COMMENTARY

May 20, 2021

Dear Clients and Colleagues:

As most of you know, fundamental research informs Global Alpha's stock selection, as it identifies equities with growing earnings that will meet or exceed our expectations. The pandemic challenged this philosophy in 2020, due to the volatile and unpredictable nature of corporate earnings. With low rates and subsidies, cashed-up investors looked elsewhere and flocked to non-earning companies, sending the Nasdaq 45.1% higher versus the S&P 500 at 18.4%.

A company with no earnings typically supports its stock price with material events that can de-risk future earnings. Investors gravitate to this approach as it can provide substantial short-term returns given the timelines around material events are well understood. Global Alpha tends to focus more on the entire capex cycle, smoothing out the volatility of a single event. For example, the technology and biotechnologies industries hold many event-driven companies.

Hedge funds are a class of investors that commonly use event-driven strategies. According to the Hedge Fund Research (HFR) Database, the highest-returning hedge fund strategies in 2020 were event-driven funds, which gained 9.3% for the year.[1] Macro hedge funds returned 5.2% for the year, while HFR's own relative value index ended 2020 up 3.3%. The hedge fund industry's total assets stand at $3.8 trillion, a 21% growth in one year. This occurred while the industry has had net outflows of -1.9% in 2020, according to Opalesque, a hedge fund publication.[2]

Interestingly, the Financial Industry Regulatory Authority (FINRA) reports that margin debt has jumped 51% since February 2020, to $823 billion in March 2021.[3] The $340 billion change is three times greater than any annual change in the last decade. It is therefore arguable that hedge funds, as well as many investors, are highly levered and exposed to event-driven companies.

Following the debacle of Archegos Capital Management, which faced massive margin calls from its prime brokers, Federal Reserve Governor Lael Brainard stated, "The Archegos event illustrates the

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[1] https://www.hfr.com/hfr-database
[2] https://www.opalesque.com/
[3] https://www.finra.org/

limited visibility into hedge fund exposures and serves as a reminder that available measures of hedge fund leverage may not be capturing important risks."

Where is all the new levered money (or at least part of it)?

According to PWC, the United States (US) equity and IPO capital markets in Q1 kicked off with yet another record, driven by the continued SPAC attack, with 389 IPOs raising $125 billion; 2020 raised $150 billion in total. A lot of this money is in newly issued, event driven, technology and biotechnology companies. The money is used to develop new products and services at an accelerated pace to catch up to their rich IPO valuations.

These amounts materialize as capex and revenues to the subcontractors of technology or biotechnology companies, commonly known as the picks and shovel of an industry. Global Alpha is invested in these types of companies, which stand to benefit from the capital exuberance described above.

Additionally, our companies are profitable and diversified. They also are of lesser interest to event-driven hedge funds. These companies could be at a lesser risk of mass sell-off due to an Archegos Capital Management type liquidity crunch. Rich in pharmaceutical history, Europe holds many excellent contract research organizations that appear in our investment universe and have the biopharma industry as clients.

Evotec (EVT:GR)

Based in Hamburg, Germany, Evotec operates multiple scientifically driven contract research centers for the biopharma industry. The company has extensive scientific knowledge to assist in genetic and biochemical drug development programs.

With the large biopharma market growing at a compound annual growth rate (CAGR) of 13.5%, Evotec has been gaining market share with a 20% growth rate. The company recently launched a low cost biological drug production platform that is expected to grow revenues considerably in the mid-term. Evotec also signed an agreement with the Japanese giant Takeda for the development of RNAi drugs.

Oxford Biomedica (OXB:LN)

Global Alpha also owns Oxford BioMedica, a biopharmaceutical company engaged in the production of viral vectors, a key component of delivering a genetic drug. Without vectors or other delivery systems, genetic material decays extremely quickly in the body. Oxford BioMedica offers a variety of vectors, including adenoviruses that are used in the present coronavirus vaccination program with AstraZeneca. However, it specializes in lentivirals, which have proven very efficient with biologics.

The FDA is predicting a wave of cell and gene therapies coming to market in the next few years, which is set to drive the overall end market to exceed $20 billion in the mid-term. The lentivirus vector market is expected to grow in excess of $1 billion by 2026, from $350-400 million today.

Have a great day.

The Global Alpha team