced Income

Sanofi is one of the world's largest pharmaceutical firms, with a well-diversified business portfolio that includes pharmaceuticals, generics, vaccines and consumer care products. The company is also diversified geographically: the U.S. and Europe represent approximately 40% and 25% of total revenues, respectively, while emerging markets and Asia make up the rest. Sanofi has top positions in drugs aimed to combat rare genetic diseases, and in a broad range of vaccines and consumer products.

We have held Sanofi in various portfolios for well over a decade. At the time of our initial purchase, Sanofi, along with many of its pharmaceutical peers, was struggling with several challenges, including patent expirations for its large products, increased competition, and poor research and development (R&D) productivity. We believed these issues led the market to be overly pessimistic about Sanofi's long-term prospects.

While revenues were impacted by patent expirations, Sanofi managed the difficult period through cost reductions, asset restructuring, and strategic capital deployment. At the same time, Sanofi continued to strengthen its pipeline through investing a meaningful portion of its revenues in R&D, licensing, and bolt-on acquisitions. During this past decade of transformation, the company has been able to consistently generate healthy free cash flow, continuously increase its dividends, and optimize its business portfolio through divestments and acquisitions. Furthermore, the launch and subsequent success of asthma/atopic dermatitis medication Dupixent (co-developed with Regeneron) has helped the company revert to revenue growth.

Recently, investor concern about the uncertainty related to the litigation focused on heartburn medicine Zantac led Sanofi's share price to decline meaningfully, driving its market cap to drop by over $20bn in a week's time in August 2022. While the market seems to assign close to a worst-case scenario, we believe the ultimate liability will likely be split among multiple companies and any subsequent charges may take some time to be paid out.

Despite this recent market negativity, we believe Sanofi merits a continued inclusion in our portfolios. We appreciate the company's ongoing efforts to cut costs and strengthen its margins. The pipeline has been improving, revenues have been growing, and there is minimal patent expiration risk over the next few years. We also take comfort in the substantial value of Sanofi's franchises in vaccines and consumer products, which the market may be underappreciating. Moreover, litigation risks have always been a consideration in our valuations for pharmaceutical firms, and we reflect this in our assumption of a higher cost of equity/higher discount rate for these businesses. We believe Sanofi has a strong balance sheet that should help protect the downside of potential damages related to the litigation. At its current valuation, Sanofi offers an appealing margin of safety to us.

Closing Comment

We remain convinced that value investing has a place in most portfolios. Brandes has sought to be a faithful practitioner of the style for nearly five decades, and we do not think that it's different this time; there may always be a new normal, but the core principles of value investing will always make sense to us. As we embark on this new year, we are mindful that we can't predict what the world has in store for investors. That's why the concept of margin of safety is so key to our approach. To quote our founder, Charles Brandes, paraphrasing his mentor, Benjamin Graham:

> "Value investing is timeless. It's as relevant today as it was 100 years ago. The principles haven't changed and never will." (Charles Brandes, *Value Investing Today*)
>
> "In the old legend the wise men finally boiled down the history of mortal affairs into the single phrase, 'This too will pass.' Confronted with a like challenge to distill the secret of sound investment into three words, we venture the motto, Margin of Safety." (Benjamin Graham, *Chapter 20: "Margin of Safety" as the Central Concept of Investment, The Intelligent Investor*)

Thank you,

Brandes Investment Partners

[1] As of 12/31/2022. Source: Ken French Data Library. The universe and value/growth distinction is defined by HML (High Minus Low) is the average return on the two value portfolios (small value and big value) minus the average return on the two growth portfolios (small growth and big growth). The portfolios, which are constructed at the end of each June, are the intersections of 2 portfolios formed on size (market equity, ME) and 3 portfolios formed on the ratio of book equity to market equity (BE/ME). The size breakpoint for year t is the median NYSE market equity at the end of June of year t. BE/ME for June of year t is the book equity for the last fiscal year end in t-1 divided by ME for December of t-1. The BE/ME breakpoints are the 30th and 70th NYSE percentiles. Includes all NYSE, AMEX, and NASDAQ firms. HML for July of year t to June of t+1 include all NYSE, AMEX, and NASDAQ stocks for which we have market equity data for December of t-1 and June of t, and (positive) book equity data for t-1.

Operating Margin: Operating income divided by net sales; used to measure a company's operating efficiency.

Free Cash Flow: Total cash flow from operations less capital expenditures.

The MSCI EAFE Index with net dividends captures large and mid cap representation of developed market countries excluding the U.S. and Canada. **The MSCI EAFE Growth Index** with gross dividends captures large and mid cap securities across developed market countries, excluding the United States and Canada, exhibiting growth style characteristics, defined using long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend. **The MSCI EAFE Value Index** with net dividends captures large and mid cap securities across developed market countries, excluding the United States and Canada, exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield**.** **The MSCI Emerging Markets Index** with net dividends captures large and mid cap representation of emerging market countries. Data prior to 2001 is gross dividend and linked to the net dividend returns. **The MSCI Emerging Markets Growth Index** with gross dividends captures large and mid cap securities exhibiting growth style characteristics, defined using long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend. **The MSCI Emerging Markets Value Index** with gross dividends captures large and mid cap securities exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield. **The MSCI Europe Index** with net dividends captures large and mid cap representation of developed market countries in Europe. **The MSCI Europe Growth Index** captures large and mid cap securities across developed Europe exhibiting growth style characteristics, defined using long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend. **The MSCI Europe Value Index** captures large and mid cap securities across developed Europe exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield. **The MSCI Japan Index** with net dividends is designed to measure the performance of large and mid cap segments of the Japan market. **The MSCI Japan Value Index** captures large and mid cap Japanese securities exhibiting overall value style characteristics, defined using book value to price, 12-month forward earnings to price and dividend yield. **The MSCI Japan Growth Index** captures large and mid cap securities exhibiting overall growth style characteristics in Japan, defined using long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend. **The MSCI World Index** with net dividends captures large and mid cap representation of developed markets. **The MSCI World Growth Index** with gross dividends captures large and mid cap securities across developed market countries exhibiting growth style characteristics, defined using long-term forward earnings per share (EPS) growth rate, short-term forward EPS growth rate, current internal growth rate, long-term historical EPS growth trend, and long-term historical sales per share growth trend. **The MSCI World Value Index** with net dividends captures large and mid cap securities across developed market countries exhibiting value style characteristics, defined using book value to price, 12-month forward earnings to price, and dividend yield. **The Russell 1000 Index** with gross dividends measures performance of the large cap segment of the U.S. equity universe. **The Russell 1000 Growth Index** with gross dividends measures performance of the large cap growth segment of the U.S. equity universe. Securities are categorized as growth or value based on their relative book-to-price ratios, historical sales growth, and expected earnings growth. **The Russell 1000 Value Index** with gross dividends measures performance of the large cap segment of the U.S. equity universe. Securities are categorized as growth or value based on their relative book-to-price ratios, historical sales growth, and expected earnings growth.

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