GLOBAL VALUE ADVISORS
A Division of Moody Aldrich Partners

International Small Cap

First Quarter 2023

COMMENTARY

GVA Expects Higher Interest Rates and Inflation and Bets on Value and Small Cap

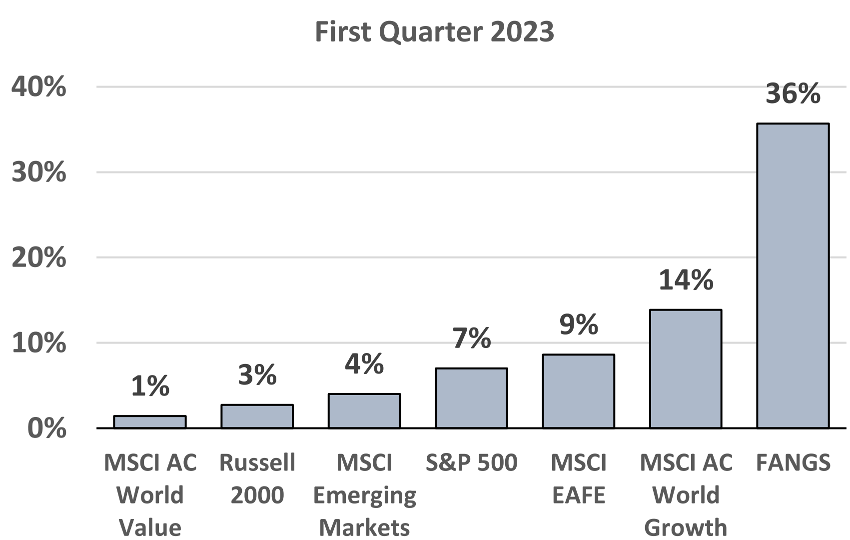
Total Returns (Net of Fees)	Q1
GVA International Small Cap	**6.9%**
MSCI All Country World ex-USA Small Cap Index*	4.7%
MSCI All Country World ex-USA Small Cap Value Index	3.8%
MSCI All Country World ex-USA Small Cap Growth Index	5.6%

Regional Indices	Q1
MSCI Japan Small Cap	4.1%
MSCI United Kingdom Small Cap	4.6%
MSCI Emerging Markets Small Cap	3.9%
MSCI Europe ex UK Small Cap	9.2%
MSCI Pacific ex Japan Small Cap	-0.0%

	GVA International Small Cap Net Return	MSCI ACWI ex-USA Small Cap Net Return*
1 Year	-1.1%	-10.4%
3 Years**	14.7%	15.0%
Since Inception**	0.9%	1.7%

*Benchmark | **Annualized

The first quarter of 2023 saw the dramatic reversal of last year's trends: after a dismal 2022, growth stocks surged 14% as FANG+ delivered a best in class +36% return after a bruising -46% in 2022. Three names (Apple, Nvidia, and Microsoft) contributed 54% of the quarterly gains in the S&P500. The banking crisis in early March magnified the growth rally, as investors treated Big Tech as a safe haven. After being 2022's best equity category, global value stocks were the bottom performer this quarter. Worth noticing, international developed outpaced the US market for the second quarter in a row, despite the stellar performance of the S&P 500's heaviest constituents. Europe avoided an energy crisis this past winter and is currently benefitting more than American companies from China's reopening.



Source: FactSet

In that context, GVA's Global Equity and Emerging Markets strategies underperformed over the quarter while its International Small Cap strategy eked out a positive relative return.

Over the past 6 months, equity markets have retraced half of what they lost from peak (Jan-22) to trough (Oct-22). Sticking to our view that we are in the very early innings of a regime change which should give birth to a new market leadership favoring value, small/mid, non-US names, we see this strong start of the year as a bear market rally, symptomatic of the deflating phase of a major speculative bubble. As Michael Burry observed, "after 2000, the Nasdaq had 16 bear market rallies

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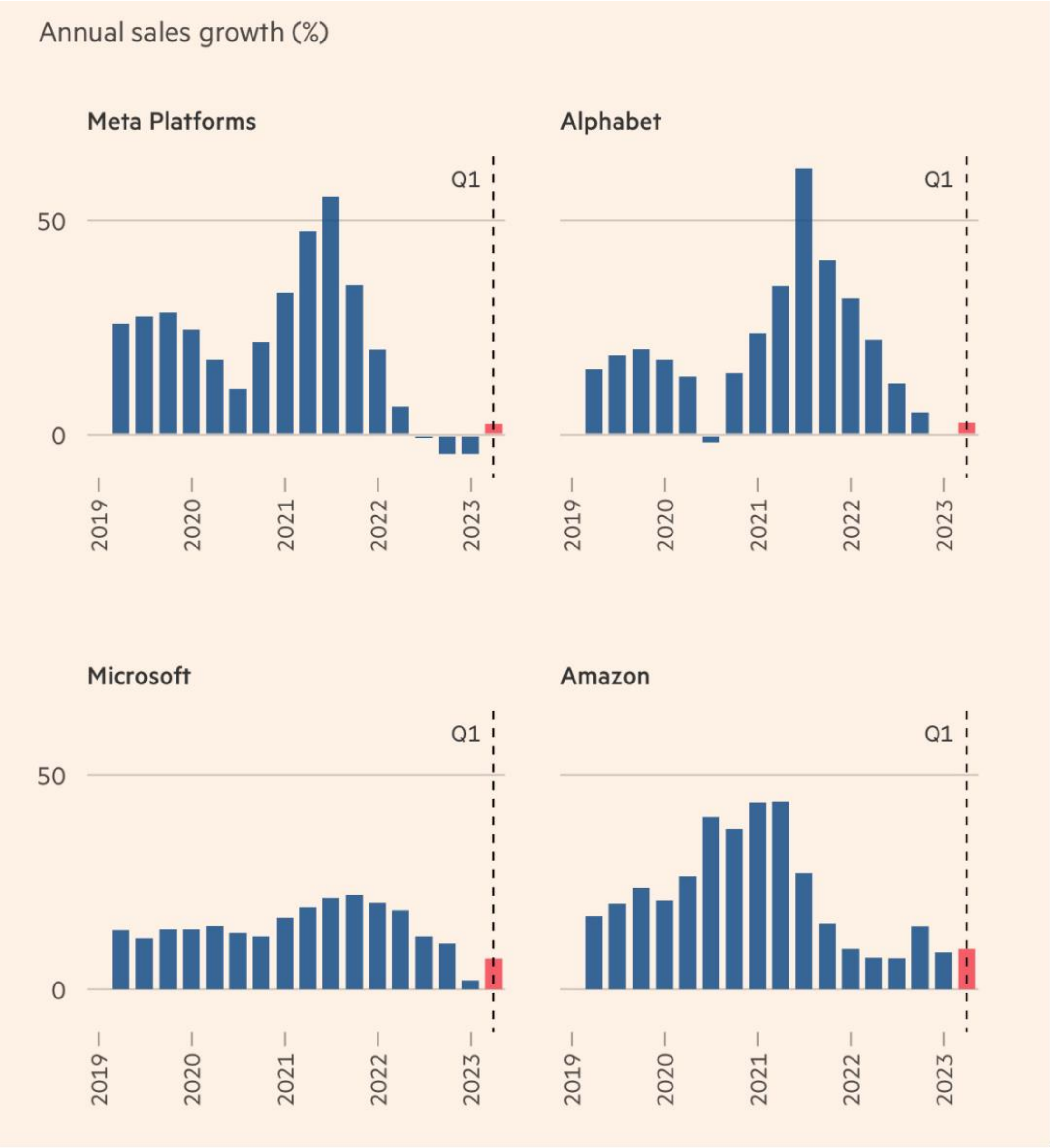
greater than10% and averaging 22.7% before bottoming down 78%. After 1929, the Dow had 10 bear market rallies greater than10% and averaging 22.8% before bottoming down 89%".

FANG+ stocks continue to look expensive, given their cloudy growth prospects. The following chart from the Financial Times captures the post Covid growth hangover these companies are currently dealing with:



Source Financial Times April 2023

The average FANG+ stock currently trades at 30.0x NTM EPS. This compares to the S&P 500 trading at 16x NTM EPS, ex-FANG+. Large cap tech companies went on an unprecedented hiring spree during the pandemic, with an anticipation that high growth rates would stick around for years to come. From 2019-2022, the average FANG+ saw a whopping 77% growth in total headcount. Management teams are now scrambling to cut headcount, as demand comes in below expectations. There is a decent likelihood that more layoffs will be needed.

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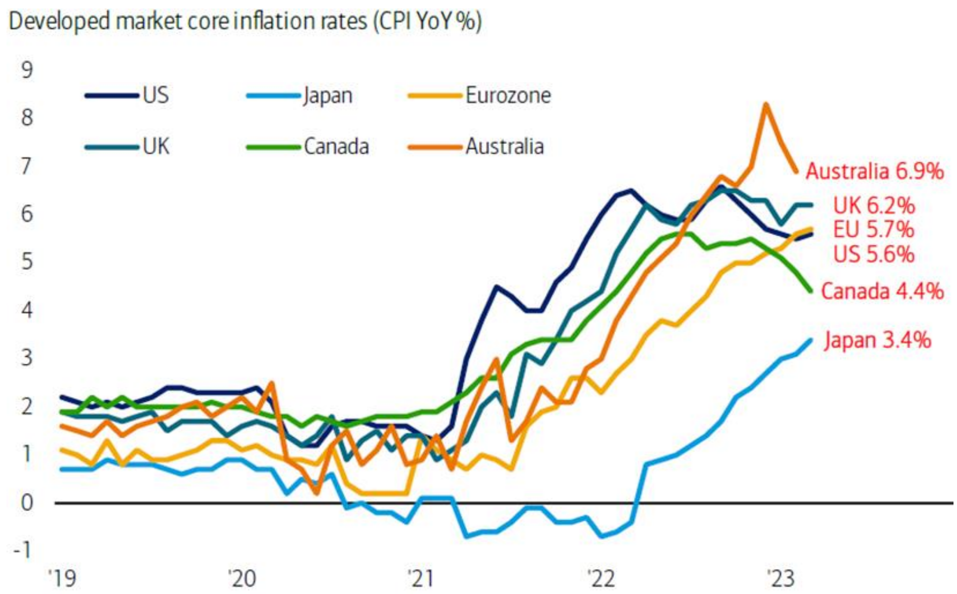
Company	Market Cap (B)	PE NTM	Consensus EPS Growth 2023	Total Headcount 2019	2022	% Increase
Meta (Facebook)	$619	19.1	35%	44,942	86,482	92%
Apple	$2,665	26.6	-3%	137,000	164,000	20%
Netflix	$145	26.7	12%	8,600	12,800	49%
Microsoft	$2,267	28.4	4%	144,000	221,000	53%
Amazon	$1,125	60.3	N/A	798,000	1,541,000	93%
Alphabet (Google)	$1,371	19.0	17%	118,899	190,234	60%
Average	$1,365	30.0	13%	208,574	369,253	77%

Source: Factset, as of April 28, 2023. Headcount data from Macrotrends.

As mentioned in our Q4 2022 commentary (link), we believe that the deflating process is incomplete: valuation spreads have barely shrunk from their February 2022 peak despite macroeconomic and interest rates outlooks that are less supportive for equities and particularly for the expensive segment of the universe.

GVA believes that the central banks' efforts to rein in inflation might have further to go for fear of locking in higher CPIs for longer, as illustrated by the following graph:



Source: BofA Global Investment Strategy, Bloomberg

We expect the Fed to raise rates one more time before putting its action on hold. If the Fed were to fold now, although the initial market reaction would probably be positive, soon enough, equities might be subject to a repricing to account for a structural mid-single digit inflation rate. This could take the US equity index P/E LTM ratio from 22.7 times as of December 2022 to 15 times, based on the past 70 years of observations:

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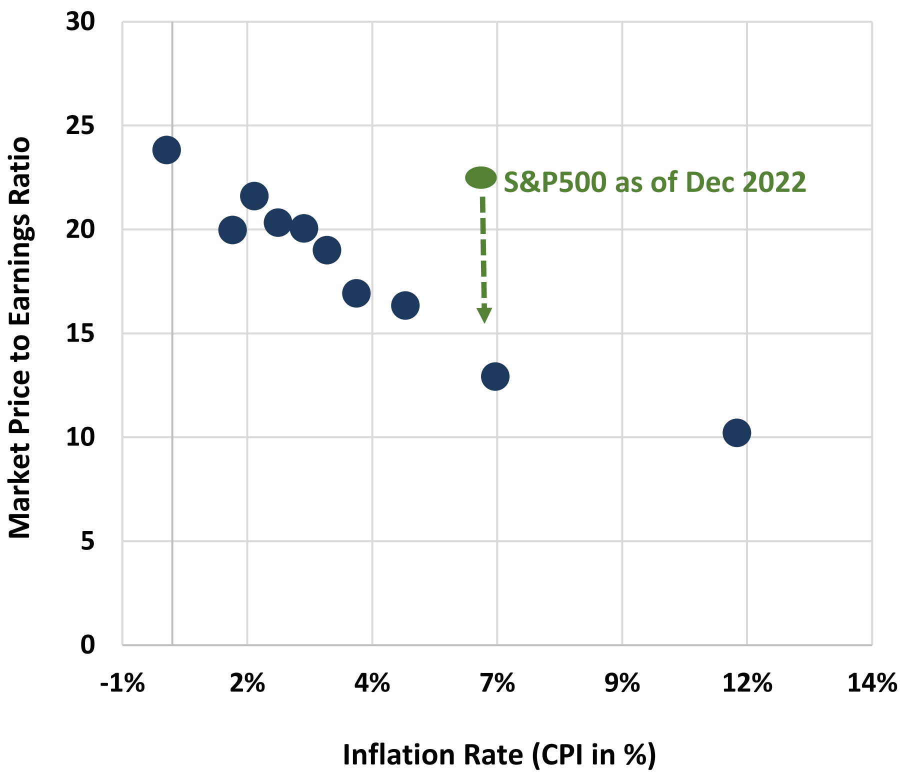
S&P 500 P/E and CPI (1945-2022)
Deciles formed on inflation (monthly observations)



Source: Fama and French dataset mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html. Cheapness based on P/B, Inflationary Event uses a six month lag. CPI from Robert Shiller http://www.econ.yale.edu/~shiller/data.htm

Although this is not GVA's short term scenario (GVA believes that the Covid19-related supply shocks will subside and the impending economic slowdown should temporarily tame inflation), it is certainly GVA's belief that inflationary forces will remain in place for longer than the markets anticipate, and that higher interest rates and higher inflation rates should be expected going forward. William White, the former economist at the Bank of International Settlements was interviewed recently on the topic[1]: He listed a variety of reasons for expecting future aggregate supply to be constrained, and for future investment needs to strengthen. This implied a sustained need for higher real and nominal interest rates, raising fears of both financial instability and fiscal unsustainability.

If this scenario materializes, GVA's portfolios would certainly benefit as low-priced stocks would likely outperform. During periods of high interest rates, investors focus their attention on companies with current earnings visibility and high sustainable dividends (i.e. Value) and less so on companies that rely on substantial cash flow and profits to occur in the future (i.e. Growth). As a result, Value typically outperforms in higher rate environments.

1. https://themarket.ch/interview/william-white-financial-markets-could-get-a-terrible-reckoning-ld.8478

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The following study of six inflationary events in the US over the past 100 years confirms Value's dominance:

Inflationary Event	Segment of the market	CPI	Dividend	Real Capital Gain*	Total Nominal Return*	Total Real Return*
1941-1943	Cheap 30%	9.1%	8.0%	2.6%	19.6%	9.6%
	Expensive 30%	9.1%	5.6%	-13.0%	1.7%	-6.7%
1946-1948	Cheap 30%	11.9%	5.1%	-9.6%	7.4%	-4.1%
	Expensive 30%	11.9%	3.9%	-15.4%	0.4%	-10.3%
1950-1951	Cheap 30%	8.5%	9.1%	12.3%	29.9%	19.7%
	Expensive 30%	8.5%	7.5%	-2.1%	13.9%	4.9%
1973-1982	Cheap 30%	8.9%	6.6%	-0.5%	14.9%	5.6%
	Expensive 30%	8.9%	3.2%	-9.3%	2.8%	-5.6%
1989-1991	Cheap 30%	5.2%	5.5%	-2.9%	7.8%	2.5%
	Expensive 30%	5.2%	2.5%	8.8%	16.5%	10.8%
2021-2023	Cheap 30%	7.3%	2.9%	24.0%	34.2%	25.1%
	Expensive 30%	7.3%	1.0%	-0.5%	7.8%	0.5%
Average	Cheap 30%	8.5%	6.2%	4.3%	18.9%	9.7%
Average	Expensive 30%	8.5%	3.9%	-5.2%	7.2%	-1.1%
Average	Market	8.5%	4.6%	-3.5%	9.6%	1.1%

Source: Fama and French dataset mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html. Cheapness based on P/B, Inflationary Event uses a six month lag. CPI from Robert Shiller www.econ.yale.edu/~shiller/data.htm *Returns are annualized

The main takeaways of this study are that in periods of high inflation (CPI greater than 5%), US equity markets have typically struggled and delivered subpar annual real returns of 1.1% versus 7.1% real, over the past 100 years. This is due to lower real capital gains, as valuation multiples compress and real EPS growth disappoints.

Most importantly, the value segment of the equity universe has delivered positive real returns in all but one of these inflationary episodes thanks to its higher dividend distribution and a positive average real capital gain. Overall, in these 6 inflationary events, value stocks have delivered an average +9.7% annual real return versus +1.1% for the index and -1.1% for the expensive names.

This certainly reinforces GVA's confidence in its positioning during these turbulent times. Our process focuses exclusively on companies that meet our four cornerstone investment criteria:

1. High and consistent FCF
2. High and consistent Shareholder Yields (dividends + buybacks + debt repayments)
3. Strong balance sheets
4. Cheapest 20% valuation

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In a recessionary environment, GVA's strategies are well positioned to outperform. Companies with high FCF and strong balance sheets often emerge from downturns in stronger competitive positions, as the weaker peers with high balance sheet gearing struggle to survive. GVA's strategies are also making active bets on Value, Small Cap, and Non-US. We believe several, if not all, of these bets will result in tailwinds to performance over the medium term, particularly in the macro-economic outlook described above.

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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The standard investment management fee schedule for new business is as follows: 0.60% in perpetuity on all investments made prior to strategy assets reaching $150 million, thereafter, 1.00% on the first $25 million and 0.90% on all additional funds. Management fees are paid quarterly in arrears. Actual investment advisory fees incurred by clients may vary.