CAPSTONE
GLOBAL INVESTMENTS

**First Quarter 2018**

**Capstone High Quality Small Cap**

There are three main building blocks of our investment process, small cap, high quality, and attractive valuation. We like to own companies that are growing faster than the market while trading at a significant discount. When we started our firm, we chose a portfolio of 45 companies that met all of these criteria and have steadily managed our holdings for 28 months. Over that time frame, our turnover has been approximately 40% year. Our annualized since inception return, after all fees and expenses, is 12.11%, compared to the Russell 2000 annualized return over the same period of 12.63%. Below is a table that corresponds to the characteristics of the portfolio at year-end 2015, year-end 2016, year-end 2017, and quarter end. The shaded lines show the ratio of the metric in relation to our main benchmark, the Russell 2000.

| | 12/31/2015 | 12/31/2016 | 12/29/2017 | 3/30/2018 |
|---|---|---|---|---|
| FY1 P/E | 12.1 | 13.7 | 13.7 | 13.4 |
| Benchmark relative | 0.7x | 0.7x | 0.7x | 0.7x |
| ROE | 19.5 | 18 | 19.7 | 19 |
| Benchmark relative | 3x | 3x | 3.4x | 3.1x |
| Earnings Growth* | 29.5 | 39.2 | 23.5 | 23.6 |
| Benchmark relative | 2.43x | 3.46x | 2.1x | 1.8x |
| Debt. to Cap. | 36.2 | 30.5 | 24.8 | 25.7 |
| Benchmark relative | 1.03x | 0.83x | 0.71x | 0.77x |

*Historical 3 Year
Source: Factset

We have maintained our valuation bias against the benchmark with the PE of our portfolio being just 70% that of the Russell 2000. The ROE of the portfolio is three times that of the benchmark, and the earnings growth of our portfolio is almost twice that of the benchmark. Our portfolio's earnings growth has remained better than the benchmark during the period, as has our Net Debt to Market Capitalization ratio. Our disciplined process has enabled us to continue to upgrade our holdings while maintaining an attractive portfolio of stocks. We currently have a portfolio that, when compared to its benchmark, is three times as profitable, has EPS growth two times as high, and is trading at a thirty percent discount. For the quarter we were down -1.99% after fees, underperforming the Russell 2000 return of -0.08% but outperforming the Russell 2000 Value return of -2.60%.

**First Quarter 2018**

**Capstone Global Investments High Quality Small Cap Strategy**

| As of March 31, 2018 (net of fees) | | | |
|---|---|---|---|
| | 1Q 2018 | 1 Year | Since Inception* |
| HQ Small Cap | -1.99% | 2.17% | 12.11% |
| Russell 2000 | -0.08% | 11.79% | 12.63% |
| Russell 2000 Value | -2.60% | 5.14% | 12.27% |
| *Annualized with Inception Date 12/01/2015 | | | |

**29-DEC-2017 to 30-MAR-2018**

| Ticker | | Contribution To Return |
|---|---|---|
| | | |
| | **5 Highest** | **2.39** |
| WD | Walker & Dunlop, Inc. | 0.59 |
| CASH | Meta Financial Group, Inc. | 0.56 |
| RTEC | Rudolph Technologies, Inc. | 0.49 |
| KEM | KEMET Corporation | 0.49 |
| PFBC | Preferred Bank | 0.26 |
| | **5 Lowest** | **-2.20** |
| CAI | CAI International, Inc. | -0.66 |
| UCTT | Ultra Clean Holdings, Inc. | -0.43 |
| BSIG | BrightSphere Investment Group Plc | -0.40 |
| HOFT | Hooker Furniture Corporation | -0.37 |
| CTB | Cooper Tire & Rubber Company | -0.34 |

**Quarterly Attribution:**

The quarter, much like the last 18 months, was a story of large cap growth stock leadership. Small cap stocks and specifically, small cap value stocks, did not perform nearly as well as the rest of the market. Within the Russell 2000, small cap stocks with earnings trading at less than 14x FY1 EPS returned on average -3.1% vs a +2% return for stocks trading at a multiple of over 27x. Value has continued to be out of favor, with momentum and forecasted growth leading for the quarter. Our technology companies performed poorly during the quarter having peaked out. The optical networking space became overcrowded, lost pricing power, and earnings began to deteriorate. Somewhat offsetting our difficulty in Technology our stock selection in Financials was very good. The Health Technology industry is about 10% of the Russell 2000. Biotech stocks continued to rally and despite having no current earnings many of them were up more than 50% during the quarter.

## Portfolio Review

During the quarter, we sold five positions. Two of the companies generated long-term gains for the portfolio, and the appreciation resulted in stretched valuations in our assessment. Three of the positions sold had deteriorating earnings, and generated losses in the portfolio.

We bought three stocks during the quarter:

Prestige Brands Holdings (PBH) – one of the largest independent over the counter healthcare companies with brands like Clear Eyes, Chloraseptic, BC and Goody's. Historically the company was building a portfolio of brands through acquisition, but now is focusing on using its sizable free cash flow to reduce debt and buy back its undervalued shares. The stock is trading on a forward PE of just 10x and has low double-digit earnings growth and low double-digit ROE.

Brightsphere (BSIG) – formerly known as Old Mutual Asset Management, the rebranded institutional investment firm is trading at just 7x forward EPS with a balanced book of AUM. Their platform includes public and private equity with global distribution. The $250 Billion asset manager has boutique affiliates of Acadian; Barrow, Hanley, Mewhinney & Strauss; Copper Rock, Campbell Global, and Investment Counselors of Maryland. The combined entity bring strategic synergies to help the boutiques grow faster than they could on their own.

Meritor (MTOR) –is a leading supplier of drivetrain systems and components, including axles and brakes for commercial vehicles. Heavy-truck orders remain elevated in a strengthening market with tighter capacity. Trading at just 7x EPS with high double-digit ROE and double-digit YOY EPS growth. We believe the risk-reward is in our favor here.

## Closing Comments

We continue to maintain what we view as an attractive portfolio of holdings. We are frustrated that large-cap growth stocks have dominated the market and that small-cap value has been out of favor. Over short periods of time, we will lag the benchmark, but we believe that the fundamental building blocks of our investment process, small cap, high quality and attractive valuation, will generate a well-constructed portfolio, potentially outpacing the market. Even though the growth style has outperformed value we prefer to pay less for better earnings growth. We believe our portfolio represents excellent value with better fundamentals than the market. We do not enjoy periods of underperformance, but our strategy is to buy high quality companies with solid balance sheets that are growing faster than the market at a discount. We believe that over time our portfolio will perform attractively.

Sincerely,

Chad Deakins, CFA

**Portfolio Manager, CIO**

## Capstone Global Investments Performance Results:

## High Quality Small Cap Equity - December 1, 2015 through March 31, 2018

| Year | Gross of Fee Return (%) | Net of Fee Return (%) | Russell 2K Return (%) | Russell 2KV Return (%) | Number of Portfolios | Composite Dispersion (%) | Total Composite Assets at End of Period | Total Strategy Assets at End of Period | Total Firm AUM | Total Firm AUA |
|---|---|---|---|---|---|---|---|---|---|---|
| 12/1/2015 to 12/31/2015 | -4.81 | -4.89 | -5.02 | -5.02 | 1 | 0 | <1 | <1 | <1 | <1 |
| 2016 | 32.3 | 31.02 | 21.32 | 21.32 | 3 | 0.01 | 2 | 2 | 3.5 | 3.5 |
| 2017 | 7.98 | 6.91 | 14.63 | 14.63 | 5 | 0.01 | 2.5 | 5.8 | 6.3 | 9.6 |
| YTD 2018 | -1.75 | -1.99 | -0.08 | -2.6 | 7 | 0.05 | 2.9 | 6.2 | 8.4 | 11.6 |

## GIPS Disclosures:

Capstone Global Investments claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards for the period December 1, 2015 through March 31, 2018. Capstone has not been independently verified for GIPS compliance.

1. Capstone Global Investments is an independent investment adviser registered with the State of Georgia. Capstone was founded in December of 2015 and manages small-cap equity strategies. For composite reporting purposes, the Firm is defined as all equity portfolios managed by Capstone.
2. Beginning December 2015, the composite includes only (SMA) portfolios benchmarked to the Russell 2000 Small Cap Index.
3. The Capstone High Quality Small Cap Equity SMA Composite is composed of portfolios invested in US equities which have a market capitalization greater than $50 million and less than $10 billion. The investment goal is to find high quality investment opportunities that are trading at a discount to the market and have a catalyst to help propel their relative valuation up to fair value. A complete description of the composite is available on request.
4. The composite was created in January 2016. A complete list and description of firm composites and performance results are available upon request.
5. All returns are expressed in US dollars. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.
6. The primary benchmark for the Capstone High Quality Small Cap Equity composite is the Russell 2000 Small Cap Index (Net). The Russell 2000 Small Cap Index returns are provided to represent the investment environment existing during the time periods shown. For comparison purposes, the index is fully invested and includes the reinvestment of income. The returns for the index do not include any trading costs, management fees, or other costs. Index returns have been taken from published sources.
7. Gross returns presented above as supplemental information. The SMA fee includes all charges for trading costs, portfolio management, custody, and other administrative fees. Net returns are calculated by subtracting the highest applicable SMA fee (1.00% on an annual basis, or 0.083% monthly) on a monthly basis from the gross composite monthly return. The standard fee schedule in effect is as follows: 1.00% on total assets.
8. The minimum portfolio size for the U.S. High Quality Small Cap Equity composite is seventy-five thousand dollars.
9. Past performance is not indicative of future results and no investment is guaranteed for the return of principal and/or return on investments. All information provided and used in calculations is believed to be correct, but accuracy cannot be guaranteed. Please consult with a financial professional before investing.
10. Composite dispersion is measured as the average of monthly standard deviations for the periods shown.
11. Upon request, Capstone Global Investments will provide a list of all securities recommended for the previous year. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities discussed herein.