

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's annualized return of 9.3% over the same period. 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	6/30/2019
FY1 P/E	12.1	13.7	13.7	8.4	9.9
Benchmark relative	0.7x	0.7x	0.7x	0.6x	0.6x
ROE	19.5	18	19.7	20.8	19.5
Benchmark relative	3x	3x	3.4x	3.4x	3.3x
Earnings Growth*	29.5	39.2	23.5	18.6	31
Benchmark relative	2.43x	3.46x	2.1x	1.5x	1.8x
Debt. to Cap.	36.2	30.5	24.8	32.3	31.3
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 that are growing and profitable. We have a significant amount of our own capital invested in the strategy. The performance of our equity portfolio this quarter was strong, showing the continued absolute and relative performance trends that we saw last quarter.

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 over 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. For the quarter the portfolio was up 4.0% after fees, outperforming the Russell 2000 return of 2.1% and Russell 2000 Value return of 1.37%.

Two quarters ago we wrote in our 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 are receiving some rebound now for the second quarter in a row.

Given our performance in 2018, our first and second quarter results represent a significant improvement. When evaluating any manager, focused attention must be given to the consistency of investment process and 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 quarter to hold ourselves accountable for our consistent approach, which we believe will deliver strong relative returns over time.

Portfolio Review

New Purchases

Safe Bulkers (SB) – The company engages in the ownership and operation of dry bulk vessels. They operate particularly in the coal, grain, and iron ore area. Its fleet includes Panamax, Kamsarmax, Post-Panamax and Capesize vessels. We have been waiting for the right time to enter an investment in this area and with the number of ships low and a constant demand it looks like the sector might have bottomed. With the Baltic Dry Index turning upward dramatically, pricing should improve, and this stock should become more profitable.

America’s Car-Mart (CRMT) – The company is involved in the sale of older models of used vehicles and the provision of financing for its customers. With the threat of tariffs and vehicles lasting longer this appears to be a good business. It has a double-digit ROE, double digit earnings growth and is trading at its lowest forward PE multiple in over two years. After a recent pullback, we think now is a good entry point.

Fabrinet (FN) – The company provides optical packaging and electronic manufacturing services to OEMs (Original Equipment Manufacturer). After a selloff in the semiconductor space due to the “trade war”, we think the stock looks attractive. With the stock trading at 12.9x FY1 PE, accelerating growth, and double-digit profitability, now looks like a good entry point for this business as well.

Blucora (BCOR) – The company provides technology solutions to consumers, small businesses, and tax professionals. It operates in the Wealth Management and Tax Preparation segments. It distributes its Wealth Management products through HD Vest and its Tax Preparation service primarily through TaxAct. With strong accelerating growth and trading at only 11.5x FY1 PE, we believe the stock has plenty of upside.

Portfolio Review (Continued)

Stocks Sold

TRI Point Homes (TPH) – TRI Point designs, builds, and sells single family homes and condominiums. A large exposure to the slowing California housing market has depressed earnings and reduced profitability. With negative estimate revisions and rising short interest, we exited the name.

Univar (UNVR) – Univar is a chemical and ingredients distributor and provider with a portfolio of over 4,500 products distributed into the global supply chain. Earnings growth has slowed, which is partially due to the trade war. Analysts have brought down the growth outlook and short interest has started to rise. We think things will get worse before they get better, so we exited the name.

Penske (PAG) – PAG engages in the distribution of commercial vehicles. Growth has stalled out and profitability is falling. The tariffs have threatened the entire value chain in the automotive and truck space. With a sharp increase in short interest we decided to exit the name.

Walker & Dunlap (WD) – We have been a longtime holder of this multifamily focused lender and investor and feel the multifamily housing space is beginning to be over built. Growth is slowing, and profits have hit their peak. We think it is time to take the profit and reinvest elsewhere.

Quarterly Attribution:

We had a good quarter on both an absolute and relative basis. The next page includes a list the stocks that had the best and worst contribution to our performance for the quarter. To summarize, we had great stock selection in the cheapest segment of the market as measured by forward P/E. Our focus on profitability helped us avoid value traps in the cheaper part of the market. Focusing on stocks that only have earnings was also beneficial to performance.

Closing Comments

We continue to maintain what we view as an attractive portfolio of holdings. Valuation spreads remain very wide, and we believe 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 continue to perform attractively.

Sincerely,

Chad Deakins, CFA **Portfolio Manager, CIO**

Capstone Global Investments High Quality Small Cap Strategy

	HQ Small Cap	Russell 2000 V	Russell 2000
2Q 2019	4.0%	1.4%	2.1%
1 Year	-10.0%	-6.3%	-3.3%
3 Year	7.4%	9.8%	12.3%
ITD*	4.7%	8.3%	9.3%

**Top/Bottom Contributors to Return
High/Low
29-MAR-2019 to 28-JUN-2019**

Ticker		Average Weight	Total Return	Contribution To Return
5 Highest		15.88	18.05	2.64
MTOR	Meritor, Inc.	3.46	19.16	0.65
TKR	Timken Company	3.20	18.41	0.56
ATKR	Atkore International Group Inc.	2.97	20.16	0.53
VPG	Vishay Precision Group, Inc.	2.73	18.77	0.45
VCTR	Victory Capital Holdings, Inc. Class A	3.53	14.38	0.45
5 Lowest		12.19	-14.11	-1.82
WWW	Wolverine World Wide, Inc.	1.75	-22.64	-0.44
BSIG	Brightsphere Investment Group Plc	2.71	-15.09	-0.44
RUSHB	Rush Enterprises, Inc. Class B	3.24	-10.87	-0.36
SPR	Spirit AeroSystems Holdings, Inc. Class A	2.65	-10.96	-0.31
MCFT	Mastercraft Boat Holdings, Inc.	1.84	-13.20	-0.28

Capstone Global Investments Performance Results:

High Quality Small Cap Equity - December 1, 2015 through June 30, 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	20.7	20.13	17	13.5	8	0.05	2.8	3.6 ¹²	6.8 ¹²	7.6 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 June 30, 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 July 30th.