

Capstone High Quality Small Cap

There are three main attributes 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 these criteria and have steadily managed our holdings for 3 years. Our annualized since inception return, after all fees and expenses, is 3.8% compared to the Russell 2000 annualized return over the same period of 9.3%. Below is a table that corresponds to the characteristics of the portfolio periodically. 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	12/31/2018	3/31/2019
FY1 P/E	12.1	13.7	13.7	8.4	9.4
Benchmark relative	0.7x	0.7x	0.7x	0.6x	0.6x
ROE	19.5	18	19.7	20.8	22.1
Benchmark relative	3x	3x	3.4x	3.4x	3.8x
Earnings Growth*	29.5	39.2	23.5	18.6	30.5
Benchmark relative	2.43x	3.46x	2.1x	1.5x	1.9x
Debt. to Cap.	36.2	30.5	24.8	32.3	31.4
Benchmark relative	1.03x	0.83x	0.71x	0.97x	0.94x
*Historical 3 year Source: Factset					

As value investors, we buy only stocks that have earnings. We only buy stocks that are growing and profitable. We have a significant amount of our own capital invested in the strategy. This quarter we were up slightly more than our benchmark.

We have maintained our valuation bias against the benchmark. The PE of our portfolio is now 60% of the Russell 2000. The ROE of the portfolio is almost four 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. For the quarter the portfolio was up 15.6% after fees, outperforming the Russell 2000 return of 14.6% and Russell 2000 Value return of 11.9%.

Quarterly Attribution:

As we wrote in last quarter's letter, "We can observe and report, but we cannot give a specific reason why. The Russell 3000 growth PE less the Russell 3000 value PE currently stands at more than two standard deviations away from its long-term average. This is often a point of inflection. We have experienced underperformance before, but there was a rebound resulting in overall outperformance." It appears that we may be receiving some rebound now.

Given our underperformance in 2018, our first quarter results represent a significant improvement. When evaluating any manager, focused attention must be given to the consistency of investment process execution. During seasons of underperformance, it is all too common for a manager to drift away from the core process while seeking improved performance. At Capstone, our investment process does not drift in times of underperformance or opposite. We publish our portfolio characteristic for each and every quarter, to hold ourselves accountable for our consistent approach, which we believe will deliver attractive relative returns over time.

Portfolio Review

New Purchases

Timken (TKR) – We added to this position. Timken engages in the engineering, manufacture, and marketing of bearings, transmissions, gearboxes, belts, chain, lubrication systems, couplings, industrial clutches and brakes, and related products. We originally bought the stock after a sell-off. We see a stock trading at an attractive valuation with solid EPS growth and positive EPS revisions from the analyst community.

PennyMac Mortgage Investment Trust (PMT) – This is a mortgage REIT and it was trading below book value while paying a consistent monthly dividend at an annual yield of over 10%. With the Fed on hold and inflation under control we see little change in the interest rate environment over the next 12 months and will collect the income and the price appreciation as the valuation normalizes.

Cabot Microelectronics (CCMP) – The firm offers chemical and mechanical slurries for polishing computer chips as they are manufactured. The company has actual earnings growth of over 40% over the last year and a high teens ROE. It is highly correlated with the semiconductor industry. It has a net cash position, pays a dividend and is trading at the lower range of the PE band over the last 3 years.

Portfolio Review (Continued)

FS Bancorp (FSBW) – The holding company for 1st Security Bank of Washington, which provides normal community bank services like checking, savings, home loans, personal loans, and investment services. After the selloff in the fourth quarter the bank was trading at a 9x PE which is a 25% discount to its 5-year average. It has shown continued earnings growth and solid profitability. With ongoing bank consolidation this company could be an attractive prospect.

Delphi Technologies (DLPH) – Delphi engages in development, design, and manufacture of integrated powertrain technologies. The stock has sold off from \$60 to \$19 and was trading at a 6X PE. Earnings growth looks to have bottomed out and is rebounding. For a smaller cap company there are a large number of analysts following this stock (18). Estimates for this year and next year are being revised upward.

Wolverine World Wide (WWW) – This company designs, manufactures, licenses and markets branded casual, active lifestyle, work, and outdoor sport footwear and apparel. Its brands are Merrell, CAT, Hush Puppies, Chaco, Sperry, Saucony, Keds, Wolverine, Harley Davidson and HvTest. With stable growth from the work brands (CAT, Wolverine, Bates) and strong double-digit growth in Merrell the outlook is positive. At a 13x PE and a high teens ROE the stock looks cheap and has beaten estimates every quarter for the last 3 years.

Closing Comments

We continue to maintain what we view as an attractive portfolio of holdings. Valuation spreads remain very wide and we believe that we are positioned for strong returns if market participants continue to act rationally. We believe that the fundamental building blocks of our investment process (small cap, high quality, and attractive valuation) will generate a well-constructed portfolio, with the potential to outpace the market. Our portfolio represents excellent value with better fundamentals than the market. 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 High Quality Small Cap Strategy

	HQ Small Cap	Russell 2000	Russell 2000 V
1Q 2019	15.6%	14.6%	11.9%
1 Year	-13.2%	2.0%	0.2%
3 Year	6.3%	12.9%	10.9%
ITD*	3.8%	9.3%	8.5%

Top/Bottom 10 Contributors to Return
High/Low - Port. Contribution To Return
31-DEC-2018 to 29-MAR-2019

Ticker		Average Weight	Total Return	Contribution To Return
	Total	100.00	16.03	16.03
	5 Highest	16.13	40.12	5.66
NMIH	NMI Holdings, Inc. Class A	4.52	44.93	1.77
VCTR	Victory Capital Holdings, Inc. Class A	2.73	46.97	1.09
CCS	Century Communities, Inc.	2.78	38.88	0.98
TPL	Texas Pacific Land Trust	2.45	44.03	0.93
ESNT	Essent Group Ltd.	3.64	27.12	0.89
	5 Lowest	10.66	-3.93	-0.47
NCS	NCI Building Systems, Inc.	1.25	-14.21	-0.16
PBH	Prestige Consumer Healthcare Inc	2.99	-3.14	-0.13
FSBW	FS Bancorp, Inc.	0.58	-3.61	-0.07
CBPX	Continental Building Products, Inc.	3.25	-2.59	-0.06
KEM	KEMET Corporation	2.58	-3.00	-0.04

Capstone Global Investments Performance Results:

High Quality Small Cap Equity - December 1, 2015 through March 31, 2019

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	-5.3	1	0	<1	<1	<1	<1
2016	32.3	31.02	21.3	31.7	3	0.01	2	2	3.5	3.5
2017	7.98	6.91	14.6	7.8	5	0.01	2.5	5.8	6.3	9.6
2018	-25.59	-26.35	-11.02	-12.84	8	0.05	2.4	5.4	6.3	9.3
YTD	15.8	15.6	14.6	11.9	8	0.05	2.8	5.4 ¹²	6.3 ¹²	9.3 ¹²

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, 2019. 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.
12. Estimated. To be updated April 30th.