

February 1, 2019

Dear clients and colleagues,

In January, the Global Alpha team was in Shanghai attending the UBS Greater China Conference, which hosted 227 Chinese corporations and more than 2,000 investors. The inclusion of Chinese equities and bonds in global benchmarks may help explain the record high level of investor attendance. Sentiment at the conference was cautiously optimistic. Economists and macro speakers at the conference noted that they did not see a global recession happening in the near future. US-China trade friction was the most frequently mentioned topic during investors' meetings with corporations.

China's real GDP growth for 2018 came out last month at 6.6%, the lowest level since 1990. There is no doubt that the trade conflict negatively affected the economy to some extent, but most companies we spoke with saw limited impact to their businesses. Some exporters have the option of shifting production to countries such as Vietnam if higher tariffs are imposed. Many agree that even without the trade tension, the economy is already slowing down. The lack of reform or even reversal of some past reforms has hit the confidence level of many corporations.

This week we would like to talk about some topics and trends we observed during this trip, some of which will benefit our portfolio companies.

Consumption downgrade or upgrade?

A key debate about Chinese consumption behaviour in 2018 is whether consumption downgraded. Many people claim they have become more price-conscious because of their shrinking disposable income. That is why platforms offering group buying deals, such as Pinduoduo, are booming in China. We feel that the consumption behaviour of the Chinese people is definitely evolving, but not necessarily downgrading. According to a presentation by Nielson China, "Trading Up or Down: Demystifying Consumption Trends in China", Chinese consumers are becoming more rational in their spending habits. They tend to pay more for high quality products, not necessarily for famous brands.

There is a premiumization trend in certain types of products. One of them is personal care products, such as skincare and cosmetics. Consumers are willing to pay a premium in exchange for effective products with better ingredients. L'Occitane, which is one of our holdings, will benefit from this trend. The company is known around the world as a manufacturer and retailer of cosmetics and well-being products based on natural and organic ingredients. The company has enjoyed good sales growth in China. In the first three quarters of 2018, its sales in China increased 12.7% year on year, on a constant currency basis. It has been doing well in the e-commerce channel. Sales on Tmall (the largest B2C online retail platform in China) delivered 60% year-on-year growth during 2018's Double Eleven promotion event. L'Occitane also launched a flagship store on JD.com (the number two B2C online

retailer in China, after Alibaba's Taobao and Tmall) in the second quarter of 2018 and has seen good progress so far. We believe China and Asia markets will be the growth drivers in 2019.

Another key focus is on healthy living. With the improvements in the standard of living, people in China have started to pay special attention to food healthiness. Vitasoy, a long-term holding at Global Alpha, makes low-fat and low-sugar soy milk. Their VITASOY and VITA brands are recognized in China as high quality and healthy drinks. In the first half of fiscal year 2019 sales in China across all channels, including e-commerce, grew strongly, increasing 30% year-on-year on a local currency basis.

We also observed that mobile payment and online shopping are becoming indispensable to people in China. They no longer carry cash or cards. WeChat Pay and Ali Pay are accepted everywhere from high-end restaurants to fruit stands. Food delivery people in their uniforms are seen everywhere, and nicely packaged foods or groceries can be delivered to your door within 30-40 minutes. People rarely go to shopping malls nowadays. Tmall or JD.com are their go-to options for shopping, and that is why an increasing number of brands are opening flagship stores on those platforms.

Overall, we remain cautiously optimistic about China's economy in 2019 and have confidence in the holdings in our portfolio. Later this month we will be in Japan, again for investor conferences, and will update with you then.

Have a great weekend.

The Global Alpha team