

October 11, 2013

Dear clients and colleagues,

Equity markets in many developed markets have had strong performance over the past year. This is despite the various sources of market uncertainties such as the continuing civil war in Syria, rising interest rates, the budget/debt ceiling negotiations in the United States, to name a few. Investors have ample reasons to turn bearish.

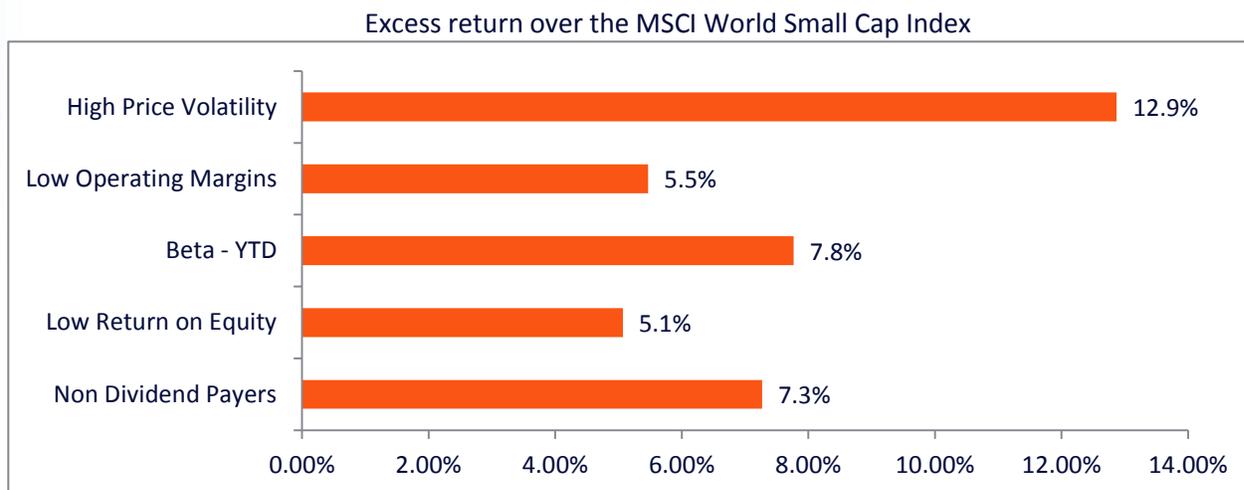
On the flip side, the US economy continues to improve led by recovery in the housing sector. The UK economy is growing, and data coming out of China is improving; all these factors point to a stronger global economy.

The MSCI World Small Cap Index is up 28.5% YTD. The top five percent of the performers in the index represent 32% of the index returns. Stocks in the 1st quartile are up 45.2%, twice the median return of 22.7% YTD.

In terms of our portfolio around 48% of the global small cap portfolio has outperformed the Index. When compared to the median return 58% of the holdings have outperformed.

What is working?

Risk and momentum appear to be the only trades working. As shown below, momentum and low quality stocks in the index have outperformed the index through September (YTD).



Source: Bloomberg, Global Alpha

Some of the high flying stocks in the index this year are:

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient's individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha's analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.

Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.

- Gungho Online Entertainment - a Japanese developer of video games is up 750.4% YTD even after a correction of 54% from its high. At its peak the company's market cap was larger than Nintendo with only 15% of the sales.
- Tesla Motors - a manufacturer of electric cars is up 457% YTD. Its P/E is 281x.
- Blumont Group, a Singapore listed company which invests in minerals and energy. Its market cap has surged from about \$415M at the start of the year to \$4.5B making it larger than the property giant Keppel Residence. Its P/E is 446x.

In a world that has grown more volatile and uncertain over the last five years, the natural tendency has been to shorten the time horizon over which objectives are measured and to tolerate less and less deviation from benchmark indexes. At Global Alpha our objectives are quite different.

Our clients like our emphasis on long-term returns and prefer our approach of taking lower amounts of risk. One of the challenges in doing this is the divergence in performance as compared to the index. While not pleasant, relative underperformance is a byproduct of having capital preservation as the key component.

At Global Alpha our strategy has and will be to identify "unrecognized growth" companies with accelerating earnings, strong balance sheets, high insider ownership and a business strategy misinterpreted by investors. We utilize a bottom up, research-based approach to identify these inefficiencies to produce a conviction based portfolio with sustainable alpha.

Have a nice long weekend.

The Global Alpha team

This report is provided solely for informational purposes and nothing in this document constitutes an offer or a solicitation of an offer to purchase any security. This report has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient and does not constitute a representation that any investment strategy is suitable or appropriate to a recipient's individual circumstances. Global Alpha Capital Management Ltd. (Global Alpha) in no case directly or implicitly guarantees the future value of securities mentioned in this document. The opinions expressed herein are based on Global Alpha's analysis as at the date of this report, and any opinions, projections or estimates may be changed without notice. Global Alpha, its affiliates, directors, officers and employees may buy, sell or hold a position in securities of a company(ies) mentioned herein. The particulars contained herein were obtained from sources, which Global believes to be reliable but Global Alpha makes no representation or warranty as to the completeness or accuracy of the information contained herein and accepts no responsibility or liability for loss or damage arising from the receipt or use of this document or its contents.

Performance figures are stated in Canadian dollars and are net of trading costs and gross of operating expenses and management fees. Further information about the Global Small Cap Composite is available by contacting the firm. Global Alpha Capital Management Ltd. (Global Alpha) claims compliance with the Global Investment Performance Standards (GIPS[®]) and has prepared and presented this report in compliance with the GIPS. Global Alpha has not been independently verified.