Brandes Investment Partners
Emerging Markets Equity Strategy Notes – Private Client
Third Quarter 2021 (July 1 – September 30, 2021)

The Brandes Emerging Markets Equity Strategy outperformed its benchmark, the MSCI Emerging Markets Index, and the MSCI Emerging Markets Value Index, in the third quarter.

Positive Contributors
Significant contributors included holdings in communication services, led by Mexico's **America Movil**.

Continuing the trend from the last few quarters, select cyclicals performed well, specifically Russia's **Sberbank** and **Lukoil**, Thailand-based **Siam Commercial Bank** and Austria-domiciled **Erste Group**.

Performance Detractors
While our underweight to China aided relative performance, several of our holdings there performed poorly due to intensified regulatory pressure as the government shifts priority from growth to economic and social stability, as well as national security strength. The regulatory intervention is specific, targeted and spans several industries, and it was holdings in these industries that were poor performers in the quarter, namely gaming companies **Wynn Macau** and **Galaxy Entertainment Group**, internet company **Alibaba** and insurer **Ping An Insurance**.

Alibaba's shares fell amid recent Chinese regulations aimed at reducing monopolistic behavior as well as controlling data security and systemic financial risks. The new regulatory measures include heightened scrutiny on data-rich platform companies seeking to list overseas. At this juncture, we believe our investment in Alibaba does not present as much risk as implied by the market correction for several reasons:

1. The regulatory crackdown is not about banning variable interest entities (VIEs; used by large Chinese companies to access capital in the U.S.), as such a move would put many companies out of business and likely be extremely detrimental for the Chinese economy and capital markets. Instead, it focuses on data-rich companies (e.g., internet platform firms) and how to prevent them from listing overseas without being compliant with Chinese data security concerns.
2. Alibaba has a Hong Kong listing in addition to its ADR listing. In the event of an ADR delisting, investors can choose to convert to Hong Kong-listed shares.
3. Alibaba has already been fined for its anti-competitive behavior and Ant Financial, one of its subsidiaries, is undergoing business model changes to comply with the new fintech regulations. While there may be other pieces of regulation that could emerge, we believe much of Alibaba's headwinds has been reflected in its market price.

Meanwhile, the Macau government and gaming regulators issued a regulatory framework in mid-September that generally calls for enhanced scrutiny of concessionaires and an increase in local ownership. Against the fragile backdrop of Chinese regulatory tightening, the market reacted negatively, with Wynn Macau and Galaxy Entertainment down materially on the news. There are legitimate reasons for the market to be concerned, but we feel the correction has been overdone. We maintained our holding in Wynn Macau and added to our position in Galaxy Entertainment.

Beyond holdings in China, detractors included Mexico's **Cemex** and Indonesian tobacco company **PT Gudang Garam** .

Select Activity in the Quarter
The Emerging Markets Investment Committee took advantage of increased volatility and added Credicorp to the portfolio.

Creditcorp (BAP) is the dominant financial services company in Peru with over 30% lending share and 33% deposit share through its universal bank subsidiary BCP and its microfinance subsidiary Mibanco. BAP is also a leading player in the underpenetrated insurance sector with leading positions in health, property and casualty, and life insurance.

BAP is a banking group that we've long wanted to own, but the valuation wasn't attractive enough. Credicorp traded at a premium price as a premium franchise, and a crisis was likely needed to get an opportunity. COVID-19 catalyzed that

opportunity. BAP's net income fell from S/ 4.3 billion in 2019 to S/ 347 million in 2020. Revenues were significantly impacted by narrowing net interest margins and low transaction revenues during lockdowns. Government intervention detracted as well. BAP's share price declined over 50% from pre-pandemic levels.

We view the impact on BAP to be temporary in nature. The group has dominant market positions across Peruvian financial services. Structural profitability is high and the growth runway is long given under-penetration of financial services relative to peer countries. Management expects to double the loan book in 10 years. Historically, governance has been good with the Romero family prudently overseen the group's development. Fiscal indicators are strong relative to other LatAm countries with government debt-to-GDP of 37% and sub-4% inflation.

More recent profitability is slowly trending toward historic levels supported by credit expansion, economic reopening, and credit cost normalization. Furthermore, margins should be supported by a Peru Central Bank rate hike and the amortization of Reactiva loans (program that allowed micro- and small-businesses to access ultra-low rate government guaranteed loans). Beyond recovery, political uncertainty is a key overhang, but we believe the risk is more than reflected in the company's current share price.

Other major activity included the full sells of Brazilian higher education company **Cogna Educacao** and Mexican food product company **Grupo LALA**.

Year-to-Date Briefing
The Brandes Emerging Markets Equity Strategy outperformed the MSCI Emerging Markets Index, and the MSCI Emerging Markets Value Index, for the nine months ended September 30, 2021.

Performance was led by holdings in the industrials, financials, energy and materials sectors, most notably Brazilian regional jet manufacturer **Embraer**, Mexico-based Cemex, Russia's Sberbank and South Korean steel manufacturer **POSCO.**

Holdings in China, primarily Ping An Insurance, Galaxy Entertainment and Alibaba, weighed on returns. Additionally, our underweights to India and Taiwan hurt relative performance.

Current Positioning
The recent spate of regulations by the Chinese government and the resulting poor investor sentiment caused a selloff of Chinese equities in the third quarter. In terms of timing, the second half of 2021 marks a period in which China's policymakers can afford to shift its focus from economic growth—as it is likely to be relatively strong—to the regulatory environment for its corporate sector. The new regulations affect a variety of industries and are centered around:

- Equal access to education (e.g., new rules for after-school tutoring), lowering cost burden for parents to facilitate the three-child policy (with an emphasis on social equality)
- Worker and labor protection (e.g., delivery employees)
- Anti-monopoly (e.g., regulations for internet companies)
- Data security (e.g., increased scrutiny of overseas listings)
- Containing financial risks (e.g., limiting leverage among real estate developers)

Through the new regulations, the government has emphasized its goal of "common prosperity" and seeks to defend the broader population's interests against big businesses, wealthy entrepreneurs, and foreign capital. There is an element of not wanting to breed large, monopolistic businesses that are too big to fail, too big to regulate or too big to obey. We are cognizant of the potential impacts of the regulations on individual companies and have recently conducted reviews on our Chinese holdings that we believe are most sensitive to regulatory risks. While we cannot predict whether the Chinese government will issue further regulatory actions, we do not think panic selling across the board is prudent. On the contrary, we believe the indiscriminate price correction of Chinese stocks represents an opportunity to selectively add to our China exposure, as highlighted by our increased allocation to Alibaba and our purchase of Midea.

The portfolio's positioning has not meaningfully changed so far this year. As of September 30, the Brandes Emerging Markets Equity Strategy held large sector overweights in real estate (note that we do not own any China-based real estate holdings) and consumer staples, while maintaining key underweights to technology and materials. From a country

perspective, even though Chinese companies made up our largest allocation, we were still significantly underweight relative to MSCI Emerging Markets. We also had a lower weighting to Taiwanese companies than the benchmark, while maintaining overweights to businesses in Mexico, Russia and Indonesia.

We believe the portfolio is well positioned to benefit from potential tailwinds in emerging markets, including:

- A potential for a multi-year upcycle for cyclical companies (e.g., those in energy and financials) led by both supply constraints and increased demand (not just sentiment-driven as in the early stage of the value stocks' recovery);
- Normalization of economic activity in select emerging countries where the strategy has meaningful exposure, including Latin America and Southeast Asia.

We appreciate your continued trust.

Net Cash: Total cash minus total debt.

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

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 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.

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