COMMENTARY

GLOBAL ALPHA

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Dear clients and colleagues,

The stability of a company's earnings correlates to its capacity to fend competitive, economic and regulatory pressures, the so called "defensible moat" of a franchise.

Within the Materials and Energy sector**, specialty products offer "defensible moats"**. Less cyclical in nature, specialty is often situated downstream in the value chain. Commodity bulk products are more prevalent upstream. In between, companies fight to remain specialized through innovative products, processes and offerings.

The difference between specialty and commodity can be thin; the midstream Chemical industry is a prime example. In July 2015, Dupont spun out Chemours, its low cost titanium paint pigment producer at $21 per share, they now trade at $5.16. Competitors Huntsman (-53.3%, Tronox (-75.6%) and Kronos (-53.6%) are in even worse competitive pressure over the last 6 month period, mostly from Chinese producers.

Historically notorious for having strong franchises on technology knowhow and chemical complexity, paint raw materials (pigments; $20B market) are becoming fairly similar and price is a key driving factor. With 150 medium to large scale production facilities, Chinese capacity has grown to 1.5 M tons over the years, enough to influence this 6M ton global market.

This is not an isolated case, as China's consumer economy is trying to outpace its infrastructure build programs on a growth basis. Large capacity Chinese Materials companies have no choice but to focus on exports. The rest of world's answer to this organized offense: a pretty much forced merger between Dow Chemicals and Dupont.

Global Alpha's exposure to Materials and Energy (including Chemicals) concentrates mostly on specialty in all of its Funds based on this very principal of franchise defensibility. Downstream companies are closer to end clients, moats are better defensible and product advantages are clearly defined.

Lintec (JP:7966) (-6.5%, over 6 months) a chemical adhesive company servicing mostly the electronics space, these adhesive although low volume, can command higher premiums as they have high customization.

Aptar Group (NYSE:ATR) (10.9%) is a specialty plastics company for the packaging sector, particularly in the global dispensing systems industry. They make the valves and sprays, etc. that dispense the product in the bottle.

Frutarom (TAS:FRUT) (14.9%) develops, manufactures, and markets flavors and fine ingredients used in food and beverage products, pharma-nutraceuticals, flavors and fragrances, and personal care products and cosmetics, as well as other products.

ESG Implications

Bulk commodity chemical plants are large contributors to water and air pollution through their important effluent streams, tailings and high energy usage. Lower environmental standards in certain geographies (or lack of respect by the companies) and low cost fossil energy sources are sometimes the only competitive advantages other than size as chemical facilities are typically not labor intensive.

Therefore, when global pricing for a chemical commodity falls below global average cost, large market share shifts occur which are partly allowed by ESG discrepancies between competitors. In North America and Europe, acid based treatment plants have improved their ESG profiles significantly over the last 30 years (in the 1970's, 60% of the St-Lawrence highly polluted water basin was from acid treatment facilities, whereas today the basin hosts a booming fishing industry).

We monitor these market changes closely and make sure we hold companies that do not compete on ESG discrepancy advantages (usually caught up by regulatory pressure). Staying optimistic, the Chinese water treatment market is bound for an important growth trend over the next 15 years, an important trend at Global Alpha that we will discuss in the coming months.

Have a good weekend.

The Global Alpha Team