GLOBAL ALPHA

January 27, 2012

Dear clients and colleagues,

The last 18 months have been dominated by the European debt crisis. What started in Greece quickly spread to Portugal, Ireland and Spain and saw a new acronym, PIGS. In 2011, Italy, France and most of Eastern Europe joined the troubled countries.

At the heart of the problem are a monetary union not anchored by a fiscal union, a rapidly aging population, generous social programs creating structural budget deficits, and very different economic characteristics between countries.

The pessimists are forecasting nothing less than the collapse of the Euro, even of the European Union.

We are more optimistic. In the 20th Century, Europe experienced two Great Wars, the Great Depression, hyper inflation, and two oil shocks. Nevertheless, European integration has progressed continuously since the creation of the EEC in 1957. We see the current crisis as another opportunity to further integrate those economies. We do not forecast the demise of the Euro, though we do not exclude certain countries being expelled from the eurozone.

As we discussed in many of our earlier comments, those macro-adjustments will take many more years. Financial markets are always hoping for a quick fix “a la Fed”. It will not happen. There will be volatility, but we believe that the doom scenario is becoming more an extreme outcome with a low probability.

Some of our team members spent the first two weeks of January in Europe. They met over 50 companies at two conferences as well as doing due diligence on site. Here are some observations.

- Companies are optimistic. Balance sheets are strong. 2011 did not see much impact from the bad news circulated in the media. Although visibility for 2012 is limited, trends in December and January were generally positive, especially in Asia and the US.

- There is no credit crunch. Good companies with good projects are able to get financing at attractive rate from European banks. Even Greek Banks are lending.

- Companies are putting their strong balance sheet to use. Acquisitions, buybacks and dividends are “a la mode”. Already half of the CAC40 companies have raised dividend so far this year.

We believe Europe will experience a recession, although it should be a shallower one than expected. Germany should grow in 2012.

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The problems are Governments running unsustainably high deficits. Except for Italy and Greece, the problem is not the debt/gdp level now, but the debt/gdp in a few years if those deficits are not shrunk rapidly. The good news is that the population now understands that the government will shrink. Politicians of all sides now agree on the need for austerity.

Europe has many, often overlooked, advantages.

- Personal savings rate are high in most European Countries. Individuals, except in the UK have a good financial situation, better than Canadians or Americans.

- Companies have good balance sheets with historically low debt levels, even given the low interest rate environment. Europe is China's first commercial partner, not the US.

- It is the #1 tourist destination in the world. Tourism is one of the biggest industries worldwide and growing faster than global gdp.

- European industries such as automobile, machine tools, cosmetics, food, luxury are world leading and are growing fast in emerging markets.

At the moment, the consensus is that the US will grow, Europe will have a recession and China has a 50/50 chance of a hard landing. We believe this scenario is already discounted by the markets if one looks at last year outperformance of US indices.

Our scenario is that the US will grow, Europe will have a shallow recession and China will be successful in achieving a soft landing. So the positive surprise this year may come from European and Emerging market returns.

Our stock selection is theme-driven and relies on our fundamental approach. The result is that we have an exposure of approximately 50% to Europe and Asia in our portfolio.

Have a good week.

The Global Alpha Team

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