

December 21, 2018

Dear clients and colleagues,

It is that time of year when we reflect on the year past and look to the year ahead.

What a difference a year makes. Following a very strong 2017, which capped what was one of the longest and biggest bull markets in history, in 2018 most stock markets around the world posted negative returns. To make matters worse, other asset classes, from high yield bonds to commodities, also suffered. In short, it was a difficult year for investors.

The reasons we could give are many, from slowing growth to trade wars. However, the main reason is the return to a more normal monetary policy by the US Federal Reserve and the European Central Bank. We see this as a positive outcome as it will create a more balanced risk-adjusted return profile for assets in the future and reduce the risk of asset price bubbles.

The global economy is still growing, and we do not foresee a recession in the world's most important economies in 2019. The US will continue to grow above 2% and China, with many policy tools at its disposal, will grow above 6%. Major emerging economies, such as India, Vietnam and Indonesia, may be beneficiaries of the China-US trade conflict. In short, 2019 may provide more subdued growth, but no important slowdown. This should be a major driver for profit growth and equities as valuations are now very attractive, around 14 times next year's earnings for global small cap, a discount to large cap.

Mergers and acquisitions should continue apace after a record year. Over \$3.7 trillion worth of M&A transactions were recorded in 2018, making it the third largest year on record after 2007 and 2015. Small cap volumes will continue to be very high as the risk of antitrust problems is minimal.

The Global Alpha Global and International Small Cap portfolios had a good year of relative performance in 2018. As expected, outperformance was driven by security selection. It was also a good year for takeovers, which saw names like Verifone, Sodastream and Jardine Lloyd acquired. We had to divest of a number of long-term holdings during the year as they no longer qualified as small cap investments. For example, Carl Zeiss Meditec, which had been a portfolio holding since inception in 2008, was sold after providing an annual compound return of over 21% since 2008.

We are well-positioned for 2019. The portfolios remain well diversified across many of the countries, currencies and industries included in our benchmarks.

2018 was an important milestone for Global Alpha as we celebrated our 10-year anniversary.

COMMENTARY cont.



We would like to thank you for your confidence in our team, our investment philosophy and process.

This will be our last comment for 2018; we will resume in January 2019. We would like to wish you a Happy Holiday Season and a wonderful 2019 filled with health, happiness and success.

The Global Alpha Team

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