



**January 12, 2012**

**Dear clients and colleagues,**

Happy New Year and welcome back to our first commentary of 2012.

In 2011 our Global Small Cap fund and EAFE Small Cap fund ran slightly ahead of benchmarks, despite extreme market volatility. Looking back we saw a tale of two halves: risk-on until mid-May and risk-off for the rest of year, as funds rotated to more defensive sectors. MSCI World Small Cap Index lagged behind large cap. US small cap outperformed foreign small cap in most sectors. Developed markets continued to advance ahead emerging markets. In the MSCI World Small Cap index, defensives outperformed. The leading sectors were Utilities and Consumer Staples, and the lagging ones were Materials and Information Technology.

2012 will be another volatile year for stock markets. We expect many themes in 2011 to continue: EU sovereign debt issues, sluggish economic recovery in the developed markets, as well as economic slowdown and high inflation in emerging markets.

We remain very cautious. The global economy is recovering at a tepid pace; regional differences are obvious. Europe is on the verge of recession. ECB is trying to help European banks to avoid a liquidity crisis, but the solvency issue is still on the table and won't go away any time soon. The US economy, on the other hand, looks less shaky, with improving fundamentals such as manufacturing, employment and retail sales. Japan is busy dealing with post-quake reconstruction and yen's appreciation. Emerging countries are having a tough time balancing their policies to achieve a soft landing. The rate of inflation in at least ten Asian countries has risen above 10-year averages.

Meanwhile, we see chances of upside surprises. It is reasonable to believe that by 2013 progress could be made on solving the European crisis. Market anticipation of such progress may be priced in already this year. The US economy has been showing resilience, and its housing market looks to be nearing the bottom. Several countries such as China and Australia have room to loosen their monetary policy.

Our investment strategy remains the same. The disciplined process aims to add value through security selection, not through industry or currency/country selection. As a result, we have a diversified portfolio of 55 companies in 13 countries and 36 different industries. Our favored investment themes are aging population, emerging market consumer, environment and alternative energy, high-tech, outsourcing, and infrastructure. In stock picking, we

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emphasize companies with better sales growth vs. industry, superior margins, low debt, insider ownership and cheap valuation. This should allow us to deliver better returns in both up and down markets.

We wish you all another successful and prosperous year!

Regards,

The Global Alpha Team

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