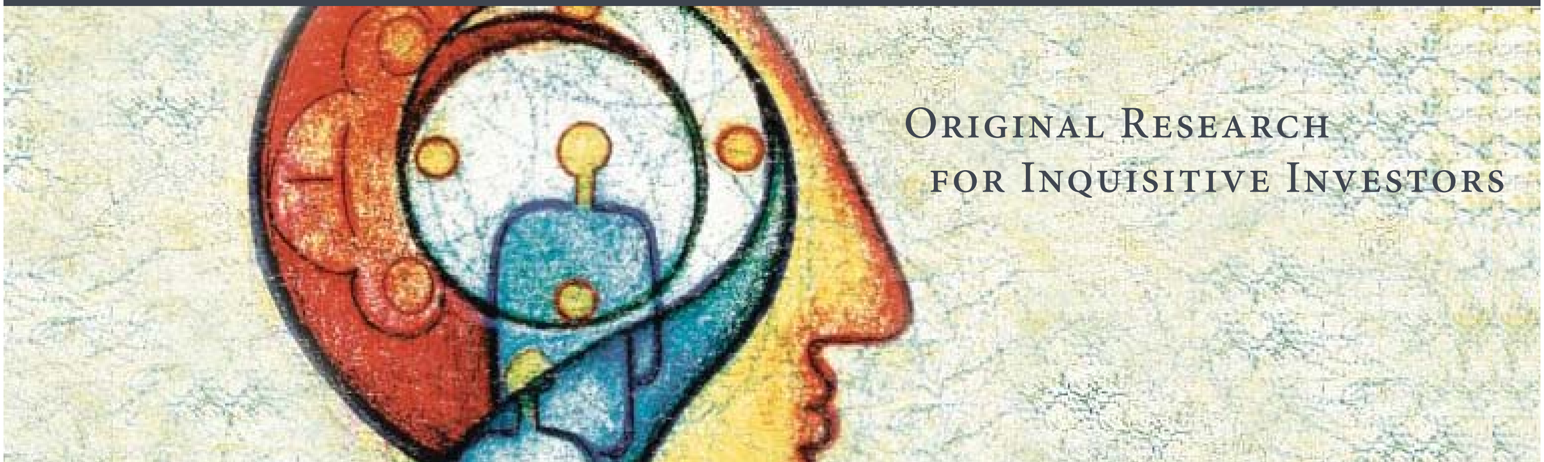

Value vs. Glamour: Emerging Markets

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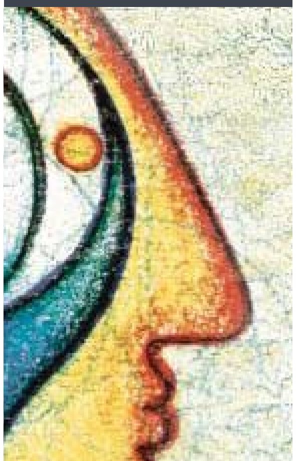
According to the International Monetary Fund, emerging markets now represent more than a third of global GDP—and are expected to grow at a faster rate than advanced economies.[1] With such explosive growth, investors often assume that an investment strategy focused on growth would yield better results. Yet, the results from the Brandes Institute's *Value vs. Glamour: A Global Phenomenon* study shows a strong evidence of a value premium in developing countries.

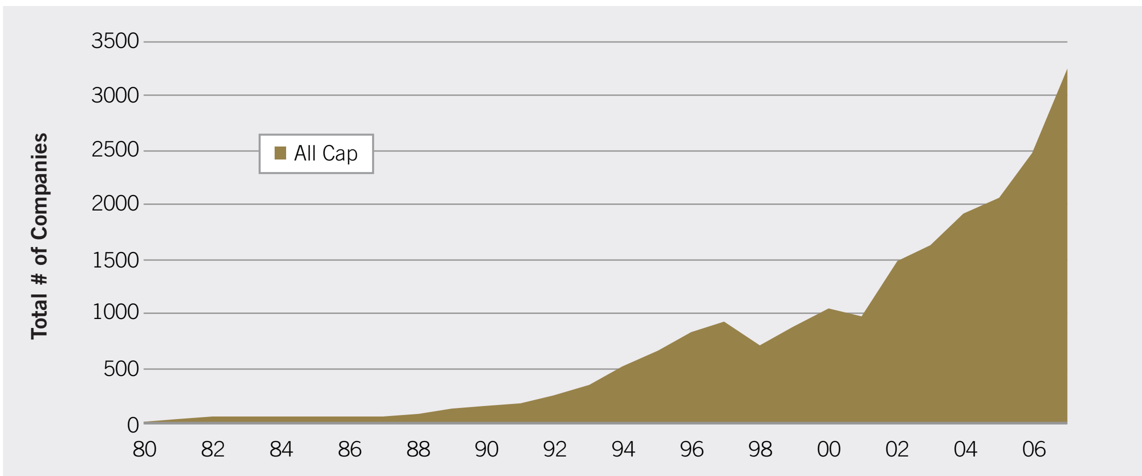
Consistent with the methodology used in the study of developed countries, the sample for emerging markets excluded the smallest 50% of all companies to represent a more truly investable universe. After the adjustment the smallest company in the sample had a market cap of $417 million. As shown in Exhibit 1, the sample size for this study increased significantly over the last 15 years, coinciding with economic growth and greater database coverage of emerging market companies.



This study shows that value stocks in emerging markets have:

- Outperformed glamour stocks over the long term
- Exceeded value stocks in developed countries
- Experienced similar price volatility as glamour stocks
- Participated more in positive markets than glamour stocks
- Fared better during down markets than glamour stocks

Exhibit 1: Emerging Market Sample Size
(June 30, 1980–June 30, 2007)



Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/12. Past performance is not a guarantee of future results.

Each June 30, stocks were placed into ten groups, or deciles, based on their fundamentals. Value stocks, those with low price-to-book (P/B), price-to-cash flow (P/CF), and price-to-earnings (P/E), filled in the upper deciles, while their glamour counterparts, those stocks with high P/B, P/CF and P/E ratios, occupied the lower deciles.

Performance for each decile was tracked over the subsequent five years. This process was repeated every year to create a series of overlapping, 5-year rolling periods. Results were averaged across all rolling periods to compare the performance of value stocks and glamour stocks over the long term.

The entire process was repeated three times to measure results based on the three separate criteria.

Results, as shown in Exhibit 2, show a strong value premium in emerging markets across metrics. For example, on a P/B basis, the average annualized 5-year return for glamour stocks in decile 1 was 4.6% versus 20.3% for value stocks in decile 10; an annualized value premium of 15.7%—more than double the premium found in non-U.S. developed markets.

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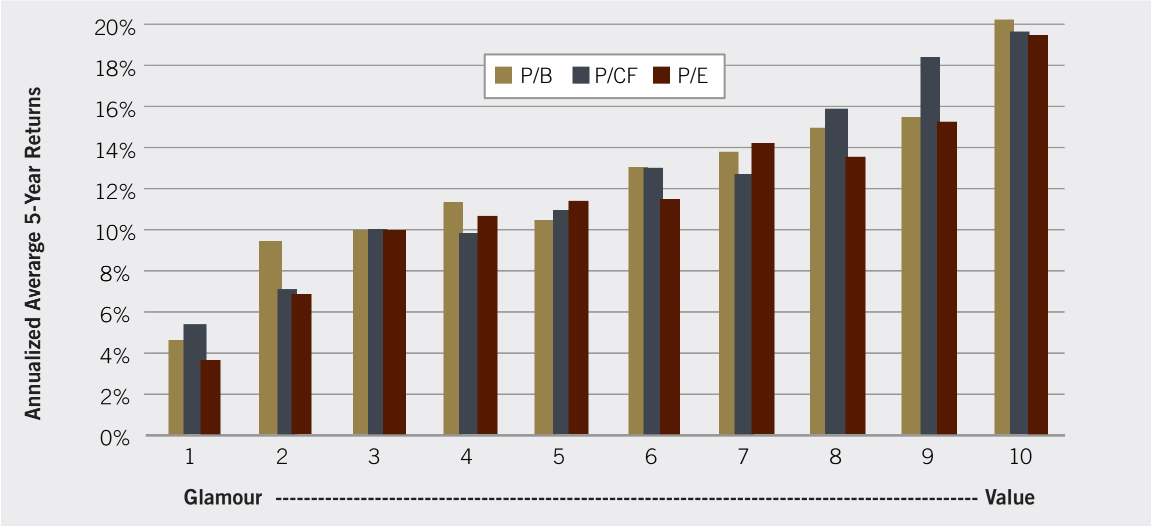
[1] IMF as of 10/1/2012, using nominal GDP. There is no assurance that a forecast will be accurate. Because of the many variables involved, an investor should not rely on forecasts without realizing their limitations.

Value Premium Consistent Across Market Caps

In the last 15 years, segmented large- and small-cap universes yielded similar results as the all cap study. On a price-to-book basis, large-cap glamour stocks in decile 1 posted average returns of 0.2% while large caps in decile 10 registered average gains of 21.3%—a difference of 21.1%. For small caps, the value premium between decile 1 and decile 10 stocks averaged 15.0%.

Exhibit 2: Annualized Average 5-Year Returns Across Metrics

(P/B, P/CF and P/E Deciles, June 30, 1981– June 30, 2012)

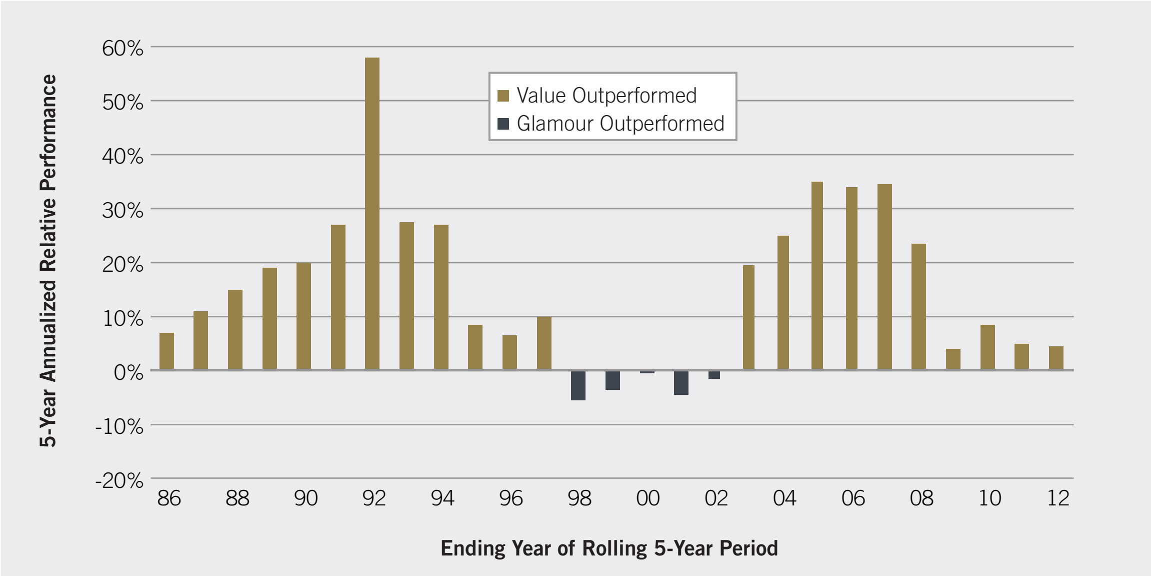


Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/12. Past performance is not a guarantee of future results.

Exhibit 3 illustrates the annualized relative performance of value stocks on a price-to-book basis, showing the persistence of the value premium over the majority of the rolling 5-year periods. We calculated relative performance by subtracting the annualized average 5-year return of stocks in decile 1 from the annualized average 5-year return of stocks in decile 10. In the few periods where glamour outperformed value, the difference exceeded 5% once, while value stocks outperformed by this amount 20 times during the study.

Exhibit 3: Rolling 5-Year Annualized Relative Performance of Value vs. Glamour

(P/B Deciles, June 30, 1981 – June 30, 2012)

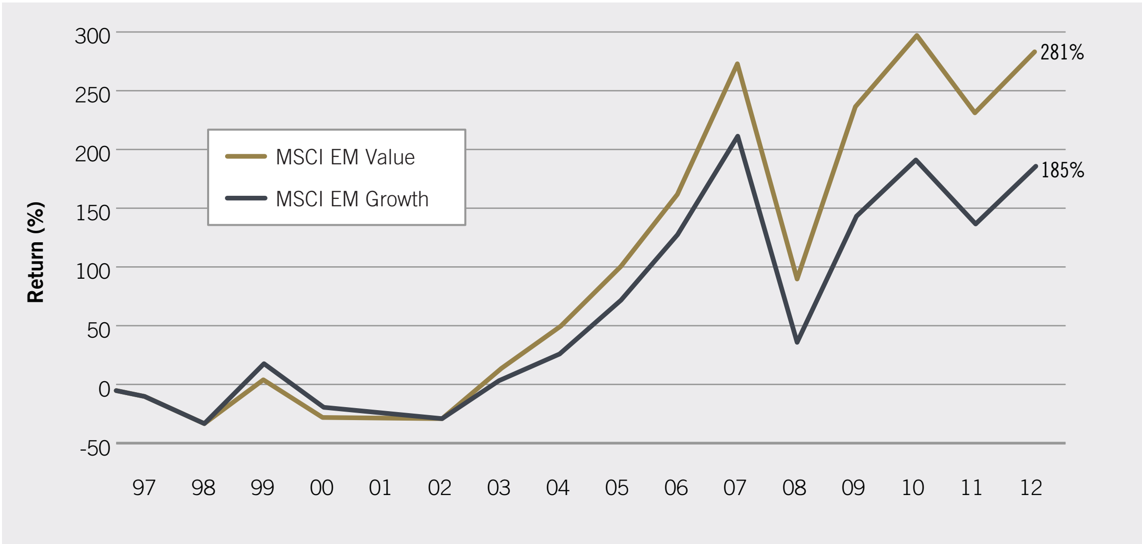


Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/2012. Past performance is not a guarantee of future results.

The value premium was also evident when comparing the MSCI Emerging Markets Growth and Value Indices. Although annual performance data for the indices only became available beginning in 1997, there is strong evidence of a value premium, with value stocks delivering an annualized outperformance of 1.96% over growth stocks. The outperformance was even more significant over the last 10 years; with value registering 3.52% annualized outperformance over growth.

Exhibit 4 shows the significant impact this outperformance can make on returns, even over a relatively short period.

Exhibit 4: MSCI EM Value Index Outperforms MSCI EM Growth Index



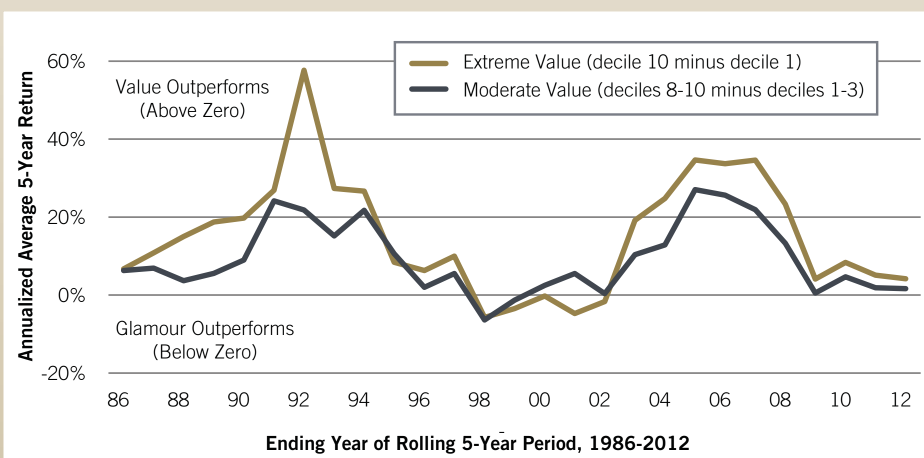
Source: FactSet, as of 12/31/2012. Past performance is not a guarantee of future results. Actual results may vary.
This hypothetical example is intended for illustrative purposes only. It does not represent the performance of any particular investments.

We then examined the price volatility in emerging markets and found the standard deviation for emerging markets was higher than developed countries. However, as seen in Exhibit 6, our study revealed little difference between value and the growth deciles in emerging markets.

MODERATE VERSUS EXTREME VALUE

On a price-to-book basis, exhibit 5 shows the returns for the extreme ends of the spectrum (decile 10 minus decile 1) as well as a broader comparison of priciest 30% of the universe (deciles 1, 2 and 3) from the average return for the cheapest 30% of the universe (deciles 8, 9 and 10). While the return advantage is not as pronounced using a broader range of deciles there is still a strong value premium.

Exhibit 5: Expanding the Value and Glamour Universe

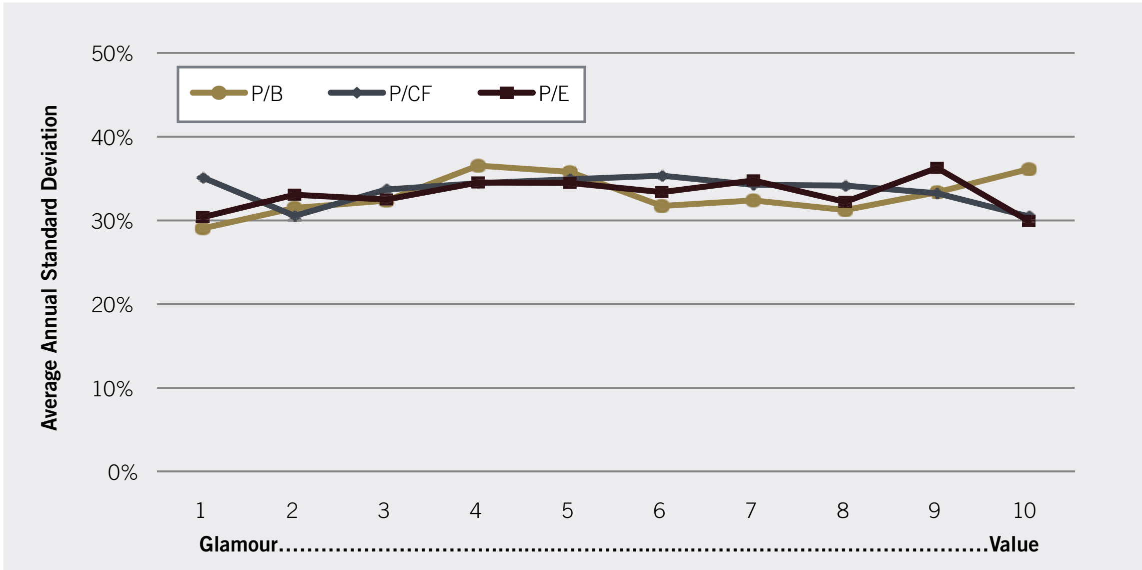


Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/2012.

Higher returns for value stocks, combined with a generally flat standard of deviation across deciles, suggest a greater premium per unit of volatility for value stocks.

Exhibit 6: Average Annual Standard Deviation by Decile

(P/B, P/CF and P/E Deciles, June 30, 1981– June 30, 2012)

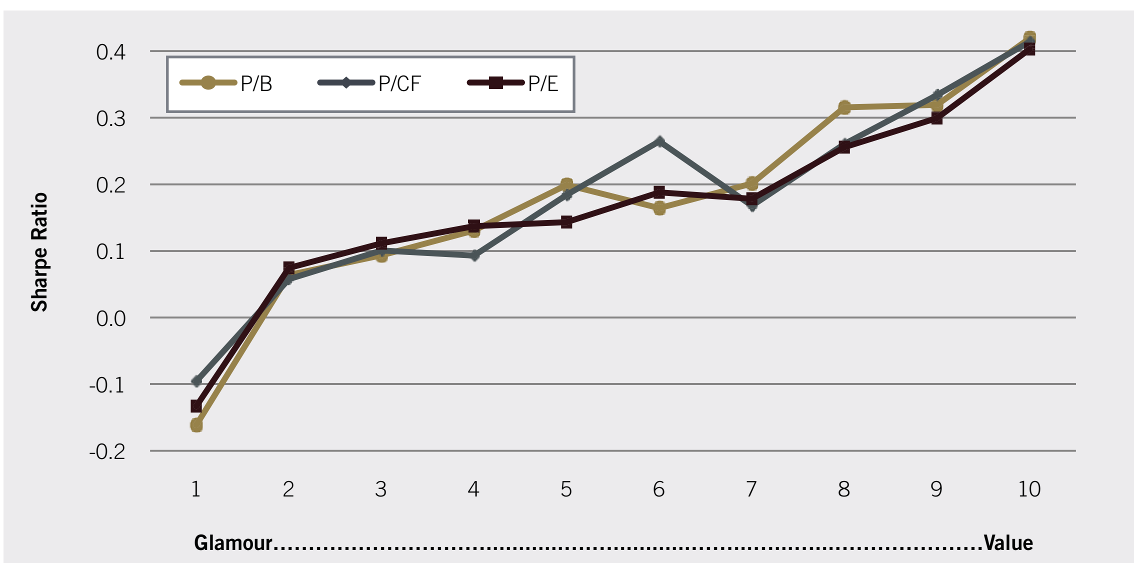


Source: Worldscope via FactSet, as of 6/30/12. Past performance is not a guarantee of future results.

Higher returns for value stocks, combined with a generally flat standard of deviation across deciles, suggest a greater premium per unit of volatility for value stocks. Exhibit 7 shows, a portfolio of decile 10 value stocks would have an average Sharpe ratio of 0.41 across metrics, while decile 1 growth stocks would average -0.13.

Exhibit 7: Decile-By-Decile Sharpe Ratio

(June 30, 1981–June 30, 2012)



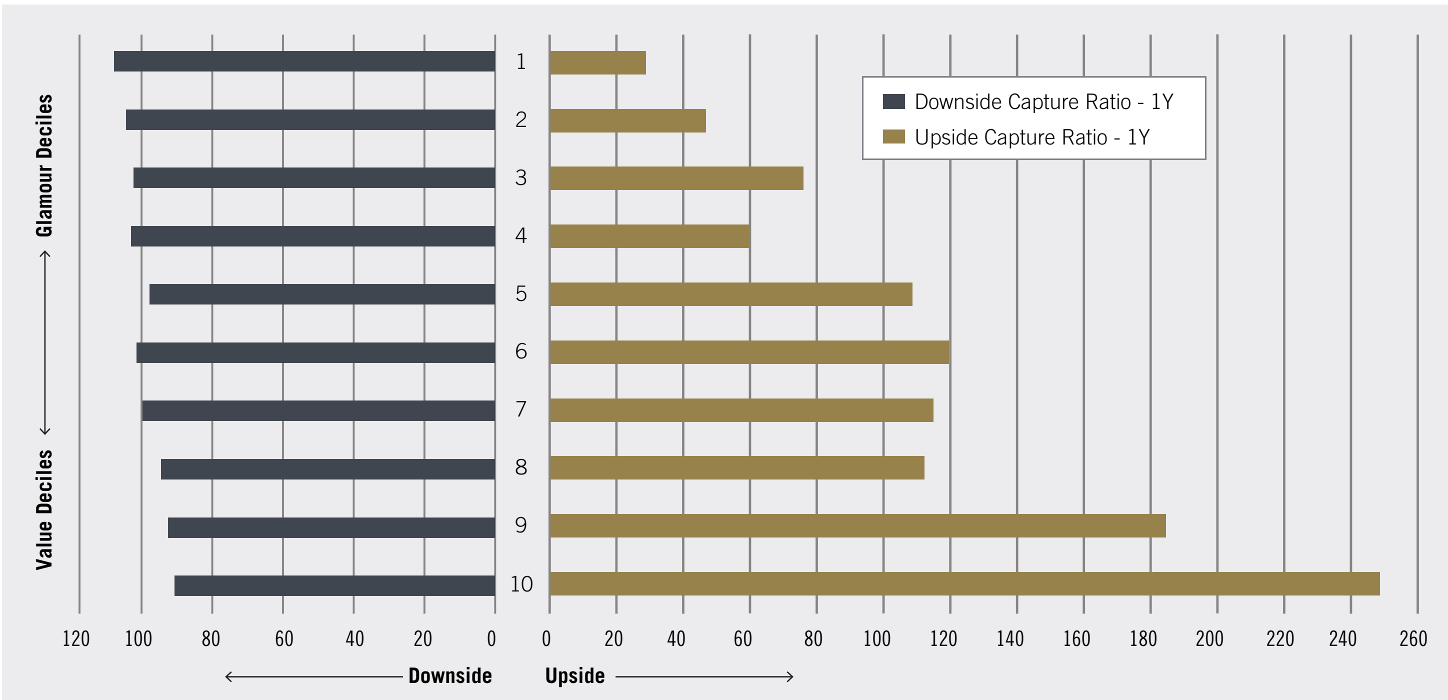
Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/2012
Past performance is not a guarantee of future results.

To measure the extent and possible source of this disparity, we examined the upside and downside capture of each decile by comparing it against the average return of holdings in the universe on an annual basis. For years where the average return was positive, we examined the extent that each decile benefited from that performance. For years with negative returns, we measured the degree each decile participated in the decline.

Exhibit 8 shows that decile 10 value stocks participated more as the market went up and fell less when the benchmark declined, offering both greater upside potential and downside protection.

Exhibit 8: Emerging Markets Upside and Downside Capture

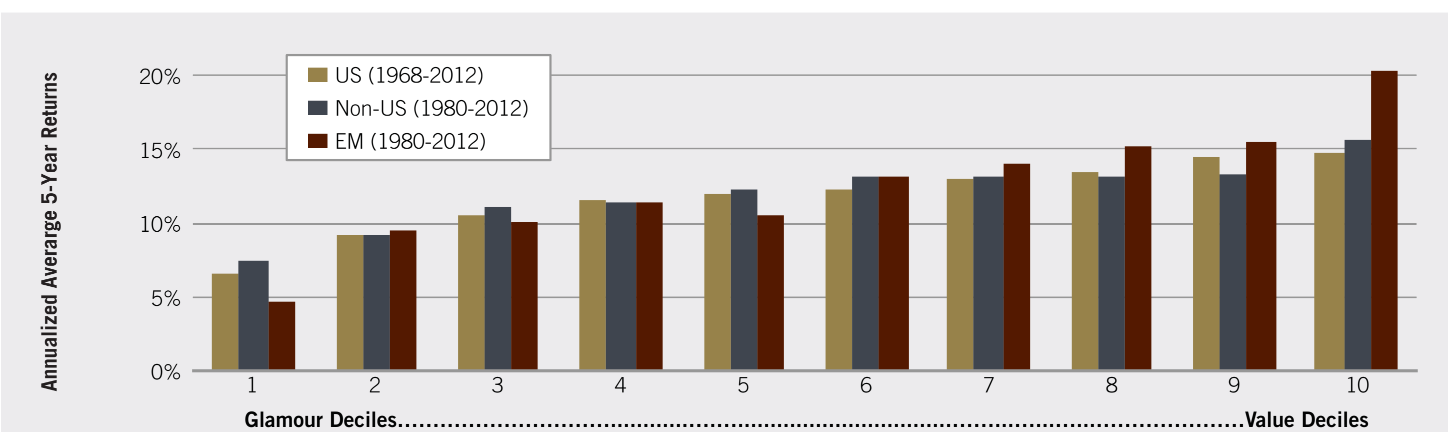
(January 31, 1987–January 31, 2012)



Source: Worldscope via Factset, The Brandes Institute; as of 6/30/2012. Past performance is not a guarantee of future results.

This apparent disparity in the risk-reward tradeoff may be contributing to the notable outperformance of value stocks in emerging markets, both in relationship to glamour stocks and to value stocks in the United States and other developed nations, as seen in Exhibit 9.

Exhibit 9: Annualized Average 5-Year Returns Across Geography



Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/2012. Past performance is not a guarantee of future results.

For value investors, this research may confirm the opportunities available in emerging market investing. As the results of this study show it is possible to generate competitive returns by focusing on companies selling at attractive valuation levels, and that high share price volatility does not necessarily equal greater downside risk.

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

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

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

The MSCI Emerging Markets Value Index with gross dividends is an unmanaged, free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of 21 emerging market country indices. Value and growth securities are categorized using a multi-factor approach with three variables to define the value investment style characteristics and five variables to define the growth investment style characteristics, including forward looking variables. Each security is placed into either the Value or Growth Indices, or may be partially allocated to both (with no double counting). The three attributes for Value index construction are: book value to price ratio, 12-months forward earnings to price ratio, and dividend yield. This index includes dividends and distributions, but does not reflect fees, brokerage commissions, withholding taxes, or other expenses of investing.

The MSCI Emerging Markets Growth Index with gross dividends is an unmanaged, free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets. The MSCI Emerging Markets Index consists of 21 emerging market country indices. Value and growth securities are categorized using a multi-factor approach with three variables to define the value investment style characteristics and five variables to define the growth investment style characteristics, including forward looking variables. Each security is placed into either the Value or Growth Indices, or may be partially allocated to both (with no double counting). The five attributes of Growth Index construction are: long-term forward earning 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. This index includes dividends and distributions, but does not reflect fees, brokerage commissions, withholding taxes, or other expenses of investing.

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