GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

Global Equity
Third Quarter 2020
COMMENTARY

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 Global Equity	**3.4%**
MSCI All Country World Index	8.1%
MSCI All Country World Value Index	4.0%
MSCI All Country World Growth Index	12.0%

Regional Indices	Q3
MSCI USA	9.5%
MSCI EAFE	4.8%
MSCI Emerging Markets	9.6%

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 3 of these long term trends.

Value stocks posted disappointing performance in the third quarter. Market participants continued to favor growth stocks, despite the valuation gap between growth and value now wider than at the height of the TMT bubble. In the quarter, MSCI ACWI Value Index underperformed its Growth counterpart by 8%. In the first nine months of 2020, value underperformed growth by a staggering 33%. For comparison, the worst full years of the TMT bubble, in 1998 and 1999, saw value underperform growth by 17% and 16% respectively.

Underperformance in the quarter was due to a combination of allocation and stock selection effects. GVA's strategy focuses exclusively on higher quality companies with strong Free Cash Flow, high shareholder returns, solid balance sheets, and cheap valuations. Companies with this profile were out of favor as growth significantly outperformed value.

GVA's globally unconstrained strategy takes advantage of material valuation disparities, demonstrated by the strategy's large overweight Emerging Markets and large underweight the US vs. the MSCI ACWI Index. We remain confident that these bets will pay off in the mid-to-long term, although they were each headwinds to the strategy in the quarter. In terms of sector exposure, Materials and Consumer Discretionary were the largest detractors, as the value stocks within the sectors underperformed their growth peers. 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.

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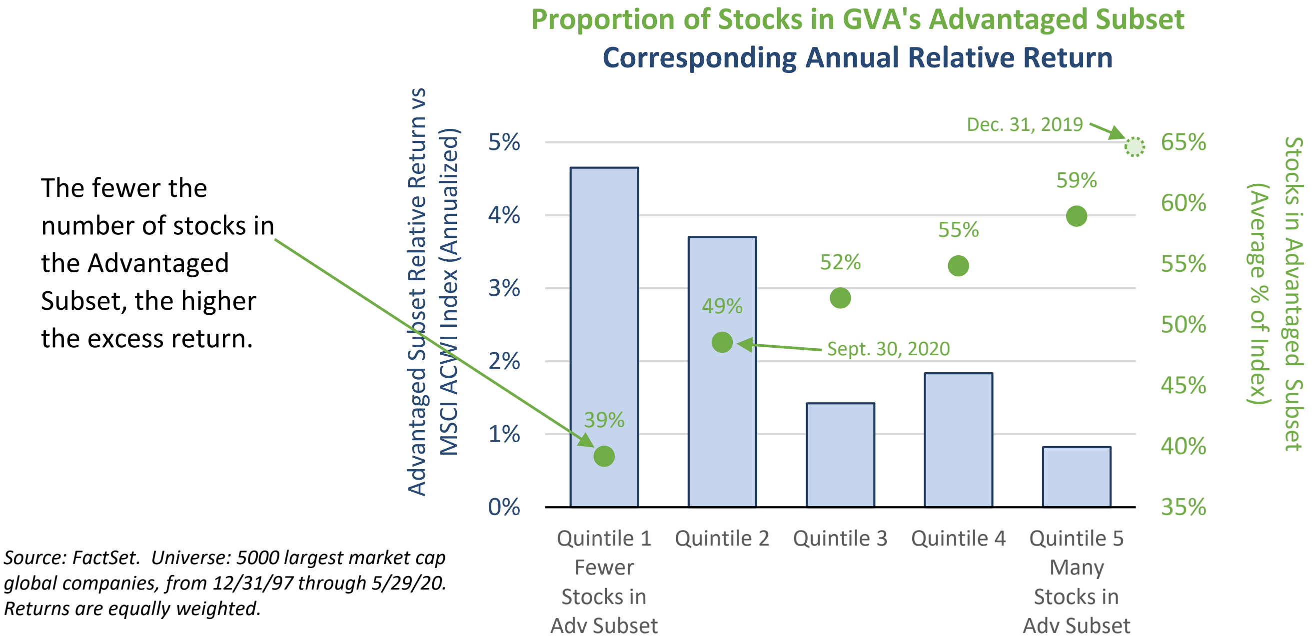
GVA's Advantaged Subset Through The Economic Cycle
Investment Implications

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 All Country World Index by 3% 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 represents about 50% 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 following chart illustrates this dynamic:



Source: FactSet. Universe: 5000 largest market cap global companies, from 12/31/97 through 5/29/20. Returns are equally weighted.

The recent crisis has triggered a major exodus out of GVA's pool of superior companies. At the end of December 2019, a record 65% of the stocks in GVA's global universe were included in the Advantaged Subset. At the end of September 2020, that number collapsed to 49% placing the current opportunity set in the second quintile in the chart above. This drastic cleansing puts the core of GVA's approach in a stronger position to outperform going forward.

Top 3 Performers in Q3 2020

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.

Ally Financial (ALLY-US)
Ally Financial provides a range of financial products & services, primarily to auto dealers and their customers. The company reported Q2 20 results in mid-July that were ahead of expectations. Auto originations have been surprisingly resilient during COVID-19. Despite the recession, the US consumer is benefitting from positive wage growth and low interest rates. ALLY's Net Interest Margin pressure has been limited and its capital position remains strong with a Common Equity Tier 1 (CET1) ratio at 10.1%. FCF Yield is 7%, Dividend Yield is 3%, and P/B is 0.7x.

Chow Tai Fook Jewellery Group (1929-HK)
Chow Tai Fook is a jewelry store operator in Hong Kong and China. The company reported Q1 FY21 results in mid-July that were in line with expectations. Most importantly, organic growth in China returned to positive territory. Chow Tai Fook has benefited from the rebound in economic activity in China, which is expected to continue into 2021. Higher gold prices are also helping support margins. Consensus is looking for EPS to grow 45% in FY21. FCF Yield is 7%, Shareholder Yield is 6%, and EV/EBITDA is 14x.

Bottom 3 Performers in Q3 2020

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.

Turkiye Garanti Bankasi Anonim Sirketi (GARAN-TR)
Garanti Bank engages in retail and commercial banking in Turkey. The company reported Q2 20 results at the end of July that were ahead of expectations. Management is looking for total loan growth of 25% in 2020 and for net interest margin to expand 50bps. Garanti's balance sheet remains well capitalized with a Common Equity Tier 1 (CET1) ratio at 15%. Unfortunately, the strong results were overshadowed by the expectations for lower asset quality and higher provisions going forward due to COVID-19. GVA sold its position in August, as Shareholder Yield turned negative on a trailing twelve month basis.

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LUKOIL PJSC (LKOH-RU)
LUKOIL engages in the exploration, production, refining, marketing and distribution of oil in Russia. The company reported mixed Q2 20 results at the end of August. EBITDA came in ahead of expectations, but net income disappointed investors as the company took impairments on its upstream assets in Uzbekistan. LUKOIL is well positioned to weather the global recession due to COVID-19. The company is a low cost producer and has net cash on the balance sheet. FCF Yield is 17%, Shareholder Yield is 12%, and P/B is 0.7x.

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,

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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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