GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

Global Equity

First Quarter 2019

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.

Q1 2019 Total Returns (Net of Fees)	
GVA Global Equity	**9.52%**
MSCI All Country World	12.18%
Value Added	**-2.66%**
MSCI All Country World Value	9.90%
MSCI All Country World Growth	14.48%

Regional Indices	
MSCI USA	13.74%
MSCI EAFE	9.98%
MSCI EM (Emerging Markets)	9.92%

The GVA Global Equity strategy returned 9.59%/9.52% (gross/net) in the 1st quarter of 2019 versus +12.18% for its benchmark, the MSCI All Country World index. The quarter saw a significant recovery of global markets after a dismal Q4 2018.

The -2.66% relative performance of the fund was driven by a negative regional allocation impact combined with a weak stock-picking contribution, generally a reflection of the value style being out of favor this quarter: the MSCI ACWI Value Index returned +9.90% for the quarter and the MSCI ACWI Growth Index returned +14.48%. Our overweight Japan penalized us, as the country and its currency's defensive nature were a headwind in the global equity markets recovery. Similarly, our positive bet in Emerging Markets coupled with a negative USA bet contributed negatively to performance. Overall, our underweight technology combined with poor stock selection in transportation, telecommunication services and retail, were the main detractors in the portfolio.

The market dynamics observed in Q1 2019 were pretty much the exact opposite of those seen in the big market scare at the end of 2018. Following the Federal Reserve's interest rate policy U-turn in January 2019, equity markets recouped most of what they had lost late last year as "risk-on" kicked in and value stocks lagged lower quality and more richly valued companies.

Our investment methodology characterizes 'risk' as the inability for a company to internally finance its operations: it has a negative free cash flow and relies on external sources of financing (debt or equity) to survive. Our research shows that over the past 20 years, these companies structurally underperform (by 8% annually) our pool of "better" companies, the ones that generate positive free cash flow and positive shareholder yield[†].

[†]Shareholder Yield = Dividends + Net Buy Backs + Change in Debt. Free Cash Flow = Cash Flow from Operations minus CapEx.

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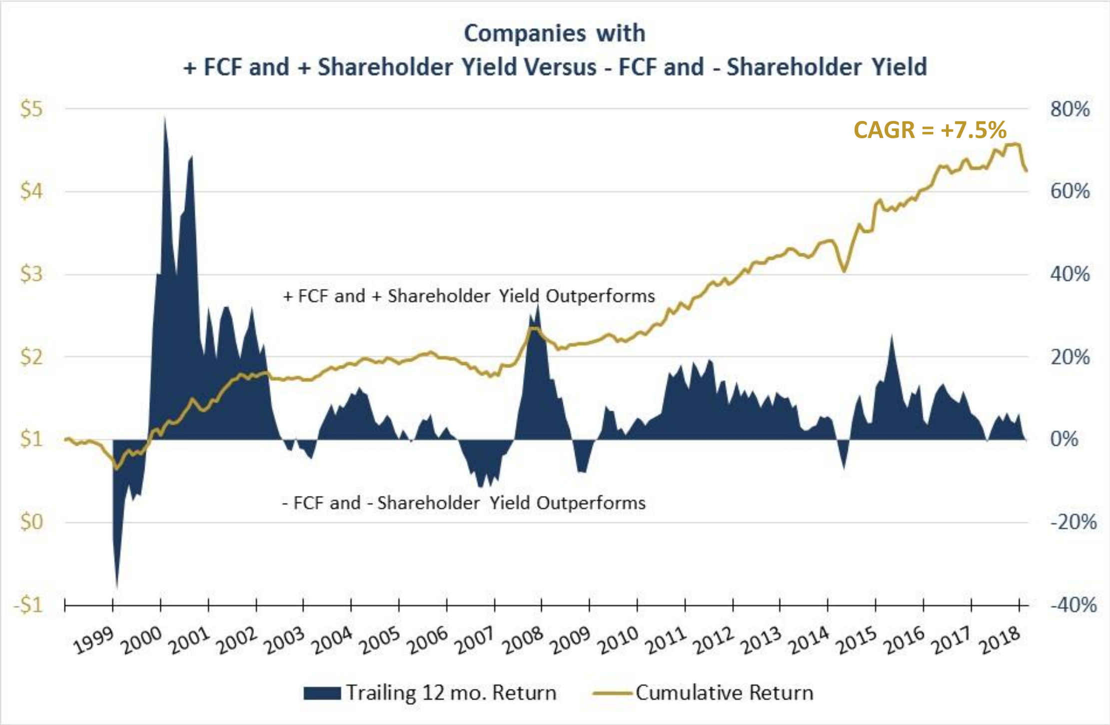

Source: Factset, Largest 5,000 market cap companies in the world. Equally weighted returns.

Only 5 times have companies with negative FCF and Shareholder Yield outperformed on a trailing twelve months basis. The outperformance of the risky names was typically short lived (less than a year), and usually coincided with bubble episodes (1999 and 2007) or central bank interventions. The first quarter of 2019 saw a similar pattern which was a headwind to our portfolio.

These brutal stock market fluctuations and changes in style leadership have no influence on our investment methodology: we are committed to value and our portfolio will always trade at a significant valuation discount to the market. Similarly, we are not now nor will we ever be exposed to companies with negative FCF or negative Shareholder Yields.

Our systematic approach ensures adherence to our key investment principles: the companies we invest in generate sufficient cash flow to maintain their assets, internally finance their growth and return unused capital to shareholders, either directly through the payment of dividends or indirectly through share buybacks or debt repayments. We avoid debt laden companies, and most importantly, we only purchase companies with cheap valuations using a blend of standard valuation metrics. We revisit, on a monthly basis, the compliance of each stock within the portfolio: any non-compliant name will be sold immediately. This prevents any drift away from our investment philosophy.

Our discipline produces a differentiated strategy compared to our peers, as illustrated by the research paper published earlier this year by Martin Lettau, Sydney Ludvigson and Paulo Manoel titled “Characteristics of Mutual Fund Portfolios: Where are the Value Funds?”. It studies the positioning of active mutual funds, Exchange-Traded Funds and hedge funds through the lens of risk factors mainly size, value and momentum. Their observations are summarized here:

> *“We show that that* ***these funds do not systematically tilt their portfolios towards profitable factors, such as low price to book ratios, high momentum, small size, high profitability and low investment growth****. Strikingly, there are virtually no low price to book funds in our sample while there are many high price to book “growth” funds.*

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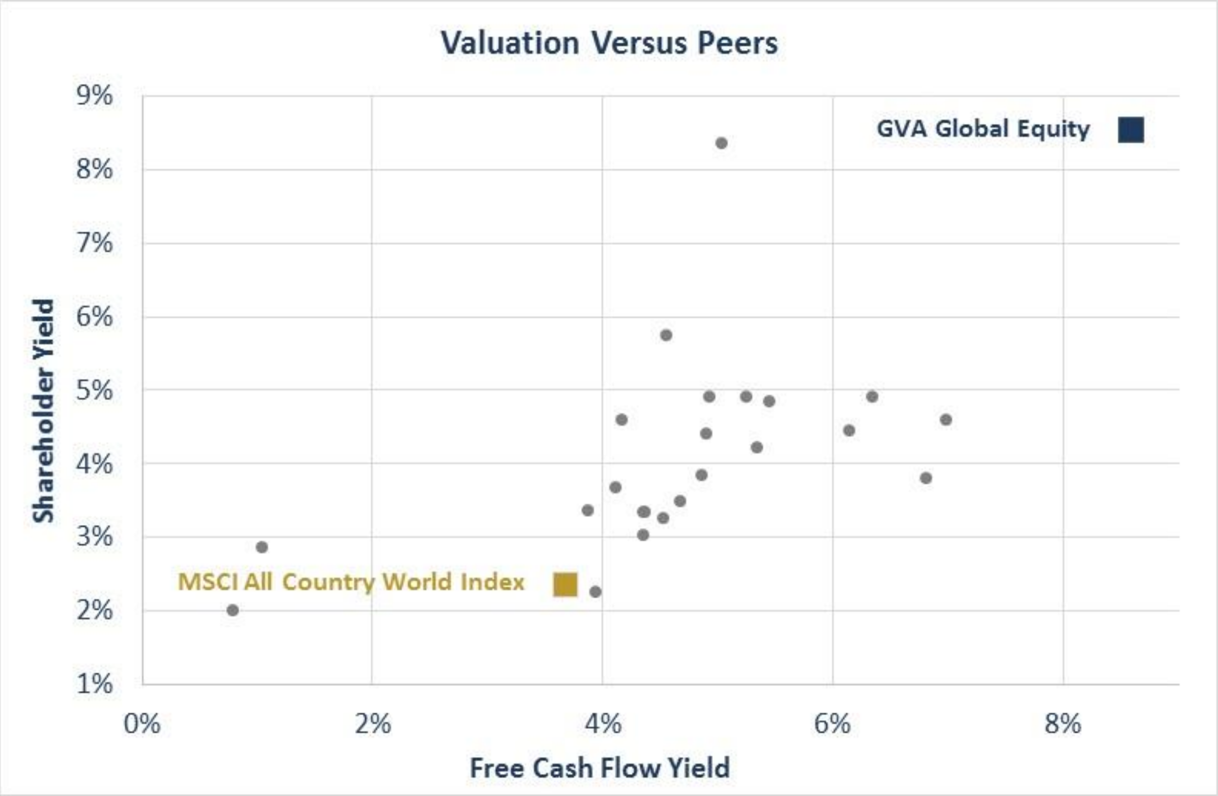
> *Portfolios of "growth" funds are concentrated in high price to book stocks **but "value" funds hold stocks across the entire price to book spectrum. In fact, most "value" funds hold a higher proportion of their portfolios in high price to book ("growth") stocks than in low price to book ("value") stocks.** While there are some micro/small/mid-cap funds, the vast majority of mutual funds hold very large stocks. But the distributions of mutual fund momentum, profitability and investment growth are concentrated around market average with little variation across funds. The characteristics distributions of ETFs and hedge funds do not differ significantly from those of mutual funds. We conclude that the characteristics of mutual fund portfolios raise a number of questions about why funds do not exploit well-known return premia."*

Our portfolio positioning is significantly different from our peer group, as our investment approach precisely tries to take advantage of the return premia discussed in the above study, such as value, small size, high profitability and low investment growth. For instance, the following graphs demonstrate the magnitude of our value tilt versus peers combined with a top-of-class low debt profitability level. In addition, our portfolio is tilted toward smaller companies and low investment growth stocks, as our focus on cash generation and return to the shareholders disqualifies aggressive spenders and favors low investment growth businesses.



Source: eVestment Alliance constituents in the Global Value Equity peer universe as of March 31, 2019. Holdings, ex-financials, for each fund were analyzed in FactSet.

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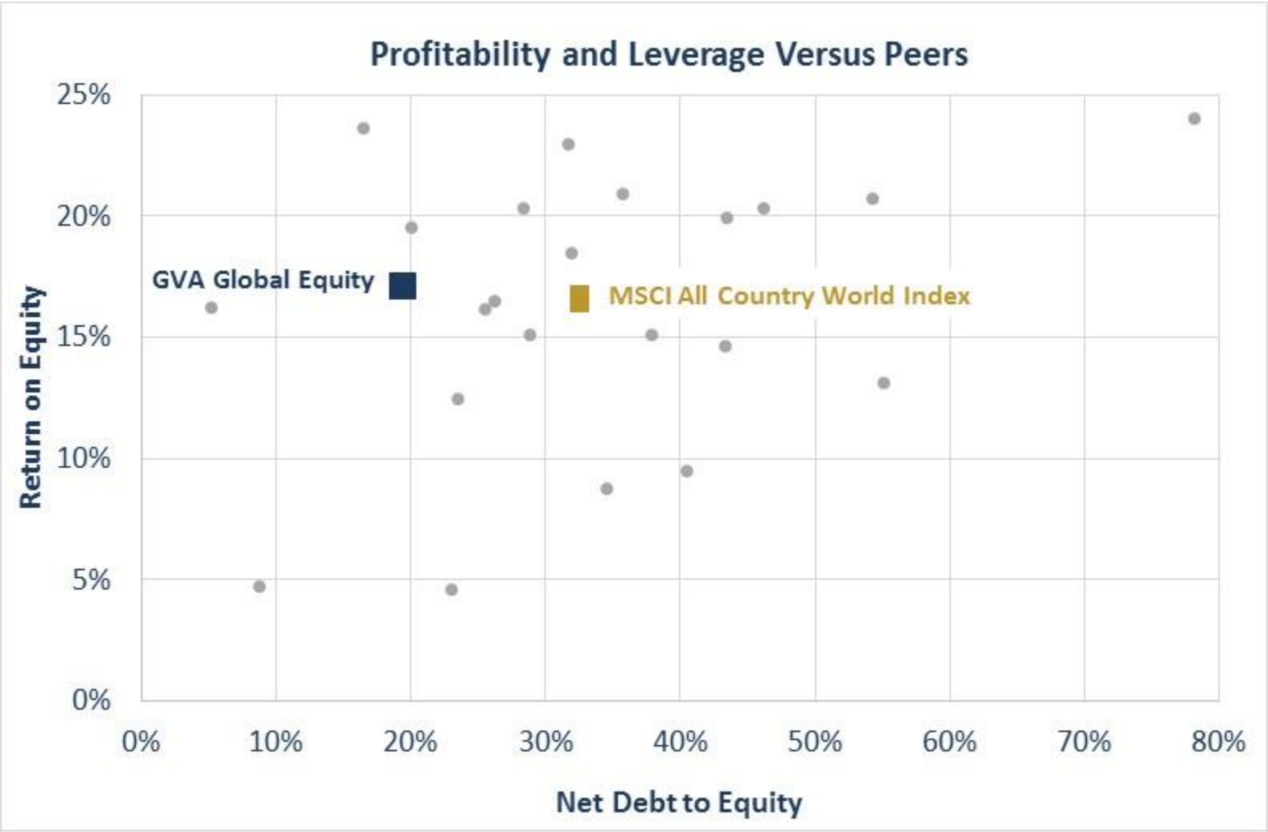

Source: eVestment Alliance constituents in the Global Value Equity peer universe as of March 31, 2019. Holdings, ex-financials, for each fund were analyzed in FactSet.. Median ROW and Net Debt to Equity.

Small Size Premia:
Median Market Cap Vs. Peer Group ($M)

Quintile 1	GVA Global Equity $8,652	$0 - $11,500
Quintile 2		$11,500 - $21,000
Quintile 3		$21,000 - $29.000
Quintile 4		$29,000 - $41,600
Quintile 5		Over $41,600

Low Investment Growth Premia:
Median Total Assets CHANGE over 12 Months Vs. Peer Group

Quintile 1	GVA Global Equity -1.9%
Quintile 2	
Quintile 3	
Quintile 4	MSCI ACWI +2.4%
Quintile 5	

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We remain steadfast in our confidence that GVA's disciplined approach, that captures several proven alpha premia, will deliver superior returns over time.

Top 3 Performers

Fortescue Metals Group (FMG-AU)
FMG is an iron ore producer based in Australia. The company reported strong quarterly results in January and reiterated full year guidance. Iron ore pricing has been rising and the commodity had an additional spike higher in Q1, following the significant dam failure at Vale (major competitor). FMG's achieved price for iron ore rose to $48/ton, which is a $5/ton increase (+12% YoY). Iron ore production was also healthy at 42.5 tons (up 5% YoY). Higher production and better pricing easily offset the rising cost inflation in the quarter (+8% YoY). FMG's FCF has been positive in each of the last 5 years, with an average FCF yield of 20%. Management pays a 4% dividend. The balance sheet is strong with net debt to EBITDA at 1x. PE NTM is 8x and the EV/EBITDA is 7x.

Cosan S.A. (CSAN3-BR)
Cosan is a Brazilian based holding company, which produces sugar and ethanol. Cosan reported strong Q4 results in mid-February with EBITDA coming in at R$1.5bn (+23% YoY and 4% ahead of consensus). Among the 3 operating businesses, Raízen Combustíveis and Comgas had strong numbers due to higher volumes and the consolidation of Argentina. Weakness in the third business, Raízen Energia, was more than offset by positive results elsewhere. FCF has been positive in 7 of the last 10 years, with an average FCF yield of 5%. Management pays a 2% dividend. The balance sheet is decent with total debt/cap at 52%. PE NTM is 11x and EV/EBITDA is 14x.

Novatek Microelectronics (3034-JP)
Novatek is a semiconductor company based in Taiwan. The shares were up almost 40% in the quarter in USD. Q4 results reported in February were significantly better than the company's guidance and consensus estimates. Strong results were driven by a favorable product mix and cost optimization. Operating margins came in at 16%, beating the high end of guidance. Net profits grew by nearly 30% YoY. Novatek has posted positive FCF in each of the last 10 years, and has an average FCF yield of 10%. Management pays a 4% dividend. The balance sheet is solid with $600Mln in net cash, or 14% of the market cap. PE NTM is below 16x and EV/EBITDA is 13x.

Bottom 3 Performers

LG Uplus Corp (032640-KR)
LG Uplus is a Korean telecom operator offering triple play services (mobile, internet, and IPTV). LGU was weak in the quarter, following strong share price performance in the 2H 18. Investors were disappointed with Q4 results (one-off impact), as well as a "cautious outlook" for 2019. Costs for 5G are expected to pressure 2019 earnings, but the short-term pain should position the company well competitively in 2020 and beyond. No changes were made to the company's stable dividend policy (dividend yield is 3%). The balance sheet is strong with net debt to EBTIDA at 1x. Valuation remains cheap: PE NTM is 11x, P/B is 1x, and EV/EBITDA is below 4x.

International Consolidated Airlines (IAG-GB)
International Airlines is the owner and operator of British Airways, Iberia, and Air Lingus. The shares are out of favor as investors worry about the uncertainty surrounding a hard Brexit scenario. Note that IAG reported strong Q4 results in late February, delivering 655m GBP in operating profit (+19% YoY and 13% ahead of consensus). Guidance for 2019 is looking for operating profits to be in-line with 2018. Despite the reassuring results, we recently sold our position in IAG. Management has done little to provide any contingency plans for a hard-Brexit scenario, and the business has the potential to be significantly impaired (i.e. all flights to Europe grounded). We plan to stay on the sidelines until we have more clarity on Brexit.

Pearson PLC (PSON-GB)
Pearson is an education company, delivering content through books and online services. The company provided mixed results in its Q4 trading update in January. Organic growth declined by 1%, and was dragged down by a deterioration in US Higher Education courseware. On the plus side, cost savings were ahead of expectations. This led to adjusted EBIT for 2018 of 546m GBP (3% ahead of consensus). Management expects top-line growth to resume in 2019, but the company has to prove they can deliver. Note that FCF generation has been positive every year for the last decade, with an average FCF yield of 7%. Dividend yield is 2%. The balance sheet is strong with LT debt/equity at only 15%. Valuation remains cheap: PE NTM is 14x, P/B is 1.4x, and EV/EBITDA is 7x.

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

Sincerely,

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For comparison purposes, the GVA Global Equity strategy performance is measured against the MSCI All Country World Index.

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