

May 25, 2018

Dear clients and colleagues,

In early May we attended the 20th Macquarie Australia Conference in Sydney, the largest conference of its kind in Australia. This year, over 140 companies and 1,000 investors participated compared to 100 companies and 800 investors last year. We also conducted on-site visits with a few of our portfolio holdings in Sydney and Cairns. Altogether we met 24 companies.

Following discussions with companies and investors, we felt that sentiments were more positive than a year ago. The Australian economy has been improving mainly due to the recovery in commodity prices, especially in the western regions where the mining sector dominates. In the eastern cities, such as Sydney, Melbourne, Brisbane and Cairns, the economy is visibly booming, with infrastructure projects in progress and groups of tourists everywhere.

Not surprisingly, in May the Reserve Bank of Australia (RBA) kept interest rates on hold at a record low of 1.5%, extending its longest-ever run without a rate change to 21 months. The central bank confirmed that the economy is getting stronger. Notwithstanding the improving labour market, wage growth remains near historic lows. The Wage Price Index was up 2.1% over the year as of March 31, 2018 compared to an inflation rate of 1.9%. The unemployment rate remains high at 5.6%. The RBA forecasts economic growth to increase gradually over the next couple of years to a little above 3%, up from 2.4% in 2017.

The rate decision came the same day as CoreLogic figures showed house prices in Australia's major cities fell for the sixth month in a row, down 0.3%, led by weakness in Sydney and Melbourne.

We remain cautiously optimistic about the Australian economy and its stock market. In our investment universe, Australia represents the second largest market in Asia (after Japan). It represents a 6.5% weight in the MSCI EAFE Small Cap Index and 2.6% in the MSCI Global Small Cap Index. Australian companies are clear leaders in ESG (Environmental, Social and Governance) in the Asia Pacific region. They have very good corporate governance structures and professional investor relations teams.

We currently invest in six Australian companies across various sectors. Below are updates from three that we met on this trip.

- Perpetual Limited is Australia's largest independent asset manager and corporate trustee service provider with a rich history dating back to 1886. As of December 31, 2017, the company had A\$32.8 billion in funds under management, A\$13.7 billion in funds under advice and A\$662.4 billion in funds under administration. Perpetual Investments has been awarded Fund Manager of the Year awards in multiple categories every year for the past decade, and Perpetual Private has been rated number one by Euromoney for advisory services to high net worth clients in Australia.

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- WorleyParson provides a wide range of consulting and advisory services to the resource, energy and industrial sectors. These services cover full asset management services and engineering, procurement and construction capability. It operates in 42 countries and has 25,700 employees. As commodity prices recover, the company's customers are gradually entering a capex growth phase which is reflected in the strong orders at WorleyParson.
- ARB is Australia's largest manufacturer and distributor of accessories for four-wheel-drive vehicles. Its products cover bull bars, rear step tow bars, turbochargers, winches and related recovery equipment. Twenty-eight percent of the company's sales are from overseas, and it has a 40% market share in Australia. The company's aftermarket business is very resilient. The founding family is in strong control of the business and has delivered a sales CAGR of over 10% in the past decade.

Have a great weekend.

The Global Alpha team

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