BRANDES
INVESTMENT PARTNERS

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The Importance of Process

When "Good" Managers Have "Bad" Performance

What Traits Do "Good" Managers Tend to Have?

The "Average" Return

*Too often, investors tend to focus exclusively on the **outcome** of an investment process – namely, the returns. To a certain degree, the focus is justified. Investors hire managers to deliver competitive results. Yet results – **especially** in the short term – can be misleading. At Brandes Investment Partners, L.P. ("Brandes"), we believe performance should be evaluated within a broader, longer-term context that includes a sharp focus on **how** those returns were generated.*

EXHIBIT 1: Processes and Outcomes

		OUTCOME	
		Good	*Bad*
Process Used to Make the Decision	*Good*	Deserved Success	Bad Break
	Bad	Dumb Luck	Poetic Justice

Source: Mauboussin, Michael. *More Than You Know.* Columbia University Press: New York. 2006. Page 10.

In his book *More Than You Know*, author and investment strategist Michael Mauboussin notes that good, short-term investment results may *not* reflect a sound investment process. See Exhibit 1. Sometimes, investors may fall prey to "outcome bias," or the potential to judge a decision differently depending upon the outcome of that decision. They may mistakenly believe that good, *short*-term results must be a sign of a good manager and poor, short-term results must reflect a bad manager or bad approach. But a bad result doesn't necessarily reflect a bad process. Even great golfers may make bad shots or play poorly in a string of tournaments. The most skilled and diligent attorneys don't win every case.

We believe that a sound investment philosophy applied consistently in all market conditions may generate some "bad breaks" or poor results over the short term. Over the long term, however, we believe a good approach will deliver favorable results.

We certainly have had periods of "bad breaks" or periods when we have underperformed. And while past performance is not a guarantee of future results, we believe an understanding of market history can be instructive. In our Global Equity Portfolio, for example, there have been a number of short-term periods where we underperformed the MSCI World Index significantly:

- June 1987: 1-year return trailed by 33%
- March 2000: 1-year return trailed by 12%
- June 2008: 1-year return trailed by 14%

In fact, there are a number of periods of three, five, and seven years where relative performance lagged. In the late 1980s and early '90s, exposure to poor-performing U.S. financial companies and a lack of exposure to the soaring Japanese market led to a long stretch of underperformance. 2009 is the second-longest stretch of underperformance, once again due to a large exposure to poor-performing U.S. financial companies.

However, some of our worst periods of absolute returns were followed by some of the best:

- June 1982: 1-year return of -13% was followed by +84% through June 1983
- September 1990: 1-year return of -17% was followed by +31% through September 1991
- March 2003: 1-year return of -30% was followed by +71% through March 2004

Since its inception in 1978, the Global Equity Portfolio has delivered an annualized gain of nearly 14.0% (through June 30, 2009). Thus, a hypothetical Global Equity account with a $100,000 initial investment in 1978 would have grown to $5.8 million by year-end 2008.[1] These performance results include periods when the account would have been down 11.8% in 1990, over 30% over a 1-year period in 2003, and down 51.7% over a 1-year period through February 2009. We remain confident that the consistent application of our investment approach will provide patient investors with long-term rewards.

When "Good" Managers Have "Bad" Performance

Actually, it is fairly common for a "good" investment process to produce "bad" short-term results. We think it's vital for people to realize that we often have little control over outcomes in the short term – but we can control the process. We *can* control how we are making decisions. Sticking with a sound, long-term process enhances our likelihood for long-term success.

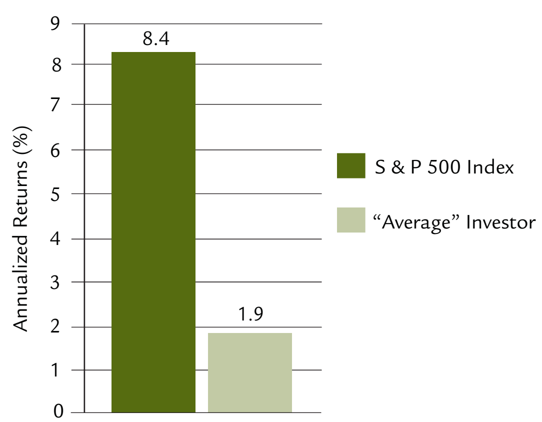
Even Warren Buffett, one of the world's greatest investors (and a Graham-and-Dodd practitioner), has suffered periods of significant underperformance. A hypothetical $10,000 investment in Buffett's company Berkshire Hathaway in 1972 fell to $5,423 by year-end 1975. The same investment in the S&P 500 Index would have been worth $10,229. By the end of that 4-year period, we believe many investors likely would have abandoned Buffett. But over the next 10 years, the initial investment with Berkshire Hathaway grew to $350,024 versus $38,397 for the S&P 500 Index (a difference of nearly 10 times).[2] Sticking with Buffett and his value investing approach would have paid handsome rewards – despite four years of underperformance. Again, please note that past performance is not a guarantee of future results.

The Brandes Institute ("Institute") has also published a series of articles called "Death, Taxes and Short-Term Underperformance" that show that the best-performing mutual funds over 10 years often had 1- and 3-year periods of poor returns within that 10-year span.

Benjamin Graham wrote, "For indeed, the investor's chief problem – and even his worst enemy – is likely to be himself."[3] Graham, regarded as the father of value investing, extolled the benefits of thinking and acting differently than the crowd. He understood that the average investor has biases and tendencies to act irrationally – especially in the short term. These biases tend to push stock prices too high during periods of optimism and too low when investors are fearful. By overcoming these biases – by acting differently than the average investor – Graham believed one could achieve better-than-average results. This "against-the-grain" approach is not easy for some people. It can be emotionally tough to purchase stocks when others are selling or to stick with a manager who is underperforming. But we believe these are the types of difficult decisions that may help bring long-term rewards.

To what extent can our biases to dwell on short-term outcomes impair our long-term investment results? Dalbar has done a series of studies on returns for the "average" fund investor – and how different they are versus a benchmark. Dalbar looked at flows into mutual funds to estimate what an average investor earned versus what a buy-and-hold strategy would have earned. According to the firm's research, for the 20 years ended 2008, the S&P 500 Index earned 8.4% annually; but the average equity fund investor earned just 1.9%. See Exhibit 2.

EXHIBIT 2: Annualized Returns for the S&P 500 Index and the "Average" Equity Fund Investor (1989 to 2008)



Source: Dalbar Quantitative Analysis of Investor Behavior, March 2009. Past performance is not a guarantee of future results. This example does not consider the effects of taxes or investment expenses. Actual results will vary.

The difference in returns stems from investors timing their purchases based on short-term performance. They tended to get out when a fund was doing poorly – and invested when a fund was doing well. In short, they bought high and sold low – precisely the opposite of the basic rule of successful investing. As Graham's quote indicates, an investor's worst enemy often is himself.

What Traits Do "Good" Managers Tend to Have?

In addition to *long*-term results and a sound, consistently applied process, we often are asked what other factors investors should consider when evaluating money managers.

We believe a sound investment *process* goes hand-in-hand with a sound investment philosophy. It should come as no surprise that we firmly believe the best way to build wealth over the long term is through value investing. The historical long-term benefits of value investing in markets around the world are well documented, as described in the Institute paper "Value vs. Glamour: A Global Phenomenon."

So, why do we believe value investing works? Our process boils down to identifying potential future cash flows (profits) that we can buy for our clients at a current discounted price. The market, at least in the short term, can be rather temperamental. Prices of shares of popular businesses in popular industries can be pushed up sharply. Meanwhile, shares of less popular businesses can be pushed lower as large numbers of shareholders rush to sell. Because of this moodiness, shares of businesses occasionally are priced in the market at bargain levels. These low prices allow value-minded managers (aided by in-depth business analysis) to buy into those businesses at discounted prices that have the potential to provide above-average long-term results.

We believe this process works because it is fundamentally sound. It is not based on the ability to predict extraordinary business growth, or "surprise" outcomes. Our process merely involves behaving as a conservative business buyer with a longer-term outlook and more level-headed approach than "the market." Of course, it doesn't work every time or with every business that is bought at a bargain. We *have* found that a sound and diversified portfolio of undervalued securities can provide highly satisfying results in the long run.

In addition to philosophy and process, we think it is important to evaluate the people making the investment decisions, as well as the firm's ownership structure. With these variables, we suggest looking for a combination of seasoned veterans and recent hires – all of whom share tremendous enthusiasm for their work. As of June 30, 2009, Brandes had 78 investment professionals with an average of 16 years of investment experience – and an average of 11 years with our firm.

Not surprisingly, we believe independently owned managers are well positioned to place client interests first. For us, our independent ownership complements our independent thinking. We are not beholden to a larger corporate parent demanding ever-escalating levels of quarterly profits. The way we manage our business is very similar to the way we manage portfolios – we are patient, steady, and have low turnover and a long-term focus.

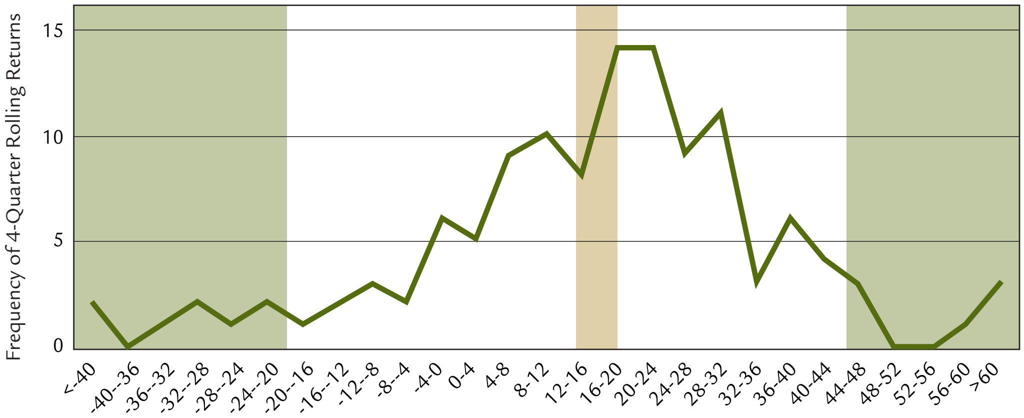
We recognize that the consistent application of our process creates portfolios that look different – and sometimes *significantly* different – from the benchmarks. Because the composition of our portfolios is different than the benchmarks, we know that our relative performance will also be different. As noted earlier, sometimes our returns will trail respective indices considerably. But, over the long haul, we remain confident that we have the right people working together as a team and a sound process built upon enduring principles to help our clients toward their long-term investment goals.

The "Average" Return

We live in an impatient, performance-obsessed world. Investment returns are measured annually, quarterly, monthly, daily – even within each day. A good manager's superior, long-term record, however, could occur despite years of poor results.

We looked at rolling, 4-quarter returns for our Global Equity strategy since its inception in 1978. The portfolio gained 15.9% during the average, rolling, 4-quarter period.[4] But, there also were

EXHIBIT 3: Range and Frequency of Rolling 4-Quarter Returns for Brandes Global Equity[5] Portfolio (Quarterly Data, January 1978 to June 2009)



	LOW EXTREME	AVERAGE RETURN RANGE	HIGH EXTREME
Return Range	**<-20.0%**	**14.0% to 18.0%**	**>44.0%**
Frequency	**8**	**8**	**8**

Source: FactSet, as of 6/30/09. Past performance is not a guarantee of future results. Returns shown are net of investment fees. Rolling periods represent a series of overlapping, smaller time periods within a single, longer-term time period. A hypothetical example is the 20-year time period from 12/31/82 through 12/31/02. This long-term period consists of 16 smaller five-year "rolling" segments. The first segment is the five-year period from 12/31/82 to 12/31/87. The next rolling segment is the five-year period from 12/31/83 to 12/31/88, and so on.

numerous occasions when the portfolio gained a lot more – and a lot less – than its average 4-quarter return, as shown in Exhibit 3.

Notice the tan shaded area around the 14.0% to 18.0% range. There were eight instances when returns were in this narrow range around the nearly 16.0% average return. Now, notice the green shaded areas at the extremes. These were times when 4-quarter returns were either less than -20.0% or greater than 44.0%. Four-quarter returns were in one or the other extreme range 16 times.

Sometimes when investors hear that a manager has a long-term average annualized return of nearly 16.0%, they may expect a consistent 16.0% return year in and year out. That is not realistic. As is the case for our Global Equity Portfolio, there have been many, many years when the results were quite different than the average. Given this long-term performance history, we suggest *not* focusing on year-to-year or quarter-to-quarter returns. Instead, we suggest sticking with a manager and focusing on the consistent application of its investment process and the long-term results it generates. Even during periods when Brandes portfolios have notably outperformed in the short term, we have advised our clients to temper their enthusiasm and maintain a long-term perspective.

Summary

We invite you to evaluate short-term results within a longer-term context – and evaluate the philosophy, people and process responsible for generating those results. Investigating each of these elements can help contribute to a richer understanding of a manager and limit the potentially adverse consequences of focusing too much attention on short-term returns – rather than the process used to generate them. There's an old saying about achieving success: "Plan your work and work your plan." If you seek to generate wealth over the long term by consistently applying value investing principles, your plan aligns with ours – and we welcome the opportunity to work with you in pursuing your goals.

[1] This hypothetical example does not consider the effects of taxes or investment expenses. Actual results may vary.

[2] This hypothetical example does not consider the effects of taxes or investment expenses. Actual results may vary.

[3] Graham, Benjamin. *The Intelligent Investor: A Book of Practical Counsel*. Fourth Revised Edition. HarperBusiness: New York. 1973. Page xv.

[4] The annualized return for the Brandes Global Equity Portfolio since inception was 13.8% as of June 30, 2009. The average rolling 4-quarter return since inception is 15.9% due to differences in the presentation of returns. We used rolling, 4-quarter returns to generate a time series of returns for our focus on the frequency of occurrence for "average" returns.

[5] The net returns, calculated in USD, presented for the Brandes Global Equity composite were calculated on a time-weighted and asset-weighted, total return basis, including reinvestment of all dividends, interest and income, realized and unrealized gains or losses and are net of brokerage commissions, execution costs, and any applicable foreign withholding taxes, without provision for federal and state income taxes, if any. As of 4/1/2006 all custodial fees are treated as administrative fees.

Prior to 1/1/2002 cash flows were weighted using a mid-month assumption, beginning 1/1/2002 cash flows are weighted on a daily basis.

Securities transactions are accounted for on the trade date. Dividend and interest income is accounted for on an accrual basis. Cash and cash equivalents are included in performance returns.

Accounts are removed from the composite when an account's market value falls below $50,000 due to capital withdrawals.

The weighted annualized management fee during the period 12/31/1977 through 12/31/2008 was 0.92% per year.

The results for individual accounts and for different periods may vary. Investors should not rely on prior performance results as a reliable indication of future results.

The MSCI World Index is an unmanaged, free float-adjusted market capitalization weighted index that is designed to measure equity market performance of the developed markets throughout the world, including the United States. This index includes dividends and distributions net of withholding taxes, but does not reflect fees, brokerage commissions, or other expenses of investing.

The S&P 500 Index is an unmanaged, market capitalization weighted index that measures the equity performance of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it can also be a suitable proxy for the total market. This index includes dividends and distributions, but does not reflect fees, brokerage commissions, withholding taxes, or other expenses of investing.

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The information provided in this material should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any security transactions, holdings, or sectors discussed were or will be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance discussed herein. International and emerging markets investing is subject to certain risks such as currency fluctuation and social and political changes; such risks may result in greater share price volatility. Strategies discussed herein are subject to change at any time by the investment manager in its discretion due to market conditions or opportunities. Please note that all indices are unmanaged and are not available for direct investment. Market conditions may impact performance. The performance results presented were achieved in particular market conditions which may not be repeated. Moreover, the current market volatility and uncertain regulatory environment may have a negative impact on future performance.

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