International Small Cap

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 International Small Cap	**2.7%**
MSCI All Country World ex-USA Small Cap Index	10.5%
MSCI All Country World ex-USA Small Cap Value Index	7.8%
MSCI All Country World ex-USA Small Cap Growth Index	13.1%

Regional Indices	Q3
MSCI Japan Small Cap	9.5%
MSCI United Kingdom Small Cap	6.5%
MSCI Emerging Markets Small Cap	11.9%
MSCI Europe ex UK Small Cap	13.0%
MSCI Pacific ex Japan Small Cap	9.3%

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 world economy 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 may 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 reversals 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 the height of the TMT bubble. In the quarter, MSCI ACWI ex-US Small Cap Value Index underperformed its Growth counterpart by 5.3%. In the first nine months of 2020, value underperformed growth by a staggering 20%. 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 shows that "junk rallies", like the one experienced in the quarter, are typically short lived.

The strategy's largest sector detractors in the quarter were Energy, Consumer Discretionary, and Financials. GVA is overweight all 3 of these cyclical sectors and the strategy's selections were out of favor. Emerging Markets was the weakest region for the strategy in the quarter, despite it being one of the top performers in the index. GVA's stock selections underperformed in Emerging Markets, as the region saw a large divergence between growth and value stocks. 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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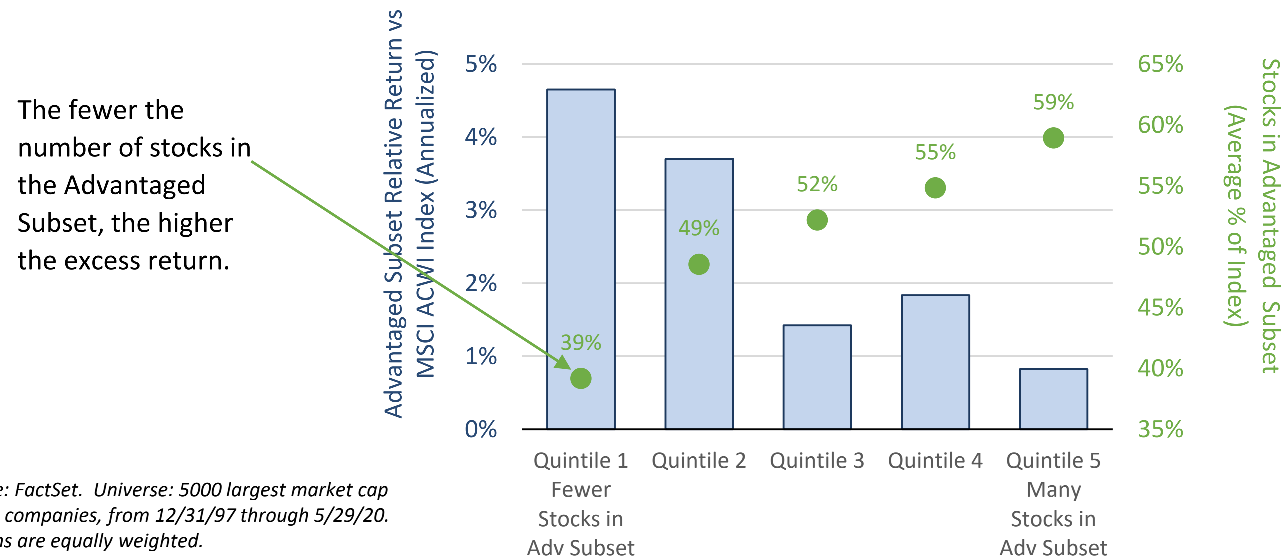
GVA's Advantaged Subset Through The Economic Cycle
Investment Implications

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 ACWI ex-USA Small Cap Index by 4.1% annualized over the past 19 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 graph illustrates this dynamic using GVA's Global Equity dataset which has data available back to 1997 versus international small cap's dataset which only goes back to 2004. A similar pattern exists for international small cap.

Proportion of Stocks in GVA's Advantaged Subset
Corresponding Annual Relative Return



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 58% of the stocks in the MSCI All Country World ex-USA Small Cap Index were included in the Advantaged Subset. At the end of September 2020, that number collapsed to 49%. This drastic cleansing of the opportunity set puts the core of GVA's approach in a stronger position going forward.

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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.

Resurs Holding AB (RESURS-SE)
Resurs Holding AB is a Nordic bank and financial services provider. The stock has been steadily rebounding off its COVID-19 lows and has so far seen limited impact on its fundamentals. 1H 20 results reported in late July showed positive growth in all of its markets, with the exception of Norway. Organic loan growth was healthy at +6% in local currency. The company's balance sheet remains strong with a Common Equity Tier 1 (CET1) ratio at 14.3%, its ROE is solid at 15%, its dividend yield is 4%, and forward 1 year PE is 9x.

LOTTE Fine Chemical (004000-KR)
LOTTE Fine Chemical is a chemical manufacturer based in Korea. Q2 20 results reported in late July were in-line with expectations. The company is on track to grow EPS 1% in 2020, despite facing a drop in demand in most of its key markets due to COVID-19. The company stands to benefit from an improvement in Global GDP growth in 2021 and beyond. The balance sheet is strong with net cash equal to roughly 33% of the market cap. FCF Yield is 13%, Shareholder Yield is 9%, and forward 1 year PE is 8x.

Bottom 3 Performers in Q2 2020

Whitehaven Coal (WHC-ASX)
Whitehaven Coal is a coal miner based in Australia. Whitehaven reported weak fiscal FY20 results in late August. Thermal coal prices have been under pressure due to the global economic slowdown. The drop in profits creates a heightened investor focus on the balance sheet. Management provided soft production guidance for FY21. GVA sold its position in Whitehaven Coal in September, as both FCF and Shareholder Yield turned negative on a trailing twelve month basis.

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.

TISCO Financial Group Public (TISCO-TH)
TISCO Financial provides commercial banking and asset management services in Thailand. The company reported fairly weak Q2 20 results in mid-July. Profits declined, as cost cutting was not enough to offset top line pressure. GVA continues to hold its position in TISCO. Although fundamentals are under pressure in the short term, the stock offers a rare combination of income (12% dividend yield), quality (low non-performing loans and 16.5% Common Equity Tier 1 (CET1) ratio), and growth. ROE at 15%, Price to Book of 1.5 and forward 1 year PE at 9x.

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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 International Small Cap strategy performance is measured against the MSCI All Country World ex-US Small Cap.

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