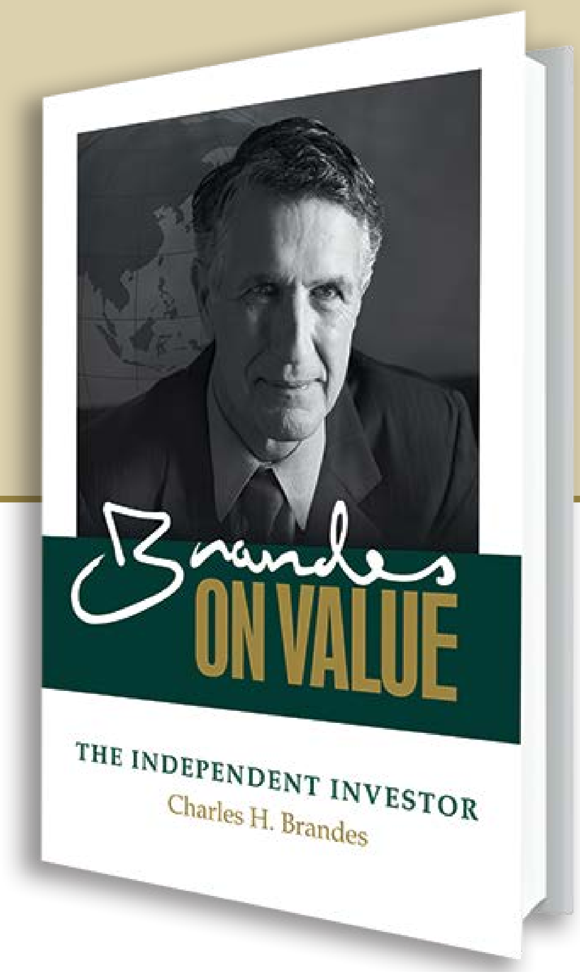
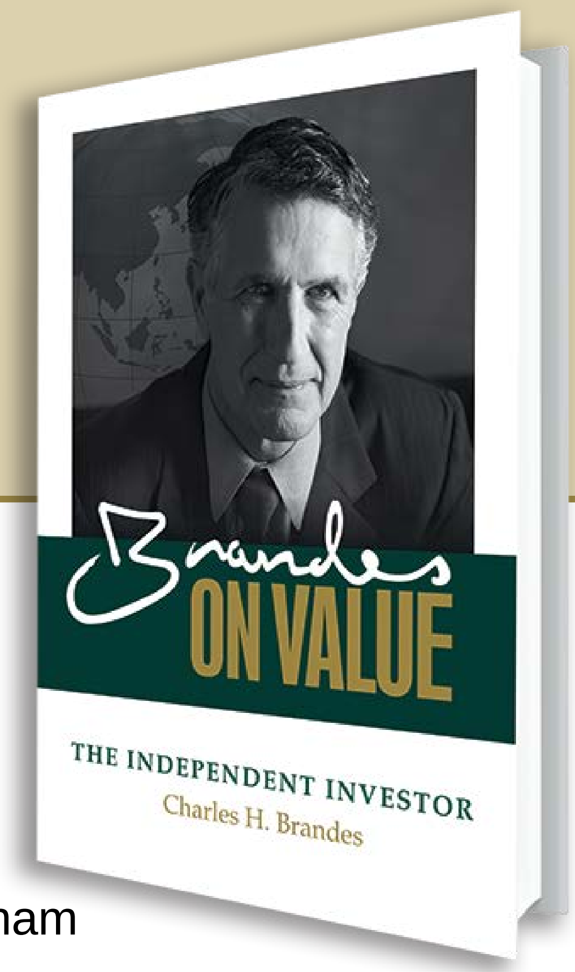
Brandes ON VALUE

Truths, Beliefs & How Brandes Works



Charles H. Brandes, CFA
Chairman
January 22, 2015

BRANDES
INVESTMENT PARTNERS



Brandes ON VALUE

- New stockbroker's chance meeting with Ben Graham
- Converted to value
- Started a company based on Graham principles

41 years later...

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Ben Graham's Influence

"You can have an extraordinary *difference in the price level* mainly because not only speculators but investors themselves are *looking at the situation through rose colored glasses* rather than dark blue glasses."
– Benjamin Graham

Source: Legacy of Benjamin Graham, The Heilbrunn Center for Graham & Dodd Investing at Columbia Business School

Presentation Points

- The Brandes DNA
- How Brandes Works: Analysis, Valuation, Construction
- What is an investment, what is NOT
- Confusion between volatility and risk
- Investor Behavior
- Reinforce case for value

The Brandes DNA

Purpose & Drivers

- Fiduciary & client-centric
- Provide superior investment services
- Nurture atmosphere of challenge & accomplishment

Investment Longevity

- Global opportunities in up & down markets
- We have to be different from benchmarks to outperform
- Long term & independent ensures client interest alignment

Process & Patience

- Fundamental valuations focused on overall MOS
- Investment Team with separate analysis & decision rights
- Discipline, consistent, repeatable

Value Philosophy

- Human behavior misprices securities
- Can earn superior returns by buying companies at a discount to our estimate of intrinsic value

Origin

- Graham & Dodd
- Bottom-Up Value Investing

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3-Part Investment Team Process

How Brandes Works

PART 1: ANALYSIS

PART 2: VALUATION

PART 3: CONSTRUCTION

Part 1: Analysis

Analyst Organization

7 Teams

1. Basic Materials
2. Consumer Staples
3. Financial Institutions
4. Industrials
5. Technology & Healthcare
6. Telecommunications
7. Utilities

From

- Mexico
- Singapore
- Brazil
- Colombia
- India
- Japan
- China

Part 1: Analysis

Tenured Analysts Cover the Globe

7 Teams

25 Research Analysts

13 Years Average Tenure

15 Years Average Leader Tenure

Research teams traveled **385,000** miles

Part 1: Analysis

What We Look for in a Company

Key Drivers

- Leverage/Debt
- Profitability (Returns and Margins)
- Free Cash Flow Conversion
- Currency Mismatch/Commodities Exposure
- Shareholder Structure

Part 1: Analysis

What We Look for in a Company

Screening

- Screening methods **vary** by industry
- Example: for utilities, we look for **low** price-to-earnings and **low** price-to-book
- Enterprise **value** to regulatory asset base

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Part 1: Analysis

What We Look for in a Company

Company Attributes

- What is the **sustainable earnings power** of the company?
- Can we rule out **long-term changes** to its outlook?
- Is it driven by a **short-term event**?
- Might it **reverse** at some point soon?

Part 2: Valuation

Investment Committee [IC] Establishes Intrinsic Value

Investment Committee

- Scrutinizes and challenges analyst’s report
- Accounts for risks
- Establishes intrinsic value or worth of company

Part 2: Valuation

Equity Sell Discipline

Investment Committee Decides to Sell

When:

- Full position sale occurs when security's price reaches estimate of intrinsic value
- Full or partial sale may occur if our estimated intrinsic value declines, making the margin of safety unattractive
- Partial or full sale may occur to free up cash for other securities with estimated or higher margin of safety

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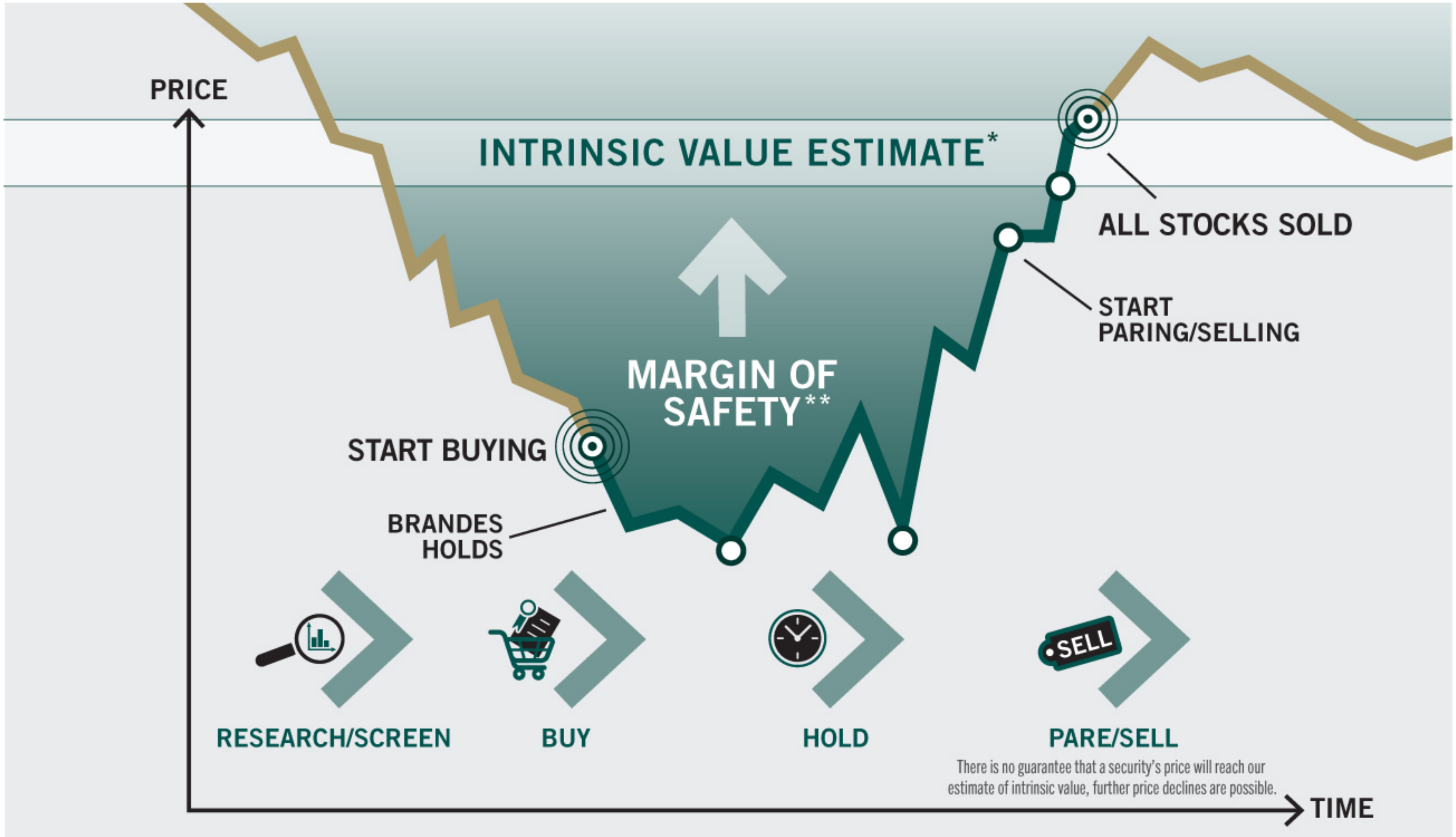
Part 3: Construction



This is a hypothetical illustration of value investing concepts. It does not represent the performance of any specific security. It assumes intrinsic value changes over time. Actual results will vary. No investment strategy can assure a profit or protect against loss.*Intrinsic value: "In general terms it is understood to be that value which is justified by the facts, e.g., the assets, earnings, dividends, definite prospects, as distinct, let us say, from market quotations established by artificial manipulation or distorted by psychological excess"— Security Analysis, 1934, page 17. **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.

Part 3: Construction

Margin of Safety

- **Only** add companies with high margins of safety that can improve returns

Part 3: Construction

Portfolio Concentration

- Portfolios have **40** to **75** holdings
- We **don't want** to be overly diversified so we can **reflect** our convictions in our portfolios

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Part 3: Construction

Custom Client Needs/Restrictions

- Social restrictions
- Country prohibitions
- Industry prohibitions
- Cash limitations

Part 3: Construction

Strategic Trading

- **11** official exchanges
- **40** alternative trading systems (dark pools)
- Markets are **severely** fragmented

If the markets are open we're onsite

Part 3: Construction

Monitoring Portfolios

- Investment committees get **frequent** reports on the strategies
- Reports show current **margin of safety** for e**very** company held based on **latest** share price

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3-Part Investment Team Process

How Brandes Works

PART 1: ANALYSIS

PART 2: VALUATION

PART 3: CONSTRUCTION

Structures ARE NOT Investments

Most Structures Focus on Short-term Volatility

- **Structures – Hedge funds, alternatives, pools, mutual funds, etc.:**
  - Vehicles for investors' need

- **Passive, low volatility strategies**
  - Methods that appear to control risk

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Structures: Fishy Approaches

- Tend to resurface in new wrappings …

Structures: Fishy Approaches in New Wrappings

Formerly Known As

- Top-down forecasting
- Portfolio Insurance
- Commodities, commercial real estate, SWAPS
- “Equities are dead” – *Business Week, 1979*

Now Known As

- Macro hedge funds
- Derivative protection
- Alternatives, currencies, private equity
- The desire for “non-equity” exposure

Volatility vs. Risk

Volatility:

- Ups and downs of the market
- Short term

Risk:

- Loss of capital
- Long term

Not the Same

Quest to Control Downside

Creates a Psychological Aversion to Risk

- Leads to “safe” behaviour – avoiding criticism
- But is it right?

ISSUE: Short-Term Volatility is Not the Same as Long-Term Risk

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Driven by Scary Stats

Canadian Demographics and Longevity Examples

- TEACHERS with retirees collecting pensions for 50 years
- NFLD & Labrador: 8,581 retired teachers collecting pensions based on 6,231 working teachers

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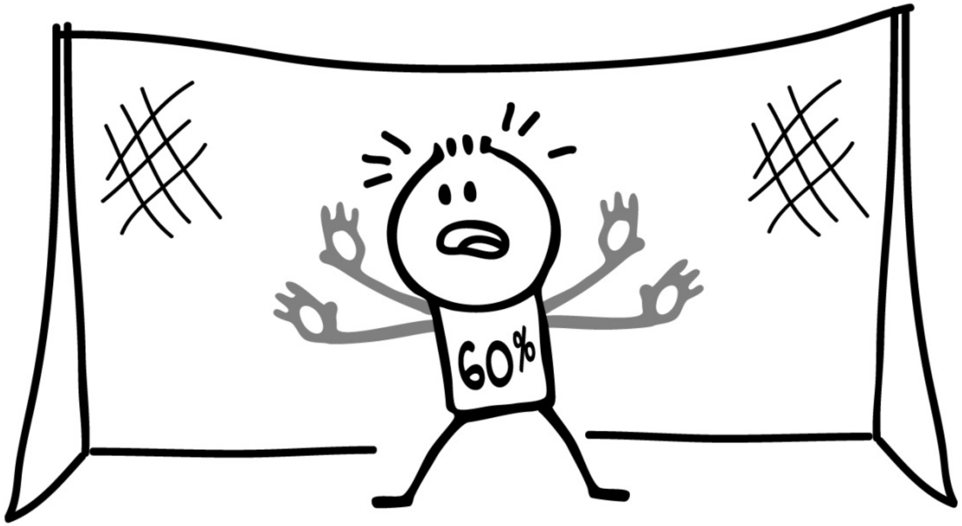
Quest to Control Downside – Bias for Action

Soccer Example – Penalty Kicks

- Goal tender will jump right and 94% of the time to anticipate block
- Thinking a 50/50 bet
- Right 40% of the time
- Considering 1 in 3 kicks are dead center
- Standing still means 60% saves
- THEY KNOW this, but can’t handle criticism for “doing nothing”



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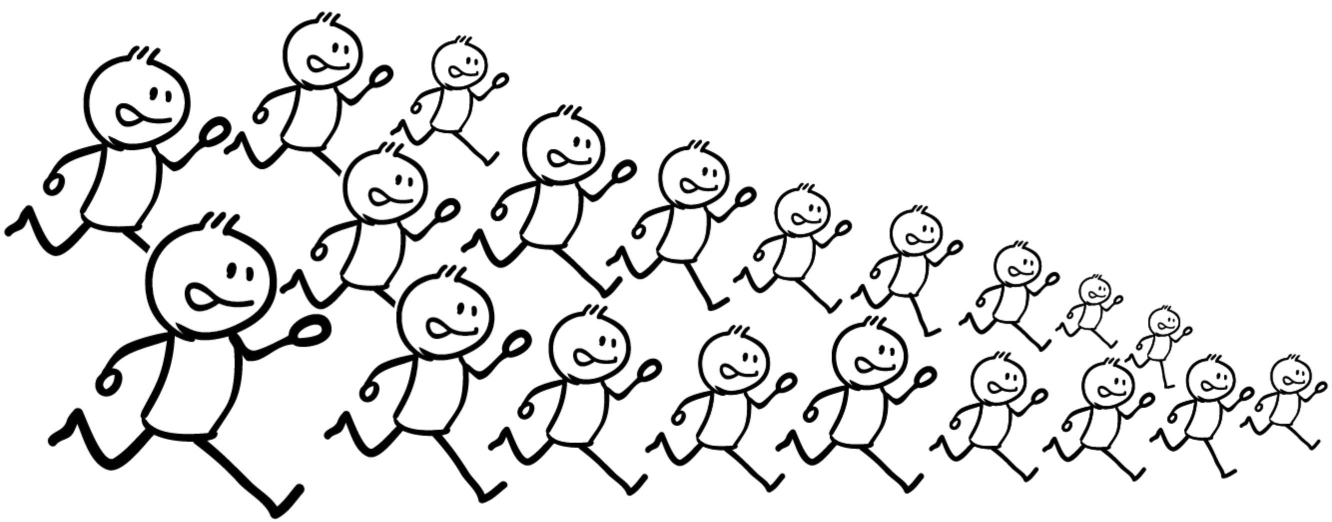
Issues with Structures & Low-Volatility Strategies

4 Risk Issues

1. Complexity and lack of transparency
2. Herding and highly correlated activity
3. De-equitization
4. Lack of effort and proper capital allocation



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1. Complexity & Lack of Transparency

Alternatives & Diversification Strategies

“Back to the Future” Study

- Alternatives and diversification strategies did not do better than simple asset allocation with appropriate re-balancing
- Diversifying keeps people busy

Bob Maynard
Chief Investment Officer, PERSI

IDAHO Public Employee Retirement System of Idaho PERSI

“To the extent that detail and complexity prevent transparency, particularly to constituencies, they can lead to complications that threaten any long-term plan when temporary, and inevitable, underperformance periods arise.” - **Bob Maynard**

Public Employee Retirement System of Idaho: persi.idaho.gov/; Back to the Future: Conventional Investing in a Complex World (http://www.brandes.com/docs/default-source/brandes-institute/back-to-the-future-conventional-investing-in-a-complex-world.pdf)

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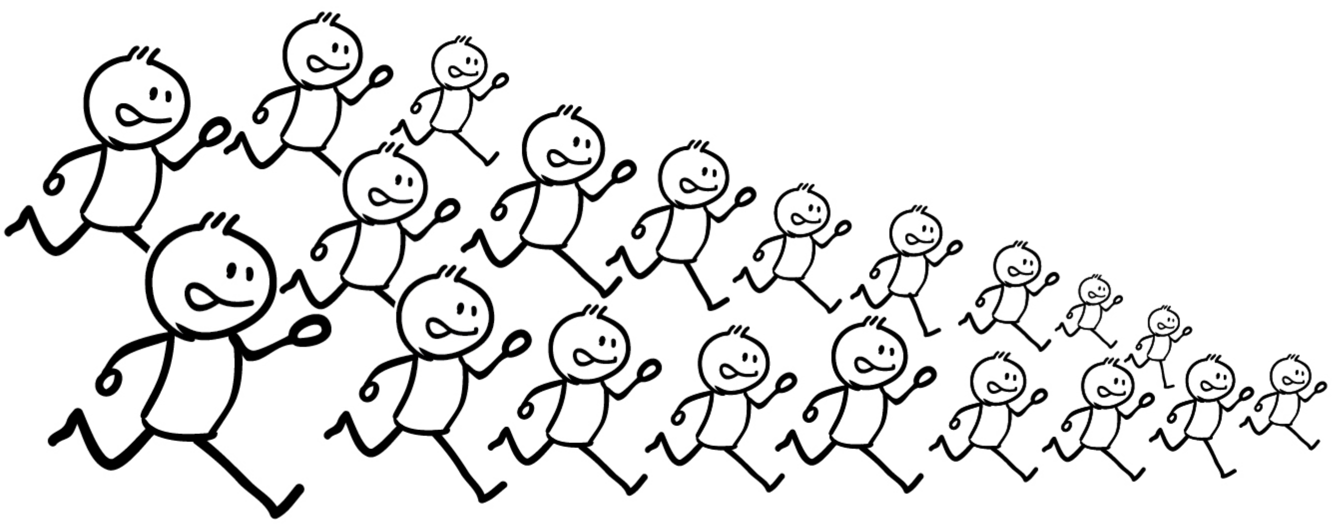
2. Herding Behaviour in Passive Strategies

Correlated Activity

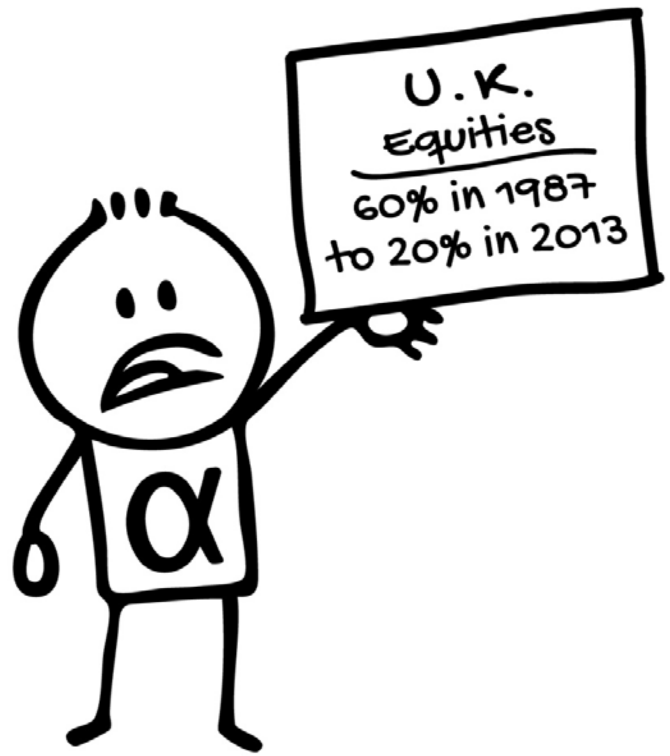
- Highly correlated activity = herding
- Result: close to 100% passive allocation



3. De-equitization

Movement Away from Wealth Generators

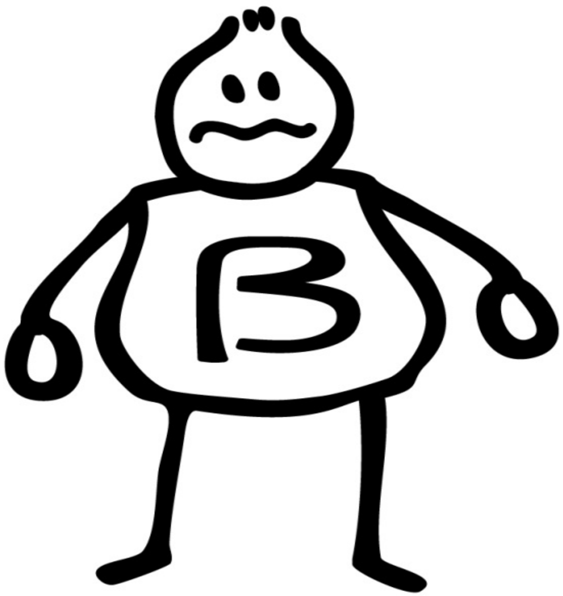
- Equities allocated among U.K. insurance companies and pension funds – dropped to 20% in 2013 from 60% in 1987
- Heightens market risk for investors
- Poorer risk sharing and weaker long-term investment



4. Lack of Proper Capital Allocation

Threats to the Broader Economic System

- No effort to allocate capital
- Capital allocated
  - BUT by size, not by economic value
- consequence: Good and high-potential projects starve



"If everyone pursues Beta, there will be no allocation of capital to good projects or high-potential projects. Capital will go to size, which is not a good way to allocate." **– Kim Shannon, Brandes Institute Summit**

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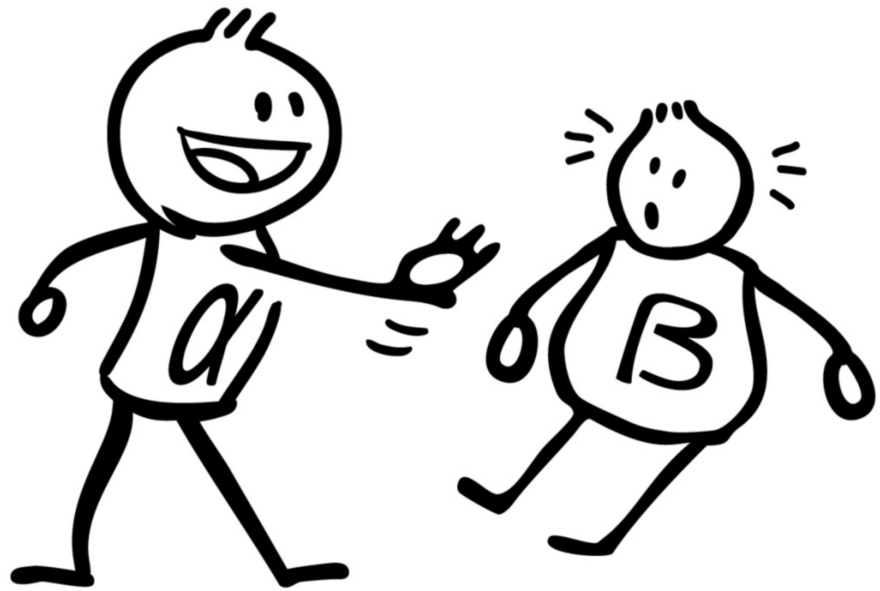
FOCUSING ONLY LOW-VOLATILITY AND PASSIVE STRATEGIES

Managers Abdicate Key Vocation Responsibility

Investment Managers Should Allocate Capital

Low-volatility and passive strategies are counter to what investment managers **are supposed to do:**



Investment Managers Are Supposed to Take on Risk & Get Paid for it

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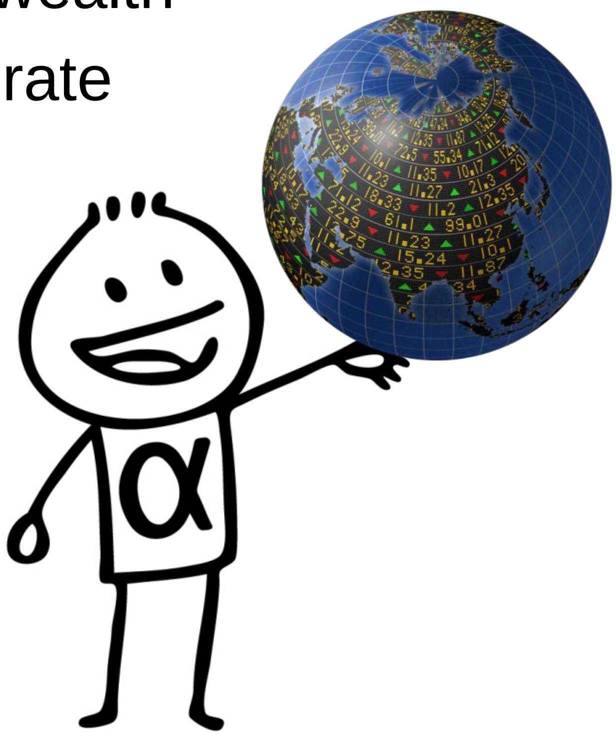
Ben Graham's Focus on Value – Right on

Harness Strong Wealth Generators

- Governments **don't** generate new wealth
- Financial engineering doesn't generate new wealth
    - Zero sum game
- Lending doesn't generate new wealth on its own



Only Companies Generate NEW Wealth

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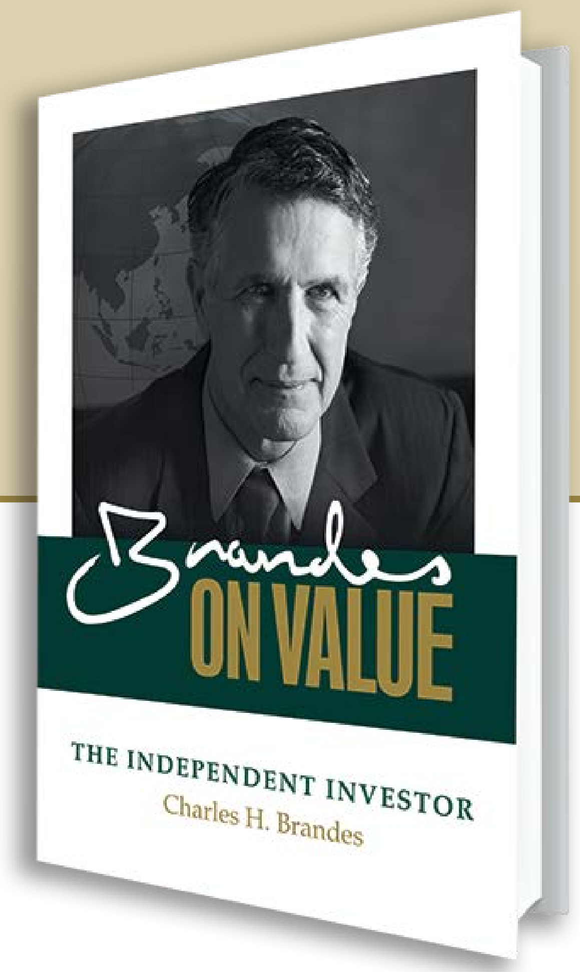
Thank You



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