Emerging Markets

Third Quarter 2020

COMMENTARY

GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

Global Value Advisors is an investment boutique specializing in long-only international and global equities. GVA is a value investor and its research shows that companies that generate positive Free Cash Flow and return capital to shareholders outperform the market. GVA uses a disciplined methodology to isolate an advantaged subset of the universe and then applies fundamental research to identify companies with sustainable Free Cash Flows to maintain their assets, finance their growth and return capital to shareholders.

Total Returns (Net of Fees)	Q3
GVA Emerging Markets	**-0.6%**
MSCI Emerging Markets Index	9.6%
MSCI Emerging Markets Value Index	4.7%
MSCI Emerging Markets Growth Index	14.2%

Regional Indices	Q3
MSCI China	12.5%
MSCI Korea	12.8%
MSCI Taiwan	16.5%
MSCI India	15.0%
MSCI Emerging Markets Small Cap	11.9%

Global equity markets continued to rebound in the third quarter and are now back to all-time highs. We are still in the early stages of the economic recovery from the COVID-19 pandemic. Central banks around the world are likely to remain highly accommodative, which should be supportive to equities. If the economic recovery continues to normalize, markets look well placed to see a rotation away from technology/growth leadership into value/cyclical names. Market valuation ratios appear stretched in the US, suggesting we should see a rotation into International and Emerging Markets. Following a decade-long run, the US dollar has also showed signs of rolling over, which should benefit international stocks. GVA is well positioned to benefit from reversal in all three of these long term trends.

Value stocks posted disappointing performance in the third quarter. Market participants continued to rotate into growth stocks, despite the valuation gap between growth and value now wider than at the height of the TMT bubble. In the quarter, MSCI Emerging Markets Value Index underperformed its Growth counterpart by 9.5%. In the first nine months of 2020, value underperformed growth by a staggering 27%. For comparison, the worst full year of the TMT bubble in 1999 saw value underperform growth by 21% for the year.

Underperformance in the quarter was due mostly to stock selection effects. GVA's strategy focuses exclusively on higher quality companies with strong Free Cash Flow, high Shareholder Yields (i.e. dividends + buybacks + debt repayments), solid balance sheets, and cheap valuations. Companies with this profile were out of favor as growth significantly outperformed value and lower quality companies outperformed the index, specifically those with negative Free Cash Flow and negative Shareholder Yields. History suggests that "junk rallies", like the one experienced in the quarter, are typically short lived.

The strategy's largest sector detractor in the quarter was Consumer Discretionary, despite it being the top performer in the MSCI Emerging Markets Index. GVA's Consumer Discretionary stock selections underperformed, as the sector saw a large divergence between growth and value stocks. This more than offset strength in Communication Services. Country weakness was fairly broad based in the quarter, with China being the standout underperformer.

CONTINUED >>

GVA's cyclical exposure has been a drag on performance in Q3 and YTD 2020, but it also positions us for significant outperformance once we see rotation out of the extreme market dynamics experienced this year.

As a reminder, GVA's value strategy focuses exclusively on the cheapest 20% of companies in its universe without sacrificing profitability or balance sheet strength. GVA only owns companies that generate consistent free cash flow, return cash to shareholders and have low debt levels. GVA's portfolio has an above average ROE, does not style drift and is well positioned for the eventual rebound in value. GVA's approach typically provides the added benefit of outperforming in modest growth led markets (i.e. if the current trend were to continue but at a more moderate pace).

GVA's Advantaged Subset Through The Economic Cycle
Investment Implications

GVA has identified an Advantaged Subset of the investment universe consisting of superior companies with structural tailwinds. All of these companies share the following attributes: they rely on the cash generated by their own operations to finance their growth and they return what is left to their shareholders either directly via dividends or indirectly through share buybacks or debt repayments. GVA's research shows that, independent of valuation, this collection of companies (the "Advantage Subset") has outperformed the MSCI Emerging Markets Index by 2.6% annually over the past 20 years at a lower level of risk (volatility). The structural edge of these superior companies can be observed across geographies, sectors, company sizes and, most importantly, the edge is robust through time. Because they are predominantly internally financed and because they adhere to a disciplined capital allocation process, these companies tend to exhibit higher profitability and lower financial leverage than the rest of the universe.

Over time, this Advantaged Subset in Emerging Markets represents about 40% of the investable universe but that number fluctuates over the course of the economic cycle. For example, in the middle of a recession, as more companies struggle to generate positive free cash flows, external capital is often needed, dividends are sometimes cut and, consequently, many companies leave this Advantaged Subset. Then, as the economy picks up and the excesses of the previous cycle get corrected, profitability rebounds, cash generation recovers, and dividend payments, share buybacks or debt repayments are reinstated. When this occurs, companies gradually migrate into the Advantaged Subset. The proportion of names in that subset is a good indicator of the relative returns of the subset: the lower that number, the higher the relative returns generated by this pool of superior companies. Conversely, if that subset becomes crowded, its relative return becomes mechanically constrained.

The recent crisis has triggered a major exodus out of GVA's pool of superior companies. At the end of December 2019, a record 55% of the stocks in GVA's emerging markets universe were included in the Advantaged Subset. At the end of September 2020, that number collapsed to 41%. This drastic cleansing of the opportunity set puts the core of GVA's approach in a stronger position to outperform going forward.

Top 3 Performers in Q3 2020

IGG, Inc (799-HK)
IGG is an online and mobile game developer, based in Taiwan. Sales are geographically diversified, with a high exposure to Asia. 1H 20 results reported in August were ahead of expectations. The company is benefiting from accelerated growth due to enhancements made to its key asset, as well as higher user engagement from COVID-19. The company's fundamentals are solid, with $2.6bn HK of net cash on the balance sheet or 24% of the market cap. Cash continues to pile up, as the company generates a 14% FCF yield. Dividend yield is 5%. Shareholder Yield is 6% and forward 1 year PE is 7x.

CONTINUED >>

Kingboard Laminates Holdings Limited (1888-HK)
Kingboard Lamitates is a global market share leader in laminates for electronic components. Profits declined in the 1H 20, but this was mainly attributed to the COVID-19 suspension of a factory, which has since been reopened. The company's end markets are benefiting from COVID-19, as sales volume of PC/laptop laminates surged 6x in the 1H 20. Kingboard is also viewed as a good proxy for the Chinese economic recovery. The balance sheet is strong with $2.3bn HK in net cash or 6% of the market cap. FCF Yield is 4%, Shareholder Yield is 13%, and forward 1 year PE is 14x.

Hana Microelectronics (HANA-TH)
Hana Microelectronics is based in Thailand and manufactures electronic components, primarily printed circuit boards. The company reported strong Q2 20 results in early August. The company has seen limited impact on its fundamentals from COVID-19, with Q2 earnings up 10% year over year. End demand for electronic products has been fairly resilient in 2020. Hana Microelectronics has reported positive FCF every year for the last decade. The balance sheet is solid with 9bn THB in net cash or 25% of the market cap. FCF Yield is 5%, Shareholder Yield is 5%, and EV/EBITDA is 12x.

Bottom 3 Performers in Q3 2020

Piraeus Bank S.A. (TPEIR-GR)
Piraeus Bank provides retail and commercial banking services in Greece. The company reported Q2 20 results in early August that were ahead of low expectations. The bank saw a rebound in net profits and an improvement in its capital position. Despite these improvements, investors remain worried about the limited visibility for Greek lenders. GVA sold its position in Piraeus Bank in September, as Shareholder Yield turned negative on a trailing twelve month basis.

Sinopec Shanghai Petrochemical (338-HK)
Sinopec Shanghai Petrochemical (SSP) engages in the processing of crude oil into petroleum and other chemical products. The company reported Q2 20 results in late August that were below expectations. The company's cost cutting efforts and its shift in business mix were not enough to offset the declines in refining and chemical margins. Lower transportation fuel demand due to COVID-19 is having a negative impact on results. SSP has a strong balance sheet to weather the downturn, with $6.7bn HK in net cash or 19% of the market cap. FCF Yield is 14%, Shareholder Yield is 6%, and P/B is 0.5x.

TATNEFT PJSC (TATN-RU)
Tatneft engages in the exploration, development and production of crude oil in Russia. The company reported Q2 20 results in late August that were ahead of expectations. That being said, profits were still down 66% in the quarter. The oil industry is under pressure from lower demand due to COVID-19. Brent crude ended the quarter at $40 per barrel, which was down from $60 per barrel one year ago. Tatneft is well positioned to weather the downturn. The company is a low cost producer and has a strong balance sheet with net debt/equity at only 5%. FCF Yield is 15%, Shareholder Yield is 19%, and forward 1 year PE is 10x.

CONTINUED >>

Please feel free to contact us with any questions or comments. Thank you for your interest in Global Value Advisors. We look forward to updating you again next quarter.

Sincerely,



Phillippe Rolland
CIO, Portfolio Manager

Todd Bassion, CFA
Portfolio Manager

Matthew Marotta
Investment Research
Portfolio Implementation

OFFICE CONTACT

18 Sewall Street
Marblehead, MA 01945

Phone
(781) 639-2750

Fax
(781) 639-2751

Disclosures

The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. A complete list of all securities recommended during the preceding year is available upon request. Past performance is not indicative of future results. The calculation methodology for the contributions to performance and a list showing all holdings' contribution to the overall strategy's performance during the measurement period is available upon request at information@globalvalueadv.com or by calling (781)-639-2750.

For comparison purposes, the GVA Emerging Markets strategy performance is measured against the MSCI Emerging Markets Index.

Past performance is no guarantee of future results. Returns are presented gross and net of management fees and include the reinvestment of all income. More information about such fees and expenses applicable to a client's investment are generally available in the Form ADV Part 2A of Moody Aldrich Partners, LLC, which is publicly available and upon request and provided to every client (along with Form ADV Part 2B) prior to investment. Actual returns may vary from the performance information presented. All performance numbers are expressed in US Dollars. This product does not use leverage, derivatives or short positions in its portfolio.

The information contained in this document is subject to updating and verification and may be subject to amendment. No representation or warranty is expressed as to the accuracy of the information contained and no liability is given by Global Value Advisors as to the accuracy of the information contained in this document and no liability is accepted for any such information. This document and the information contained within it are confidential and intended solely for the use of the individual or entity to whom they are addressed. If you are not named addressee you should not disseminate, distribute or copy this document or any of the information contained within it.

If you are not the intended recipient you are notified that disclosing, copying, distribution or taking any action in reliance on the contents of this information is strictly prohibited.