GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

Global Equity

Fourth Quarter2018

COMMENTARY

Global Value Advisors is an investment boutique specializing in long-only international and global equities. We are value investors, who buy businesses that are undervalued due to temporary, non-structural reasons. We believe in combining the discipline of quantitative investing with qualitative judgement informed by fundamental research. The key idea is companies that generate positive free cash flows and return capital to shareholders outperform the market.

Q4 2018 Total Returns (Net of Fees)	
GVA Global Equity	**-10.68%**
MSCI All Country World	-12.75%
Value Added	**+2.07%**
MSCI All Country World Value	-10.74%
MSCI All Country World Growth	-14.66%

Regional Indices	
MSCI USA	-13.81%
MSCI EAFE	-12.54%
MSCI EM (Emerging Markets)	-7.46%

The GVA Global Equity strategy returned -10.7% in the 4th quarter versus -12.8% for its benchmark, the MSCI All Country World index. During the quarter, Emerging Markets held up relatively well and the US market underperformed. The strategy is overweight Emerging Markets and underweight the US. Also critical to our strategy was the recent leadership of value stocks. Our overexposure to small and mid-capitalization companies compared to the index was a drag on performance for the second quarter in a row, as large capitalizations outperformed.

The strategy's outperformance of 2.1% was driven primarily by stock selection with a positive contribution from our regional allocation. After being a major headwind for most of the year, our overweight emerging and underweight the US paid off over the quarter. Most importantly, our stock selection in these two regions, as well as in Europe contributed significantly to the strategy's outperformance. Our holdings in the insurance, energy, retail and technology sectors showed particular resilience in this down market.

This encouraging result confirms the observations made when studying the back test of our strategy. The segment of the universe we focus on and invest in is made of cheap companies that generate enough cash flows to maintain their assets, finance their growth, and return what is left to their shareholders without relying significantly on external financing. These attributes provide the staying power that becomes critical when the economic environment deteriorates.

Our 19 year quantitative back test† (from 1999 to 2017) shows that our methodology does particularly well in down markets: over the period, the MSCI All Country World Index has had 6 down years. Our simulated portfolio beat the index in 5 of them. Importantly, the average relative return delivered in these down years is larger than the relative returns generated in up years. This downside protection does not come from defensive sector positioning. In each of these down years, our model had an overweight to cyclical industries. In some cases, that cyclical bet was significant. 2008 is a great example of that, with our model delivering +6.4% of excess return despite a sizable cyclical bet.

The performance attribution report on the following page illustrates the dynamics at work in the 2008 downturn and the staying power of the stocks held in our model portfolio.

†The information presented in the presentation represents back-tested performance based on our quantitative model and does not include fundamental analysis. The performance results shown represent a larger group of stocks than would be included if the fundamental analysis was applied. GVA's quant model narrows down our universe to approximately 125-175 stocks and then we conduct fundamental analysis in order to determine inclusion in the portfolio. The strategy being offered includes both the quantitative and qualitative analysis together however performance shown in the back-test only reflects the quantitative portion of analysis as the fundamental analysis cannot be applied. Back-tested presentations may not be relied upon for investment purposes and are not meant to represent actual current or future performance. Please see last page for more information regarding our back test.

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	31-DEC-2007 to 31-DEC-2008								
	GVA MODEL			MSCI All Country World			Attribution Analysis		
	Port. Average Weight	Port. Total Return	Port. Contrib. To Return	Bench. Average Weight	Bench. Total Return	Bench. Contrib. To Return	Allocation Effect	Selection Effect	Total Effect
Total	**100.0**	**-35.7**	**-35.7**	**100.0**	**-42.1**	**-42.1**	**-4.9**	**11.3**	**6.4**
Cyclical	71.6	-37.6	-28.2	57.5	-48.8	-29.2	-2.0	11.0	9.0
Consumer Discretionary	16.2	-36.7	-7.8	7.4	-43.5	-3.3	-0.2	0.8	0.6
Financials	25.1	-30.6	-7.3	19.8	-54.4	-11.8	-1.0	8.4	7.3
Industrials	11.8	-38.4	-4.3	10.9	-43.9	-4.6	-0.0	0.9	0.8
Information Technology	7.7	-47.3	-4.3	9.5	-43.8	-4.4	-0.1	-0.3	-0.4
Materials	9.7	-53.6	-4.6	8.1	-51.6	-4.3	0.4	-0.5	-0.1
Real Estate	1.1	-25.6	0.1	1.8	-46.1	-0.8	0.0	0.5	0.5
Defensive	28.4	-30.4	-7.5	42.5	-32.5	-13.0	-2.5	0.3	-2.2
Communication Services	11.3	-34.2	-3.6	6.8	-37.7	-2.2	0.1	0.3	0.4
Consumer Staples	4.3	-22.8	-0.7	8.7	-23.9	-1.9	-1.3	-0.0	-1.3
Energy	4.0	-44.9	-1.6	12.5	-42.3	-5.5	0.2	-0.2	-0.0
Health Care	4.1	-13.7	-0.5	9.2	-22.3	-1.9	-1.5	0.2	-1.2
Telecommunication Serv	2.1	-27.6	-0.6	0.6	-47.5	-0.3	-0.1	0.5	0.4
Utilities	2.6	-33.8	-0.6	4.7	-30.2	-1.2	-0.5	-0.0	-0.5

This is an important characteristic of our approach, and one that differentiates us from the so-called "quality-adjusted value" strategies that have mushroomed in the past 10 years, as an astute way to justify the drift away from the value style. We are not paying up for the key attributes we listed above, and this is why our model tends to guide us towards cyclical industries. Our approach provides some protection on the downside and it also positions us well when the cycle turns, as typically, our sector positioning then becomes a tailwind.

We feel very optimistic about our strategy's ability to deliver superior returns in the current market environment. The past 6 months have been an excellent way to challenge our investment principles and test our methodology. We managed to beat our index and most of our peers despite some significant headwinds.

Top 3 Performers

Fortescue Metals Group (FMG-AU)
FMG is an iron ore developer based in Australia. The company was the strategy's strongest performer in the quarter, following strong fiscal Q1 results in October. Investors were pleased to see iron ore pricing improving in the quarter. FMG's average sale price for iron ore rose to $55/ton, which is a $10/ton increase (+22%) over last quarter. The higher raw material prices more than offset the weak production (down 9% YoY) and rising cost inflation in the quarter. FMG's FCF has been positive in each of the last 5 years, with an average FCF yield of 20%. Management pays a 5% dividend and the balance sheet is strong with net debt to EBITDA at 1x. Forward 12 month PE is below 11x and the Enterprise Value/EBITDA is 2x.

Hanwha Chemical Corporation (009830-KR)
Hanwha Chemical Corp manufactures chemical products in Korea. The stock performed well in the quarter, as value stocks rebounded. Hanwha's valuation metrics trade at a significant discount to the market, with a forward 12 month PE at 6x, P/B at 0.6x, P/CF at 3x, and Enterprise Value/EBITDA below 6x. FCF has been positive in 4 out of the last 5 years, with an average FCF yield of 7%. Dividend yield is 2% and the balance sheet is in decent shape with net debt to EBITDA below 3x and interest

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coverage at 5x. Note that Q3 earnings reported in Nov were fairly weak across all business lines, with operating profits down 49% YoY and well below consensus estimates. We will be closely monitoring where the fundamentals go from here.

LG Uplus Corp (032640-KR)
LGU is a Korean telecom operator offering triple play services (mobile, internet, and IPTV). The market is consolidated with the top 3 mobile operators holding 80% market share (KT, SK, and LGU+). LGU is the smallest of the three and continues to take share, with KT still holding close to 50% of the market. LGU was a strong performer in Q4. The company reported another solid Q3 earnings in November. Operating profit rose by 7% YoY, which was ahead of consensus expectations. The company gained a record number of net mobile subscribers in the quarter. Strong cost controls more than offset ARPU declines. No changes were made to the company's stable dividend policy (dividend yield is 2%). Valuations remain cheap: PE NTM is 13x, P/B is 1x, and EV/EBITDA is 4x.

<u>Bottom 3 Performers</u>

Astellas Pharma (4503-JP)
Astellas Pharma is the 2nd largest pharma company in Japan. Astellas' share price underperformed the market in Q4 despite the company posting 1st half operating profits that were ahead of expectations and raising 2019 guidance. The company's mainstay product, Xtandi (cancer drug), drove the profit beat with +19% YoY growth in the US. Xtandi accounts for 10% of Astellas' sales and is the company's main growth driver. Investors are worried about the recent generic launch of rival drug Zytiga. Astellas feels that the impact will be limited, given its differentiated position. We continue to hold our position in the stock. Astellas has generated positive FCF in each of the last 10 years and regularly returns capital to shareholders. The dividend yield is 3% and management has reduced the share count by almost 20% over the last decade. Forward 12 month PE is 14x.

Target Corp (TGT-US)
Target is a leading US retailer with over 1,800 stores. The stock sold off following Q3 results that were slightly below expectations. We continue to hold the stock as fundamentals appear healthy and the free cash generation is strong. Same store sales were a respectable 5.1% in Q3 (consensus was looking for 5.5%). EPS grew by 20% YoY to $1.09, which was just shy of the street at $1.11. Management reiterated its 2018 guidance. Target should benefit from its loyalty program, growth in digital sales, and a series of new exclusive brand launches. The company is also well positioned to take market share from the Sears bankruptcy. Almost 600 Target stores (1/3 the store base) are located within a 5 mile radius of a Sears. Target's FCF has been positive every year for the last decade. Management pays a 4% dividend yield and regularly buys back stock. Forward 12 month PE is 12x.

Star Petroleum Refining (SPRC-TH)
Star Petroleum is a crude oil refiner based in Thailand. The stock underperformed in Q4, as Brent Crude prices plummeted from $77 per barrel down to $50 (a 35% decline). Note that oil prices have since rebounded to close to $60 per barrel. Star reported Q3 results at the beginning of November. Core earnings were down 88% YoY, which was slightly below consensus. Note that Q4 results should see some rebound, as there was a 20 day maintenance shutdown impact in Q3. Star's FCF has been positive in each of the last 6 years, with the most recent annual FCF yield at 14%. Dividend yield is 4% and the balance sheet is strong with close to zero debt. Forward 12 month PE is 9x and Enterprise Value/EBITDA is 5x.

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GVA Case Study: Autos

Automotive stocks are a good example of where GVA has added value through fundamental analysis. As a reminder, GVA's model picks stocks based on four cornerstone investment criteria:

1. Strong and consistent Free Cash Flow (FCF) generation.
2. Strong and consistent Shareholder Yield defined as dividends + net buy backs + change in debt.
3. Cheap valuation.
4. Solid balance sheets.

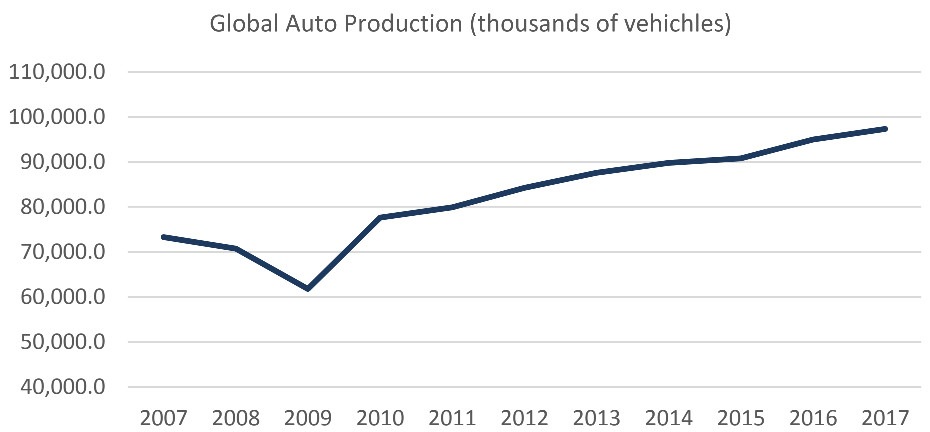
The investment team can only pick from names in the model output (100% compliant), and will then narrow the model name recommendations down to the fundamental portfolio. GVA's main limitation with its model is that the model is purely "backwards looking." The model identifies the very best companies in the world, based on average FCF generation and average shareholder yield over the last 7 years (average length of a business cycle). The model does not have an opinion on any areas outside of our four key investment criteria, such as the competitive environment, macroeconomic factors, interest rate sensitivity, or where we are in the business cycle.

In relation to the Auto Industry, the model correctly identifies 4 stocks that have best-in-class FCF and shareholder yields. The companies also have strong balance sheets and trade at cheap valuations (cheapest 20%). However, the model does not identify that we are likely at the peak of the auto cycle and that there are signs the fundamentals are rolling over. GVA believes that the strong results the model is seeing over the last 7 years with auto stocks will not be repeated in the next 3-5 years. As a result, we have excluded all four names the model wants to purchase from our fundamental portfolio. So far, this decision has been prudent.

Why has GVA excluded auto stocks:

Global auto growth has been strong over the last 7 years, but there are signs that industry fundamentals area breaking down. Auto stocks tend to be highly cyclical and purchases are mostly completed with financing. Higher interest rates and slowing global GDP growth will likely be a structural headwind to growth. At the same time, the four auto stocks the model wants to purchase have operating margins near historical highs. This gives investors little margin of safety, if the industry continues to deteriorate.

In terms of global auto production, we are well above the peak levels seen in 2007:



Source: Factset, OICA - International Organization of Motor Vehicle Manufacturers

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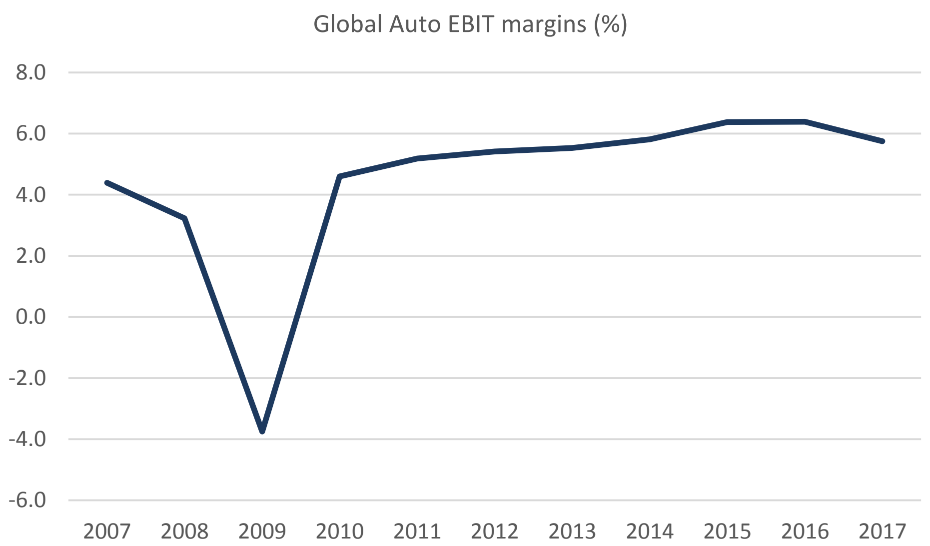
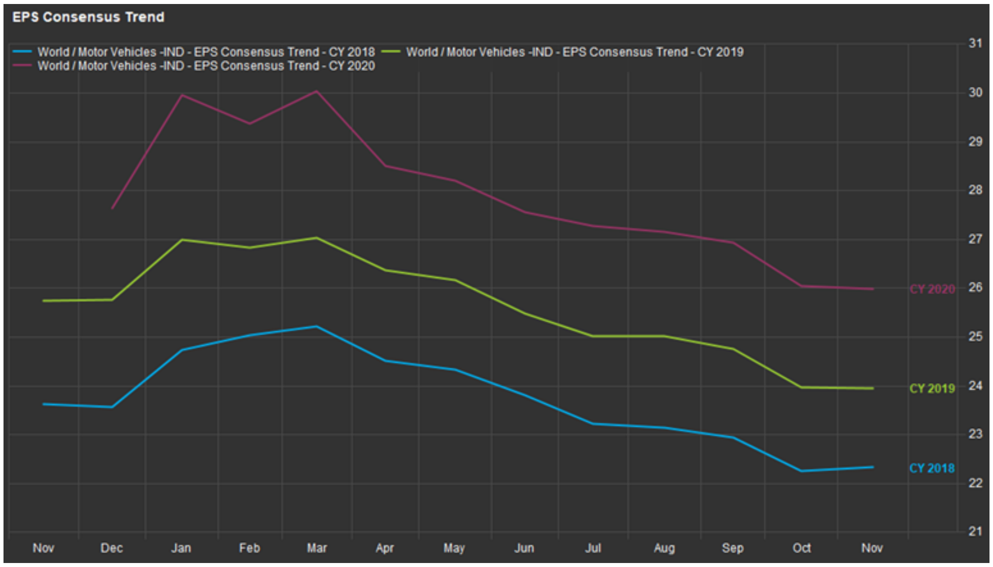
Global auto operating margins peaked in 2016 and have started to roll over:



Source: Factset aggregates

Global auto consensus EPS estimates are coming down in each of the next 3 years:



Source: Factset

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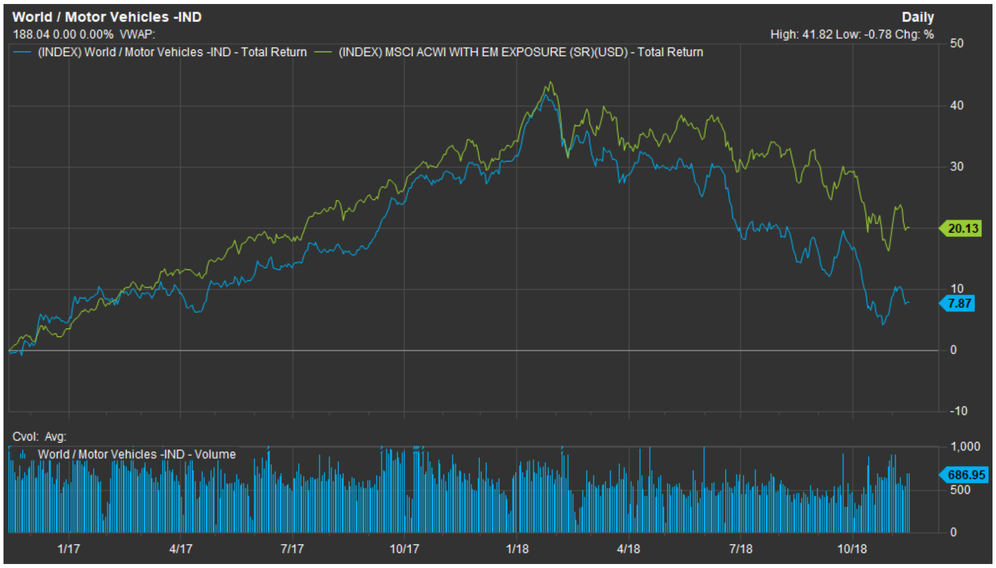
Auto stocks started underperforming global indexes at the beginning of 2018:



Source: Factset

We welcome your feedback or questions and appreciate your interest in Global Value Advisors.

Sincerely,

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For comparison purposes, the GVA International Small Cap Equity strategy performance is measured against the MSCI All Country World ex-US Small Cap.

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.

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Back-tested performance is hypothetical (it does not reflect trading in actual accounts) and is provided for informational purposes only to indicate historical performance had the portfolios been available over the relevant time period. Securities were selected with the full benefit of hindsight, after their performance over the period shown was known. There are inherent limitations of data derived from retroactive application of a quant model portfolio. The results may not reflect the impact that any material market or economic factors might have had on GVA's use of the back-test quant model if the quant model had been used during the period to actually manage client assets. GVA was not managing money during the period tested. For comparison purposes, the GVA Global Equity Quant Model performance is measured against the MSCI ACWI Index. Results do not reflect fees or expenses. Results in back-test do not guarantee future results.

GVA's quant model identifies companies with positive free cash flows, that have positive total return to shareholders, excludes companies whose leverage is in the highest 20% of the starting universe, are the cheapest 20% of the starting universe and illiquid companies are eliminated. FX is implicit in the total return. GVA's quant model back test assumes it is fully invested with no cash and includes the reinvestment of all income. The U.S. dollar is the currency used to express performance. All returns are presented gross of investment management fees, trading costs, and all other costs, expenses and commissions associated with client account trading. As there are no fees or expenses deducted, actual client returns could be materially different. The client may experience a loss.

Quant Model Universe: The GVA quant model uses the largest 5000 companies in the world as the available set of securities for each period, which are sourced from Factset.
Financial Data: The quant model uses trailing twelve month financial statement data that is sourced from the FactSet Fundamentals database. The quant model applies a date lag for each data item to avoid look-ahead bias.
Managing Quant Modeling Mistakes
Overfitting: The quant model uses a limited number of simple factors applied to a significant population size. Overfitting generally occurs with too many (and/or overly complex) factors, and with an insufficient sample size. Also, when running the quant model against various equity universes (global all cap, international all cap and international small cap), the back-tests perform consistently.
Survivorship Bias: GVA's quant-model universe consists of historical index constituents, thus eliminating any survivorship bias.
Look-ahead Bias: GVA's back-test applies a date lag to all factors used in the quant model to ensure that each observation period only uses financials that had been reported as of the observation date. The lagged back-test juxtaposed to a non-lagged back-test clearly indicates a significant bias is removed by lagging the dates.

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