COMMENTARY

July 30th, 2010

Dear clients and colleagues,

We are half-way through the Q2 earnings season. According to data compiled by Bloomberg as of this morning, 336 of the companies in the S&P 500 had reported their quarterly results. Of those, 78% had higher earnings than the same period last year. On the surprise side, 76% of companies had beaten estimates, a very high rate compared with historical levels.

Nonetheless, the widespread positive surprises have not translated into a stock market rally. From July 12th till today, Q2 earnings season so far, the S&P 500 has often been in a daily swing mode, and has moved up only 2%.

Why so? The on-going theme of economic instability does temper the earnings enthusiasm, as numerous economic data every day sends mixed signals to the market. Another reason could be the recent changes in street estimates that made the beat rather handy and less convincing. Close to the earnings season, analysts had cut estimates quite a bit, while companies not, according to Bespoke Investment Group.

Despite all the noises in the market, our team continue to look beyond the short-term volatility, and focus on companies' fundamental revenue-generation power, increasing market share, margin improvement, and long-term growth potential. In our Global Small Cap portfolio of 57 stocks, 22 had reported earnings. Of those, 17 (77%) had beaten estimates. Here are a few earnings highlights of our top holdings in the portfolio.

Jones Lang LaSalle (JLL US), 3.15% of portfolio

It is the 2nd largest publicly-traded real estate services and investment management firm in the world, with over 36,000 employees in 60 countries and annual sales of $2.5 billion. Its portfolio of property and corporate facility management services covers about 1.6 billion square feet worldwide. And its real estate asset under management reached $38 billion. Q2 revenue was up 18% y/y, and the adjusted Ebitda up 59%. EPS turned to $0.72 from a loss of $0.40 a year ago. Management saw broad improvement across business segments and regions, and was optimistic about further acceleration in 2010. Our results-check of its closest competitor, CB Richard Ellis, also showed very positive trend. Long-term industry growth is expected to be double digits annually.

Waste Connections (WCN US), 3.00% of portfolio

It is the 3rd largest publicly-traded solid waste company in the US, with over 5,400 employees and annual sales of $1.2 billion. It provides solid waste collection, transfer, disposal, and recycling services in secondary markets of the western US. It has industry-leading margin, FCF profile. Q2 revenue was up 9.1% y/y, with 5.6% organic growth and better-than-expected 1.5% operating margin expansion. EPS went up 29.7%. Increases in landfill volumes, roll-off activity, and recycled commodity prices contributed to the improvement. Management raised 2010 guidance on sales, ebitda margin and FCF, and reiterated its goal to repurchase about 6% of outstanding shares this year.

Prosegur Cia de Seguridad (PSG SM), 2.83% of portfolio

It is the #1 Spanish security company active in 13 countries, with 102,400 employees and annual sales of EUR2.2 billion. It operates in three businesses segments: guarding (surveillance), cash-in-transit (CIT) and alarms. About 50% of sales are from Latin America. Q2 revenue was up 22% y/y, with organic growth of 7% driven mostly by Latin America. EPS doubled. Brazilian sales, which represent 50% of LatAm sales, grew by 65.2%. Business in Europe remains resilient. Results were also supported by positive currency impact and improving margin.

Monro Muffler Brake & Service (MNRO US), 2.63% of portfolio

It is the largest chain of company-operated (vs. franchised) undercar care facilities in the US, with 5,000 employees in 19 US states. Annual sales are about $565 million. Its 800 stores are mainly in the northeast and mid Atlantic regions, known as the most reliable service provider and cost leader. Q2 sales reached a record of $158 million, up 23.6% y/y. EPS increased 37%. Store traffic rose 3%. Comparable store sales grew 5.1%. The growth strategy has been very steady and disciplined in the past decade, i.e. expand through acquisition, improve operating margin, and benefit from economies of scale. Management continues to anticipate steady growth and increased 2010 guidance. Sales in 2010 are expected to reach a new record.

Pharmaceutical Product Development (PPDI US), 2.58% of portfolio

PPD is a leading global contract research organization, providing drug discovery, development and lifecycle management services. It has more than 10,500 professional in 41 countries, with annual sales of $1.4 billion. Q2 revenue was up 4.3%, and adjusted EPS was up 29%. Positive momentum continued in Q2, with strong gross authorizations, low cancellations and improving development segment operating margin. We expect sales growth to accelerate in the rest of year as the company recognizes revenue from new strategic deals and service offerings, including two long-term strategic alliances with two top 10 pharmas.

Nabtesco (6268 JT), 2.5% of portfolio

Nabtesco is a leading Japanese manufacturer engaged in four business segments: precision equipments, transportation equipments, aircraft & hydraulic equipments, and industrial equipments. It has annual sales of $1.4 billion and 4,000 employees worldwide. Its unique motion control technology enables the company to gain over 50% of world market share in many product categories and to expand rapidly in emerging markets. Q2 revenue was up 35% y/y, and EPS up 9-fold. The strong recovery was led by buoyant demand from construction equipment makers in China. Management revised up guidance significantly to a 2-fold profit increase this year.

Regards

The Global Alpha Team