

October 28, 2016

Dear clients and colleagues,

Italy might be the number-one ranked luxury destination for travellers, but it has been one of the worst performing countries for investment this year. Political uncertainty combined with a challenging banking environment has caused the MSCI Italian Small Cap index to return -17.2% year-to-date compared to -6.9% for the MSCI Europe Small Cap index.

Our Italian exposure

Historically, our Italian holdings have consistently outperformed their respective industries and their benchmark, except for the last two years. We remain confident in the long-term fundamentals of the businesses and believe their share prices are in a temporary stasis before beginning their up and to-the-right move, especially given their present valuations.

We currently own two Italian names in our Global portfolios: Autogrill and Astaldi. Both of these companies share two important similarities: they are family-owned businesses and they generate the majority of their revenue outside Italy.

Autogrill is one of the largest food and beverage companies serving travellers worldwide with 50% of its revenues coming from airport locations and 40% from motorway locations. Autogrill generates half of its revenues and two-thirds of its profits in the United States. While you may not be familiar with this name, it is likely that you were a client at some point. Perhaps you took the New York State Thruway to Albany or the Illinois Turnpike to Des Plaines. Maybe you have flown out of the Los Angeles International, Toronto Pearson or Montreal Pierre Elliott Trudeau airport. If you bought food or beverages in any one of those locations, you were a client of HMSHost, a subsidiary of Autogrill. The company posted a positive first-half 2016 result with revenue growth of 5.4% and margin expansion of 50 basis points.

Astaldi is one of the world's leading construction and concession companies focused on the design and construction of large-scale civil engineering works in Italy and abroad. The group has been active for more than 80 years, with operations in 21 countries and revenues of more than €2.5B. It generates only 40% of its revenue within Italy, so is another example of a truly global corporation.

You may be surprised to know that Astaldi constructed the Autostrade del Sole (A1), the first major highway in Europe, and the Rome-Florence Fast Railway (1976), the first high-speed railway line in

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Europe. The company continued to expand in the 1980s and started doing work in the United States on motorways such as the Orlando Beltway. Examples of their current projects include construction of the Muskrat Falls Hydro project in Labrador and the contract to extend the I-95 in Florida.

The reform behind the referendum

People tend to forget that this year's Italian referendum is the third on constitutional reform in 15 years. In 2001, the "Yes" camp won, giving regions more power over the State. The 2006 referendum tried to resolve the issues caused by the current system of perfect bicameralism. That reform also proposed to give more power to the prime minister and the regions. The "No" camp won during that referendum.

This upcoming referendum will focus on two major topics: Changing the current system of "perfect bicameralism" and reviewing the balance of competence between the State and the regions.

Under the current bicameralism system, the Chamber of Deputies and the Senate have equal power in passing new laws. The proposed reform would result in a separation of power where the Chamber of Deputies would be responsible in passing laws, while the Senate would act only as a link between the central government and its regions.

On the balance of competences, the reform proposes to give the State greater power and increased responsibilities. A shift of balance would also eliminate the legislative overlap between the government and the regions.

In summary, the upcoming referendum aims to allow new laws to be passed more quickly and efficiently. Its other purpose is to make the government more stable with an improved new electoral law which would elect a clear majority government after an election.

The referendum on the constitutional reform will take place on December 4. At this time, the end result is highly unpredictable. Opinion poll surveys show a high level of undecided voters and no significant leads for either camp. While a Yes vote could be a relief and positive news in the short term, a No vote could further impact investor sentiment towards Italy. After accounting for uncertainties related to Brexit and this upcoming referendum in Italy, we expect the Italian economy to remain subdued until year-end.

Have a good weekend.

The Global Alpha Team

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