Brandes Investment Partners
Emerging Markets Equity Strategy Notes
Third Quarter 2020 (July 1 – September 30, 2020)

The Brandes Emerging Markets Equity Strategy returned 4.91% (gross of fees), underperforming its primary benchmark, the MSCI Emerging Markets Index, which was up 9.56% in the third quarter. Performance was generally in line with the MSCI Emerging Markets Value Index, which gained 4.66% in the quarter.

Positive Contributors
Leading contributors were holdings in the automobiles and auto components industries, as well as the information technology sector. Our Korean auto holdings, particularly **Hyundai Motor** and **Kia Motors**, benefited from recent strong operating profits. The stocks had previously performed poorly, partly due to the companies' lack of attractive new models in the growing SUV segment. However, it was our view that investor enthusiasm would return once these automakers refreshed their offerings, which they did in 2019. Their new large SUVs received rave reviews, their profitability improved, and both companies emerged as strong players in the electric vehicle market. Then COVID-19 hit. Global automobile sales declined rapidly, and businesses had to deal with shutdowns and the reality that a weak economic environment would last multiple quarters. Fortunately for Hyundai and Kia, South Korea never implemented a complete lockdown and auto sales in the country held up relatively well. The companies were the only major global automakers that generated positive operating profit in their automotive division in the second quarter of 2020. This factor, combined with market confidence that the recovery seen at the end of the second quarter would persist, spurred investor optimism for Hyundai and Kia.

Within information technology, strong performers included **Taiwan Semiconductor Manufacturing Company** and IT services providers **Tech Mahindra** and **Chinasoft International**. Tech-related business **Alibaba** also aided returns.

Additionally, Hong Kong-based holding company **First Pacific** and Mexican cement manufacturer **Cemex** rebounded in the quarter. New additions from earlier in the year, specifically air freight and logistics company **Aramex** and Indian media company **Zee Entertainment Enterprises**, also performed well.

Performance Detractors
Following their sharp recoveries in the second quarter, holdings in oil and gas declined, most notably Argentina-based **YPF**, Brazil-based **Petrobras**, Russian **Lukoil** and China-based **PetroChina**.

Several holdings in Indonesia and Brazil also detracted from returns, led by wireless telecom **XL Axiata** and tobacco company **Gudang Garam**, as well as higher education company **Cogna Educacao** and regional jet manufacturer **Embraer**.

Many Indonesian and Brazilian companies have been particularly hard hit amid the pandemic as governments in both countries struggle to contain the virus. Gudang Garam took the conservative measure of cutting its dividends to preserve its liquidity amid lower sales. We believe the company's solid balance sheet will help it navigate the difficult market environment and it has the potential to strengthen its profitability as consumers regain purchasing power.

Embraer has been facing an extremely difficult operating environment as the coronavirus pandemic has brought on the largest sustained impact on air travel demand in the history of the aviation industry. However, we believe Embraer is well positioned in the long term given its improved product cycle and strong competitive position for when air travel demand begins to rebound.

Furthermore, our underweight allocations to tech-related businesses and to companies in China weighed on relative returns.

Select Activity in the Quarter
The emerging markets investment committee materially reduced the portfolio's exposure to automobile and auto components companies following their strong share-price appreciation. The committee exited positions in **Hyundai**

Mobis, Kia Motors and **Dongfeng Motor**, while also paring the allocation to Hyundai Motor. These businesses represented meaningful positions within the portfolio for a number of years, although the committee controlled the aggregate allocation due to the correlated nature and cross-shareholdings of the companies, especially among those domiciled in South Korea. We took advantage of the rally to divest select investments as we believe the potential reward no longer compensates for the heightened risks from high unemployment, low consumer confidence and economic uncertainty.

We used some of the proceeds from our sales to initiate positions in China-based **Gree Electric Appliances Inc. of Zhuhai**, India's **HDFC Bank** and Taiwanese computer storage devices manufacturer **Wiwynn Corp**.

Gree Electric Appliances is a global diversified industrial group with three major brands: Gree, Tosot and Kinghome. Air conditioners and non-manufacturing businesses (e.g., raw material handling) accounted for 70% and 21% of Gree's 2019 revenue, respectively, while other segments (e.g., various home appliances, compressors, robotics) make up the remaining portion. Although it has been the market share leader in the Chinese central air-conditioner market for eight consecutive years, Gree trades lower than many of its rivals, mainly because it has been owned by a state-owned enterprise (SOE).

We see Gree as an opportunity to participate in the potential recovery of the air-conditioning and home appliance industry in China in the second half of 2020 and beyond. In 1Q20, Gree saw its year-over-year sales and net income plunge by 49% and 73%, respectively, due to the COVID-19 outbreak. In late 2019, Gree's SOE parent company sold a 15% stake (out of its 18.2% stake) to Hillhouse Capital Management, a well-regarded investment firm in China, making Hillhouse the largest shareholder of Gree. We believe the shift in ownership will improve Gree's standing going forward and help it focus on diversifying its product mix and catching up to its perceived higher quality peer, Midea, which trades at 18.1x forward earnings versus 12.9x for Gree (as of September 30).

Wiwynn is a cloud IT infrastructure provider focused exclusively on the secularly growing hyperscaler market. Hyperscalers allow for a complete mix of hardware and facilities that can scale a computing environment up to thousands of servers. The still-immature nature of the end-market means that the product is not yet commoditized, and that large players such as Wywinn are able to offer higher-value, more technologically advanced solutions to their customers compared to smaller businesses. In our opinion, an investment in Wiwynn provides exposure to one of the best secular growth trends within the technology sector at an attractive valuation. We appreciate the company's solid earnings over the last few years and its strong client base, which includes companies such as Facebook, Microsoft and Amazon. Although customer concentration is an issue and the sub-industry could see increased competition and margin compression, we believe the potential reward outweighs these risks to make Wiwynn an appealing opportunity.

HDFC Bank is one of India's leading private banks and was among the first to receive approval from the Reserve Bank of India (RBI) to set up a private bank sector in 1994 as part of RBI's policy to liberalize the industry. In our opinion, HDFC is a well-run business with a tremendous track record over the past several decades. The bank focuses on high-quality credit underwriting for both corporate and retail loans, and has historically managed the credit cycle reasonably well, something that cannot be said for many of India's financial institutions. Furthermore, growth in the Indian market has been impressive, with assets compounding above 20% for extended periods of time. Based on our analysis, strong asset quality and high growth have enabled to bank to generate impressive returns on equity, typically in the high teens and even above 20%. Although we have long viewed HDFC as a respectable bank, its valuations had not warranted an investment until the recent market volatility provided an opportunity.

Year-to-Date 2020 Briefing

The Brandes Emerging Markets Equity Strategy declined 21.60%, underperforming the MSCI Emerging Markets Index, which fell 1.16% for the nine months ended September 30, 2020, and the MSCI Emerging Markets Value Index, which was down 14.23%.

The period marked another challenging time for value investors, with value-oriented sectors, especially cyclicals (i.e., financials, energy, industrials and materials), underperforming the overall MSCI EM Index. Companies directly affected by the oil-price volatility and those experiencing declining demand as an immediate result of the coronavirus pandemic have also felt the brunt of the correction.

Specifically for the strategy, underweights to China and tech-related businesses were the leading detractors from relative returns. At the company level, Brazil's Embraer and Panamanian bank **Banco Latinoamericano de Comercio Exterior** (Bladex) performed poorly, as did Mexican real estate investment trust **Fibra Uno** and bank **Banco del Bajio**. Other detractors included event organizer **Hyve Group**, which we sold in the second quarter, Argentina-based YPF and agricultural company **Adecoagro**.

Although overall performance was disappointing, there were some bright spots within the portfolio, particularly among our tech-related holdings. Strong performers included Alibaba, Tech Mahindra, Chinasoft International and **Asustek Computer**. Moreover, third-quarter contributors Hyundai Motor and Aramex also aided year-to-date returns.

Current Positioning

The geographic and sectoral profile of the portfolio did not change substantially in the quarter. Our weighting to Asia has increased to nearly 49% (from 46% a year ago), a result of new companies added and market appreciation, although we remained significantly underweight to the region due to lower allocations to China, Taiwan and South Korea relative to the benchmark. Meanwhile, we maintained an overweight to Latin America as we believe select companies operating in the region have been unduly penalized amid the pandemic.

On a sector basis, our largest overweight was to real estate. The financials sector remained a significant underweight due to our lower exposure to banks in China, Brazil and India. We also held a lower exposure to the technology sector and tech-related businesses in other sectors (e.g., we did not hold Tencent in communication services) than did the benchmark.

We are frustrated by the year-to-date absolute and relative returns of the Brandes Emerging Markets Equity Strategy but believe the portfolio is well positioned for a potential recovery once the COVID-19 impact dissipates. We have material exposure to companies that we feel have the potential to rebound, and these holdings largely fall into three categories:

1. Companies affected by COVID-19 mobility restrictions: Embraer (aviation), Fibra Uno (REIT with retail exposure), **Genting Berhad** (casino gaming) and Cogna Educacao (on-campus education)
2. Banks impacted by accounting changes that have required upfront loan loss provisioning: Banco del Bajio, **Nova Ljubljanska Banka**, Bladex, **Sberbank**, **Absa Group**
3. Select holdings operating in Latin America, where the economic outlook is challenging and investor sentiment is poor: Adecoagro (agriculture), **Prosegur Cash** (cash-in-transit), Cemex (cement), YPF and Petrobras (oil and gas)

Furthermore, the valuation dispersion between emerging markets value and growth stocks (MSCI EM Value vs. MSCI EM Growth) continues to be very wide across various valuation metrics, which has tended to be a leading indicator of returns for value stocks relative to growth stocks.

Thank you for your continued trust.

Forward Price/Earnings: Price per share divided by expected earnings per share.

Forward Earnings: Sell-side analysts' consensus earnings estimates for the next fiscal year.

Return on Equity: Net income divided by shareholder's equity.

Operating Profits: Earnings before interests and taxes.

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.

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.

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