MARKET UPDATE

April 3, 2020

As we navigate through the COVID-19 crisis, we wanted to provide you with an update regarding what we are seeing in the different regions we cover and the actions we have taken over the past few weeks in managing our portfolios.

Here are some highlights of world reaction to the COVID-19 crisis and steps Global Alpha is taking during these extraordinary times.

Europe:

- In Europe, the shutdowns imposed over the past two weeks have sharply worsened the economic outlook for the region. Despite heavy stimulus from governments and central banks, the economic shock will likely be substantial.
- Initial government response has been focused around providing ample liquidity for businesses and preserving employment. Future initiatives will have to address the demand side.
- The low level of financial indebtedness of European corporations put them in a good position relative to their international counterparts. High personal savings rates and a very supportive unemployment benefits system should help set the stage for an upcoming recovery.
- Several companies suspended or postponed their 2020 guidance as visibility going forward has sharply diminished. The outcome will depend on the length and implications of this crisis.
- Companies exposed to the travel industry have suffered significantly, and some industrial stocks have underperformed. In the first wave of sell-offs, there was no place to hide. Even companies in the utilities, telecommunications and consumer staples sectors were severely hit.
- In recent weeks, we trimmed our exposure to the consumer-related and industrial sectors as well as to companies that were trading at relatively high multiples.

- We increased our exposure to industrials, adding positions in companies that should provide some protection in the short term or in companies that have been severely impacted and now provide an opportunity for growth.
- We are looking to increase our exposure to the health care sector, and we took advantage of a 20% price drop to initiate a position in Tecan Group. We felt the timing was right to build a position in this high quality company that provides automated lab instruments and solutions.
- We are exploring opportunities in the consumer staples, utilities and telecommunications sectors and are also considering reducing our underweight position in the consumer discretionary sector, but at a very slow pace.
- We will initiate new positions if we feel it will upgrade the quality of the portfolio. We are currently studying several candidates and are seeing some long-term investment opportunities.
- Overall, we believe that our quality bias (companies with strong balance sheet and lower leverage) should limit the damage when financial markets begin to stabilize. So far during this crisis, the reaction of global markets has been very similar to their reaction during the Great Financial Crisis in 2008, which is surprising. Like in 2008, following the initial shock of the abrupt economic deceleration that caused a 20% overall market decline, a phase of stimulus took place, providing confidence and stabilizing markets. The last leg of the downturn will relate to investor perception of future earnings. Will this current crisis continue to mimic 2008 – only time will tell.

North America:

- As infection rates in Asia and Europe occurred in advance of those in North America, valuable data on how best to contain the virus was available. However, the North American response still seems to have lagged that of both these regions.
- We are reviewing Asian and European social distancing processes, lay-offs and salary cutbacks and comparing them to what has been done in other regions at similar outbreak stages.
- We have intensified discussions with our portfolio companies. In addition to corporate reviews, we are focused on conducting balance sheet and leverage stress tests. We are also verifying what is classified as recurring revenue post-crisis, critical activity and large client activities.
- Year to date, oil and gas has been the hardest hit sector, given oversupply in the Middle East and the sharp decline in demand.

- Consumer discretionary, Materials and Industrials have suffered also with specific industries such as travel and aerospace dragging the most.
- Over the past few weeks, we have trimmed consumer discretionary companies, the ones we expect a U shape versus a V shape recovery. We also reduced industrials and names that were trading at relatively high multiples.
- Since the beginning of the year, we have initiated positions in four technology companies that are likely to perform well in the future environment. These new holdings provide exposure to the artificial intelligence, voice transmission, cybersecurity and laser technology industries.
- We are looking to add in the health care sector as a long term trend emerges for increased investment in the sector.
- Similar to Europe, we are also looking at other areas of strength that should over-perform in a recessionary environment: consumer staples, utilities and telecommunications.
- We are now looking to add in the consumer discretionary sector. We are presently underweight this sector and valuations are reaching decade lows. We opportunistically added two small positions in the homebuilding and restaurant industries that were strongly undervalued.

While the first wave of selling came from ETFs, stock declines have been fairly uniform and indiscriminate of quality. Therefore, we believe that there are many opportunities to initiate positions in high quality companies. High quality companies with strong balance sheets are better able to weather financial uncertainty and will be positioned to gain market share as the virus abates.

Asia:

Our investments in Asia are focused on companies listed on developed market indexes including Japan, Hong Kong, Singapore, Australia and New Zealand. Some of our holdings also operate businesses in China. In the past two weeks, we have had daily conversations with Asian companies and sell-side analysts. After two months of outbreak containment, Asia is showing signs of recovery. Below are a few highlights.

In China:

- People have already gone back to work. Local governments allowed schools to reopen, starting with less-affected areas.
- Retail stores are open. Factories are up and running, though operating at 60%-70% capacity due to a shortage of returned labour.
- Travel restrictions began to lift in the Hubei province on March 25; it was the first province to be locked down in January. Restrictions will remain in place for the capital city, Wuhan, until April 8.

- For foreigners entering China, most provinces require a 14-day quarantine.

In Japan:

- The outbreak was well-contained; therefore, retail stores, factories and public transportation were never closed.
- Working from home is voluntary, but most people still go to work as usual.
- Schools are expected to reopen in the next few weeks.
- Public sentiment is calm.
- The 2020 Summer Olympics were to be held in Tokyo from July 23 to August 8, 2020 but have been postponed until 2021. That the games will still be held is positive for the Japanese economy because there are many financial gains to hosting this event, such as infrastructure investments, sponsor contracts, employment and tourism.
- Japan bans travellers from restricted areas and requires a 14-day quarantine for travelers from other areas.

In Hong Kong:

- The government managed to contain the outbreak by closing schools, tracing the contacts of infected people and gradually imposing greater travel restrictions. However, travel restrictions are still in place to avoid a second wave of COVID-19 cases.
- Effective March 25, 2020, Hong Kong banned all non-residents from visiting for 14 days.
- Singapore requires a14-day quarantine for residents and long-term pass-holders returning to the country. It also bans tourists from short-term visits.

Some companies have benefitted from the current crisis, including internet solution providers as we see a greater demand for internet connection, hosting, virtual network access and system integration in both the public and private sectors. In the health care sector, electronic medical equipment makers that produce patient monitors, ventilators, defibrillators and other medical devices have seen a dramatic increase in demand for their products. This demand is not expected to lessen after the outbreak comes under control. As previously noted, consumer discretionary companies have suffered since the beginning of the pandemic, especially those related to the travel and cinema industries that have experienced a sudden and large drop in traffic.

We have not made changes to our investment approach and remain focused on:

- Quality growth
- Diversification across regions, currencies, sectors and industries
- Good opportunities to add fallen angels whose mid-term prospects remain intact

In our opinion, three things need to happen before we see an end to this global crisis and set the path towards a financial recovery:

- Actions from central banks to reassure the financial markets and investors
- Actions from governments to mitigate and control the outbreak
- Containment in the growing number of new cases and fatalities

The first two have already been initiated, and governments and central banks continue to implement measures and policies as we learn more about the virus and how to contain it. A vaccine would help prevent new cases of the virus, however, many experts do not expect one to be available before January 2021.

We will continue to update you as the situation regarding current market conditions and portfolio activities evolves.

Take care and stay safe.

The Global Alpha Team