COMMENTARY

July 10, 2020

Dear Clients and Colleagues:

As most of you know, the Global Alpha investment process is a rigorous, multi-step approach that balances our philosophy, capacity to study our investment universe and a risk management strategy that aligns with portfolio construction. Our philosophy is based on the belief that earnings are the main driver of stock prices. As the economy is affected by strong business disruptions and lack of corporate guidance due to the COVID-19 pandemic, investors have been adding risk in search of returns with pre-earnings companies. To go even further, corporations with no earnings have been touted as defensive. For example, the Nasdaq Biotechnology Index has risen by 46% since mid-March.

Aided by unprecedented monetary easing, the V-shaped recovery has pushed some stocks into bubble territory. Investors are now used to high valuations; having gone through the large-cap FAANG experience, small-cap opportunities are the logical progression.

Looking at the companies that outperformed the most in the latest quarter, we noted the following characteristics: low return on equity, high leverage, unprofitable, highly shorted, and our two favorites, zombie stocks and low share price stocks. Conversely, a number of factors lagged in the recent quarter, including low valuation, quality, profitability, yield, dividend growth and stability. The healthcare and technology sectors outperformed both during the market downturn and upswing. Lately, styles that outperformed are aggressive growth and value, with the core style (quality-related) underperforming significantly.

Can the core style make a comeback? Or is the better question when? Factors always rotate, and for many reasons. Core will surely be there when corporate balance sheets become part of the equation if we see a difficult recovery from the pandemic.

Further, COVID has become a definition for a type of stock. Heavily impacted by COVID-19, these stocks are benefiting from the pandemic with increased product demand, such as treatments or preventive measures. As well, COVID stocks can be companies that regain lost markets instantly if a treatment or vaccine is announced, markets such as the cruise ship industry.

Does Global Alpha invest in COVID stocks? Absolutely! However, betting on an imminent vaccine when 80 are in development and there is uncertainty regarding immune response seems like a risky proposition.

COVID-19 will change many business environments for an extended period of time. Our investment process considers several factors when it comes to COVID stocks: Will COVID-19 help expand a market where products and services are of important value? Is competitive risk acceptable? Do they fit our entire investment process which also involves compelling ESG values? Some of the companies in our portfolio currently have direct exposure to pandemic related markets.

We initiated a position in Ansell Limited (ANN:AU)

Ansell Limited manufactures and distributes healthcare and industrial safety products. Ansell is the global leader in providing high-end protective equipment and solutions. COVID-19 will probably increase the use of safety equipment for a long time.

- 37% of sales are directly related to COVID-19, such as single-use gloves, as well as surgical and chemical protection equipment. Some of the Ansell brands that are benefiting are:
  - AlphaTec – chemical & liquid protection (industrial);
  - Microflex – single use (healthcare);
  - Gammex – surgical (healthcare);
  - TouchNTuff – single use (healthcare);
  - Encore – surgical (healthcare).
- Target markets are 52% healthcare, 48% industrials.
- The company has plants in Malaysia, Thailand, China, Korea and Vietnam.

We were already shareholders of L'Occitane International (973:HK)

L'Occitane is a well-known household personal care and beauty brand in the natural skin care market. With an enhanced brand portfolio, the company's sales are diversified and include skincare, facial care, and cosmetics. The company is a global manufacturer and retailer of natural and organic ingredient-based cosmetics and wellness products with strong roots in Provence, France. It operates 3,420 retail outlets in 90 countries, owning 1,608 of them. Although in-store sales have taken a hit, with 30% of stores closed in June, the company has benefitted from good e-commerce growth.

L'Occitane has also recently enjoyed some success in its body care division, which accounts for 35% of its sales. The company has developed a moisturizing hand cream that also acts as a hand sanitizer. Both the sanitizer and moisturizer markets have grown during the pandemic. L'Occitane operates in the high-end segment with its well-known, all-natural brands.

Tecan is another company that is in our portfolio with COVID exposure (TECN:SW)

- Tecan provides laboratory instruments and solutions for pharmaceutical, biotechnology companies, university research, forensic and diagnostic laboratories.
- The company develops, produces, markets, and supports automation workflow solutions, including laboratory instruments, software packages, application knowhow, services, consumables, and spare parts. It also develops and manufactures OEM instruments and components. Its products include liquid handling and automation products, microplate readers and washers, software, consumables, immunoassays and antibodies, and microarray products.
- It operates through two segments: life sciences business (55%) and partnering business (45%).
- Geographical mix: Americas 41%, EU 40%, Asia 16%, rest of world 3%

Tecan is a key part of the laboratory chain as it makes the instrument that handles the samples that arrive at a laboratory for testing. As a sample enters a laboratory, it must be transferred in a receptacle that can be inserted in a diagnostic machine. If a laboratory does high volumes of these samples, the process is automated by a company like Tecan, the market leader.

Have a great weekend.

The Global Alpha team