

June 17, 2011

Dear clients and colleagues,

Following our recent trip to China, we feel that it is crucial to examine the latest government policy and its implied investment opportunities. Although the short-term market sentiment for China seems subdued due to tightening policy against stubborn inflation and housing bubbles, we remain optimistic about the country's fundamental developments and growth potential in the coming years. This week we focus on an overview of China's Twelfth Five-Year Plan. And in the next few comments, we will dive into some specific industries.

Planning is a key feature of centralized communist economies. The Communist Party of China has set up regularly a series of economic development initiatives called Five-Year Plan.

The Eleventh Five-Year Plan (2006-2010) was successfully achieved despite the global financial crisis and domestic natural disasters. In 2010, China surpassed Japan as the world's second-largest economy with GDP reaching 39.8 trillion yuan vs. target of 26.1 trillion yuan. The average annual GDP growth during this period was 11.2%, largely beating target of 7.5%. Annual income per capita also grew rapidly, up 82% for both urban and rural areas. Share of service industry to GDP reached 43% from 40.3% in 2005, slightly below target of 43.4%. Energy consumption per unit of GDP dropped 19.06%, near the target of -20%. One of the main challenges lied in job creation as the population ages.

On March 14, 2011, the government passed the Twelfth Five-Year Plan (2011-2015) which seeks to address rising inequality and create an environment for more sustainable growth by prioritizing more equitable wealth distribution, increased domestic consumption, and improved social infrastructure and social safety nets.

The plan is representative of China's efforts to rebalance its economy, shifting emphasis from investment toward consumption and from urban and coastal growth toward rural and inland development. The plan also continues to advocate objectives set out in the Eleventh Five-Year Plan to enhance environmental protection, accelerate the process of opening and reform, and emphasize Hong Kong's role as a center of international finance.

Major targets set for 2011-2015 are as follows. In bracket we show data during the 11th Five-Year Plan (2006-2010) period.

- Annual average GDP growth: 7% (Actual 11.2% vs. target 7.5%)
- GDP in 2015: 55 trillion yuan (Actual 39.8 trillion yuan in 2010 vs. target 26.1 trillion yuan)
- Proportion of service industry's output in GDP: +4% (Actual +2.5% vs. target +3%)
- Urbanization rate: to 51.5% (Actual 49.68% in 2010 vs. target from 43% to 47%)
- Average annual growth of residents' income: more than 7% (Actual 12% vs. target 5%)
- Energy consumption per unit of GDP: -16% (Actual -19.06% vs. target -20%)
- Population will be controlled below 1.39 billion (1.34 billion in 2010)
- Jobs creation: 45 million (Actual 22 million in 2005-2009 vs. target 45 million)
- Proportion of R&D expenditure in GDP: 2.2%

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient's individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha's analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.

Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with the Global Investment Performance Standards (GIPS[®]) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.

- Proportion of non-fossil fuels in primary energy consumption: 11.4%
- Carbon dioxide emissions per unit of GDP: -17%
- Release of major pollutants: down by 8%-10%
- Forest stock: up by 600 million cubic meters
- Forest coverage: 21.66%
- Proportion of expenses for medical treatment paid out of the medical Insurance fund: more than 70%
- Urban low-income housing coverage: 20%

The major theme of the Plan is to promote economic equality, which implies a turning point from the previous emphasis on headline growth. Why so?

We should start by tracing back 30 years to when the economic reform started. Deng Xiaoping, the Chinese leader back then, began to encourage privatization and allow some people and some regions to get rich first. His famous quote was: No matter the cat is black or white, if it can catch a mouse, it is a good cat. The message was a clear initiative to transform the economy more capitalist than socialist.

In the past 30 years China has experienced enormous economic growth, achieved the biggest reduction in poverty ever in history, but also seen serious economic imbalances between coastal and inland regions, and a wide income gap between rich and poor.

In such context, a balanced growth strategy is key for the next 5 years. China aims for stronger domestic consumption supported by an adequate level of wage growth, a strengthened social safety net and opportunities for rural citizens to move to cities without losing access to benefits and services. Such initiatives suggest to us that many industries will benefit from the structural change such as retail, healthcare, infrastructure, agriculture, and alternative energy, etc. In the next few comments, we will examine the impact on some of these industries and identify investment opportunities.

Have a good weekend.

The Global Alpha team

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient's individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha's analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.

Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with the Global Investment Performance Standards (GIPS[®]) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.