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F O C U S

A B r a n d e s P u b l i c a t i o n

The Case for International Investing

Investment Opportunity

Diversification

Unique Challenges

In this issue of *The FOCUS*, we make the case for international investing. Specifically, we highlight two primary reasons to consider non-U.S. investment: the vast opportunity available in international equity markets, and the potential diversification benefits these non-U.S. stocks can provide. In addition, we discuss unique challenges inherent in international investing — and how an experienced investment advisory firm can help address them.

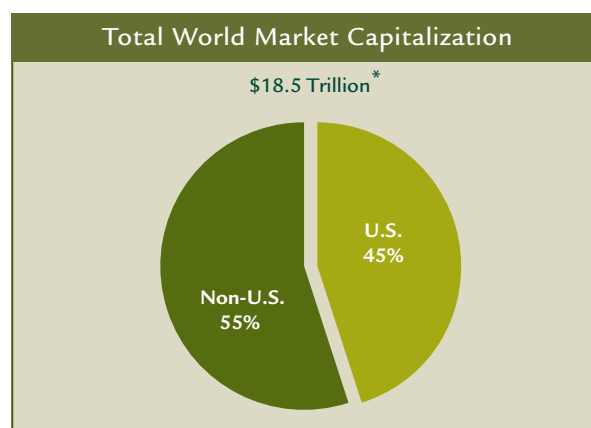
A MATTER OF OPPORTUNITY

As value investors, we believe that a stock's price and its fair or "intrinsic" value often detach from one another in the short term. Because of the emotionally charged nature of the overall market — where sentiment can shift from carefree optimism to fear and uncertainty seemingly overnight — prices of stocks tend to fluctuate much more than the intrinsic value of the companies they represent. This irrationality can materialize on the upside, lifting prices to dangerously lofty heights. It can also appear on the downside, dragging prices for select stocks to bargain levels.

Value investors target the latter situation, purchasing out-of-favor stocks that are trading at discounts to their estimated fair values, with the intention of holding these stocks until the market recognizes their inherent worth. By confidently approaching the short-term vagaries of the market with rational, objective analysis, we aim to identify compelling investment opportunities and deliver favorable long-term results.

How does the value approach tie in with international investing? Simply put, we believe that broadening our search for attractively priced stocks to markets around the world increases our chances of success. In other words, the more opportunities we examine, the more likely we are to find compelling ones — and we believe international markets offer a deep pool of investment potential.

In the chart below, we examine the composition of the MSCI All Country World Index (ACWI). Specifically, we focus on market capitalization, or the total market value of index members. As the chart indicates, U.S. stocks contribute less than half of the ACWI's market cap. With companies outside the United States providing 55% of the Index's total value, investors who focus only on U.S. companies are overlooking opportunities in a large portion of the universe of stocks.



Source: MSCI via FactSet. * Estimated market cap of the countries in the MSCI All Country World Index. (Data as of 12/31/08)

In fact, a FactSet search conducted at year-end 2008 identified 2,990 publicly traded companies in the United States with free float over \$100 million. When non-U.S. markets were incorporated into the search, the number of firms identified nearly tripled, jumping to 10,965.

Are these international companies minor players compared to their U.S. counterparts? Not necessarily. Undeniably, many of the world's largest firms are based in the United States. However, a wide range of non-U.S. companies also command sizable, industry-leading market caps. For example, an examination of the constituents of the ACWI indicates that at the end of 2008, non-U.S. firms represented 10 of the world's 10 largest real estate & development and automobile companies, and 9 of the world's 10 largest airline companies.

One more point to consider when contemplating non-U.S. stocks is that, in many cases, they might be trading at inexpensive prices compared to equities in the United States. The table below contrasts valuation ratios of the MSCI US Index with those of the MSCI All Country World Index ex-US (ACWI ex-US) as of year-end 2008. The ACWI ex-US was significantly more attractive based on the price-to-earnings, price-to-book, price-to-cash flow, and dividend yield metrics.

	MSCI US	ACWI ex-US
Price-to-earnings	13.8x	9.0x
Price-to-book	1.7x	1.3x
Price-to-cash flow	7.1x	5.3x
Dividend yield	2.9%	4.6%

Source: MSCI via FactSet (Data as of 12/31/08)

Overall, we believe that the wide array of companies traded in international markets forms a valuable source of investment potential. As value investors, we search company by company for compelling investment opportunities — and an international perspective means we have more opportunities from which to choose.

THE POTENTIAL BENEFITS OF DIVERSIFICATION

Even including price declines suffered in the early part of this decade, the last 20 years represent a fairly bullish period for stocks in the United States. Through much of the 1980s and 1990s, U.S. stocks advanced fairly regularly, generally resulting in substantial gains for market indices. Over the 20-year period ending December 31, 2008, the S&P 500 Index posted an annualized return of 7.1%.

What might be surprising is that — despite these favorable results — the U.S., as represented by the S&P 500, was not the world's best performing market

over the time period. As the table in the next column indicates, the S&P 500 actually ranked eight among developed markets, with the MSCI Country indices of seven other nations posting stronger returns.

Rank	Country	Ann. Returns 12/31/1988-12/31/2008
1	Switzerland	9.5%
2	Hong Kong	9.0%
3	Denmark	8.8%
4	Spain	8.2%
5	Finland	7.9%
6	Netherlands	7.6%
7	Sweden	7.6%
8	S&P 500 Index	7.1%
9	France	6.8%
10	Germany	6.8%

Source: MSCI via FactSet (Data as of 12/31/08)

While past performance is no guarantee of future results, we believe this helps begin to illustrate the diversification benefits non-U.S. stocks can provide. Over the last two decades, an investor limited to U.S. equities might very well have earned favorable returns. An investor with an international perspective, however, had access to U.S. stocks as well as stocks traded in the best-performing markets around the globe.

Of course, higher returns represent only one of the potential benefits of diversification. A second advantage involves correlation, or the co-movement of stock prices.

To understand correlation, first imagine a pair of hypothetical stocks that each gain 10% in a given year — and that always move in tandem on each day along the way. On day one, if stock A goes up 3%, stock B also goes up 3%. On day two, if stock A goes down 2%, stock B also posts a 2% decline. These two securities would be considered “perfectly correlated.” In other words, their daily prices would move in lockstep as the stocks approach their 10% annual gain.

Next, think of another pair of stocks that also post 10% advances in a given year — but aren't quite as perfectly matched as A and B. For example, stock X might gain 2% on day one, while stock Y declines by 1%. And on day two, stock X could drop 1%, while stock Y stays even. At the end of the year, both stocks ended up gaining 10%, but they followed different daily paths to get there.

Finally, compare a mutual fund that consists of stocks A and B with one that holds X and Y. Because the components of the first fund are perfectly correlated, one would expect it to exhibit significant day-to-day volatility — after all, A and B are either both up or both down, with no counter-balancing effect. In contrast, the second fund might post somewhat smoother daily returns. Because X and Y do not move together, ups and downs for one security could moderate the price moves of the other, resulting in less overall volatility.

Like stocks X and Y in our example, U.S. stocks and their non-U.S. counterparts typically don't move in lockstep. The chart below traces the rolling 3-year

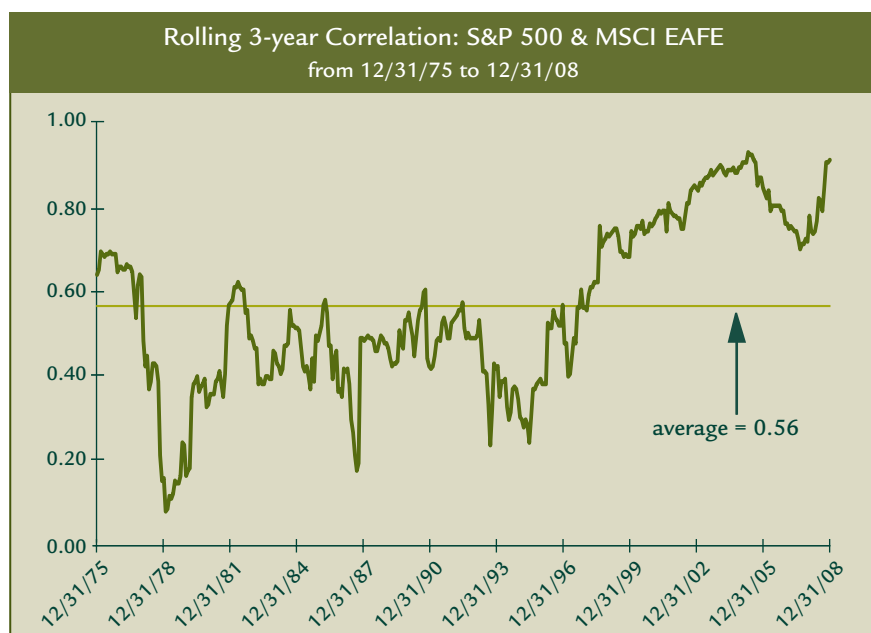
correlation of monthly returns for the S&P 500 Index and the MSCI EAFE Index (EAFE). While the correlation has fluctuated widely over the last 32 years, it averages 0.56 — significantly less than a “perfect” correlation of 1.00.

Interestingly, rolling 3-year correlation readings over the last few years have remained above historical average. Does this mean the diversification benefits of international investing have diminished?

We don't think so. Recent increases in correlation seem to coincide with the worldwide technology stock run-up of the late 1990s, and its subsequent unwinding. This coupling of dominant short-term trends and boosted correlation is not new. In the early 1970s, for example, the collapse of exchange rate controls and the oil embargo coincided with a sharp downturn in stock prices around the world — and a corresponding increase in correlation.

While critics of global diversification often point to higher correlations as evidence of reduced

diversification benefits internationally, we believe diversification benefits are not necessarily synonymous with correlation of the aggregate indices (S&P 500 and MSCI EAFE, in this case). We observe that the opportunity set widens when the underlying *components* of the international markets each show significantly different correlation patterns against the S&P 500. For example, the same combined “EAFE vs. S&P 500” correlation could be the result of either some markets being very highly correlated with the United States, while others are totally uncorrelated, or all markets having similar correlations with the S&P 500. In the first case, investors have a greater chance to make very good (or very bad) decisions than they do in the second.



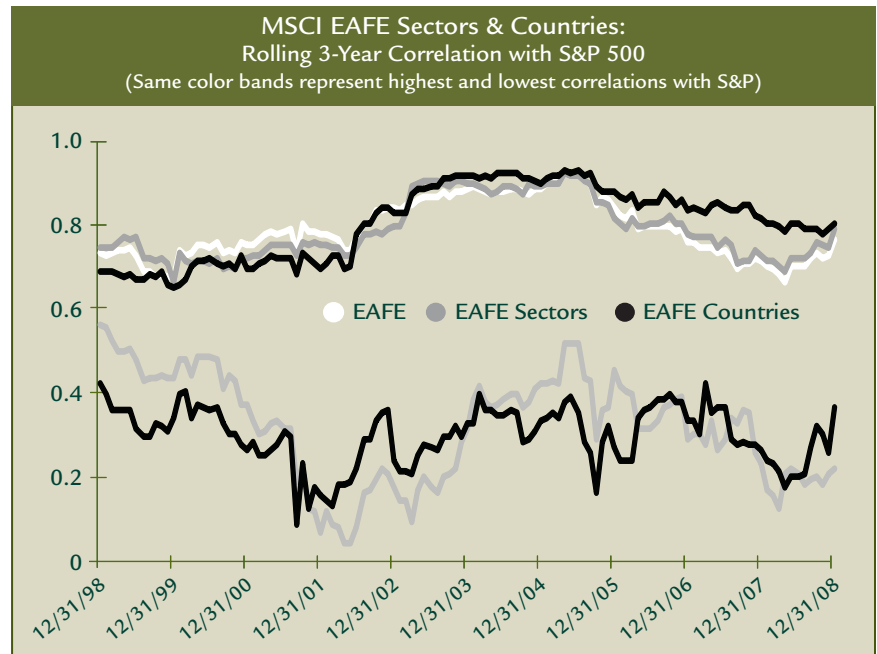
Source: MSCI via FactSet (Data as of 12/31/08)

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.

Observing the *spread* between the highest and lowest correlations of the primary components of EAFE against the S&P 500 indicates whether the opportunity set for an active investor is widening or narrowing. This breakdown of EAFE into components can be done either by country or by sector. A “top-down” country investor would then see more advantage to global diversification when the spread between the highest and lowest country correlations is wide, and less when the countries all tend to have the same correlation with the S&P.

A “thematic” or sector-focused investor would see more advantage when the spread between the highest and lowest sector correlations is wide. However, a bottom-up stock-picker should not be concerned whether it is country or sector that offers the wider spread of correlations. Shifts in the influence on diversification benefits between countries and sectors do not suggest that opportunities are declining. It just means that the types of opportunities change over time. Only those investors who are locked into a “country only” or a “sector only” approach should be concerned. We believe stock-picking opportunities should be available in any environment as long as a spread persists between the various components of the markets. To illustrate this, we look more closely at the correlation between the S&P 500 and EAFE indices, focusing not only on the country correlations but also sectors.

The white line in the chart above shows the previously addressed relationship between the correlation of the S&P 500 and the EAFE Index using 3-year rolling monthly returns. While this white line demonstrates the correlation of total returns for the two indices, the gray lines represent the range of correlations



Source: MSCI via FactSet (December 1995 to December 2008)

between the S&P 500 and the various EAFE sectors. The top gray line shows the highest correlation of any EAFE sector against the S&P 500 at each point in time. Conversely, the lower gray line shows the lowest correlation of any EAFE sector against the S&P 500. We used the same approach for the 21 countries comprising the EAFE Index and illustrated our findings using black lines. Thus, the upper black line in the chart above illustrates the highest correlation among EAFE countries against the S&P 500, and the lower black line shows the lowest.

We draw attention to the spread *between* the lines. Early in the period, the spread of sector correlations (between the gray lines) was narrower, limiting the opportunity for deriving diversification benefits through sector allocation. However the spread between the gray lines widened over time, reaching its widest point in 2002 and suggesting greater opportunity for achieving diversification benefits through sector allocation. More recently, the spread has widened again, suggesting increased opportunity through sector allocation.

The spread between the black lines narrowed over time, reaching its low in 2000, and subsequently widening from there. This reflected the conventional wisdom that the benefits from international diversification were decreasing — but, as we have shown, that view is a one-dimensional perspective in a three-dimensional world comprised of countries, sectors, and most important for bottom-up investors — individual stocks. In 2008, the spread between the black lines narrowed, suggesting international diversification benefits were increasing.

UNIQUE CHALLENGES — AND HOW WE ADDRESS THEM

Just as international stocks can boost opportunity and offer potential diversification benefits, they also present a variety of unique challenges. When analyzing non-U.S. stocks, an investor must contend with, among other things, country-to-country differences in accounting standards. Once international stocks are purchased in a fund, the fund gains exposure to the economic and political climates of each stock's home country. And throughout an investor's holding period, fluctuations in currency exchange rates could influence fund returns.

We believe each of these factors means international investing should be considered carefully, and in the context of an investor's overall goals and risk tolerance levels. Additionally, when purchasing non-U.S. stocks, we recommend partnering with an experienced investment advisory firm.

Since our founding in 1974, Brandes Investment Partners® has used the value investing approach to identify attractive opportunities in international equity markets. Our analysts are well-versed in the idiosyncrasies of different accounting approaches —

and are adept at digging deep into a company's economic and political environments to gain insight into its appeal. We believe these skills are key to our analysts' main goal: estimating the intrinsic value of each of the companies we cover.

When assessing this value, the potential influence of economic, political, and currency factors is a concern. We address these issues by insisting on a significant margin of safety — the difference between our purchase price and our fair value estimate. And as a final precaution, we limit our funds' concentrations in any one country or industry.

IN CLOSING

Decades of experience with international investing have convinced us of the advantages non-U.S. stocks can provide. As value investors, we aim to deliver favorable long-term returns by searching company-by-company for compelling investment opportunities — and an international perspective means we have more opportunities from which to choose. The diversification benefits of international investing also contribute to the potential for enhanced performance, and could help reduce portfolio volatility, as well.

Of course, investment in non-U.S. stocks requires the ongoing evaluation of unique issues such as social, political, economic, and currency factors. However, by partnering with an experienced investment advisory firm, we believe an investor can take advantage of the vast opportunity presented by international investing.

To learn more about international investing, please contact us:

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The MSCI All Country World (ACWI) Index is an unmanaged, free float-adjusted market capitalization weighted index designed to measure equity market performance of developed and emerging markets, including the United States. This index includes dividends and distributions, but does not reflect fees, brokerage commissions, withholding taxes, 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.

The MSCI EAFE (Europe, Australasia, Far East) Index is an unmanaged, free float-adjusted market capitalization weighted index designed to measure equity market performance of developed markets, excluding the United States and Canada. This index often is used as a benchmark for international equity portfolios and includes dividends and distributions net of withholding taxes, but does not reflect fees, brokerage commissions, or other expenses of investing.

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

The MSCI All Country World ex-US (ACWI ex-US) Index is an unmanaged, free float-adjusted market capitalization weighted index designed to measure equity market performance of developed and emerging markets, excluding the United States. This index includes dividends and distributions, but does not reflect fees, brokerage commissions, withholding taxes, or other expenses of investing.

MSCI Country Indices - free float-adjusted market capitalization indices that are designed to measure equity market performance in that specific country. The index returns reflect the reinvestment of dividends and capital gains, if any, but do not reflect fees, brokerage commissions, or other expenses of investing.

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

Price/Book: Price per share divided by book value per share.

Price/CashFlow: Price per share divided by cash flow per share.

Measuring free float capitalization involves taking an equity's price and multiplying it by the number of shares available in the market, excluding "locked-in" shares such as those with sales restrictions or shares held by governments.

Dividend Yield - annual income from the investment (dividend, interest, etc.) divided by the current market price of the investment.

Past Performance is not a guarantee of future results.

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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.

Diversification does not assure a profit or protect against loss in a declining market.

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