

February 22, 2019

Dear clients and colleagues,

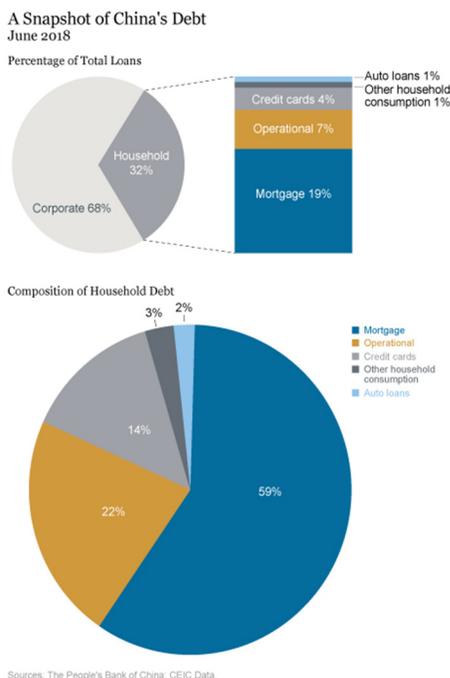
In last week’s commentary, we discussed Europe’s healthy balance sheets and European household debt and contrasted these with countries such as Canada, the UK and the Netherlands.

Total global debt levels reached a new high in 2018 at US\$247 trillion, up from US\$164 trillion in January 2009. That is an increase from 213% to 235% of GDP during the same period.

Debt levels in China have increased much faster and have now reached 280% of GDP, up from 163% in 2008, with corporations and households accounting for the majority of the increase. China’s debt is now close to 20% of global GDP compared to 6% in 2009.

China’s latest response to the economic slowdown? — ease credit and encourage lending. In the short term these measures appear to be working. In January, Chinese banks lent a record amount of 3,230 billion Yuan, or about US\$500 billion, up 44% from December. The Chinese stock market is up almost 15% year to date.

China’s household debt as a percentage of GDP surged to 53.2% at the end of 2018 compared to 18% in 2008. In China the household debt-to-income ratio is now higher than in the US. The situation has become so concerning that major rating agencies are sounding the alarm and their concern was echoed by the Federal Reserve of New York last week.



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In summary, household debt is worrying in many countries, and unless income rises faster than debt, we do not see the consumer taking the lead for the next stage of economic expansion.

We are also starting to see stress in the area of consumer credit. In 2007, US subprime mortgages were the culprit for the global financial crisis of 2008-2010. This time, some industry watchers have stated that student loans, or even automobile loans, could be one of the catalysts for the next crisis.

In the US, the New York Fed estimates that more than seven million Americans are behind on their car loans, that is 90 days behind on their payments.



Each of Global Alpha’s portfolios is exposed to the debt collection industry. In our Global Small Cap Portfolio we own US-based PRA Group (PRAA US).

PRA Group is based in Norfolk, Virginia and was formed in 1996. It is one of the largest publicly traded buyers of distressed consumer debt in the US and Europe. It buys written-off credit card receivables and other debts from lenders and then collects on them. Basically, PRA buys debt for \$0.05-\$0.10 on the dollar and recovers \$0.12- \$0.14. Historically, PRA has collected 2.5x-3x its purchase price. The last few years have been difficult for the company, in part because of the benign credit and bankruptcy cycle, too much capital to buy portfolios, increasing prices and increased regulatory scrutiny. However, in the last 12 months, PRA has seen sales reaccelerate into the double digits from negative growth in the last two years.

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COMMENTARY cont.



In our International Small Cap Portfolio, we recently added Italian DoBank S.p.A. (DOB IM).

DoBank has a business model different from PRA Group. It is a pure servicer of non-performing loans. Its clients are banks, pension funds and credit investors. DoBank does not buy the assets, it provides recovery, credit management, debt collection, due diligence, structuring and ancillary services to its clients. Its revenue model is based on the recovered amounts or as a percentage of the assets recovered. As Europe is still working through its defaulted assets from the global financial crisis, DoBank stands to benefit as an independent servicer.

Have a good week.

The Global Alpha Team