

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 3.9% compared to the Russell 2000's annualized return of 8% 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	9/30/2019
FY1 P/E	12.1	13.7	13.7	8.4	10.0
Benchmark relative	0.7x	0.7x	0.7x	0.6x	0.6x
ROE	19.5	18	19.7	20.8	19.2
Benchmark relative	3x	3x	3.4x	3.4x	3.3x
Earnings Growth*	29.5	39.2	23.5	18.6	29.7
Benchmark relative	2.43x	3.46x	2.1x	1.5x	1.9x
Debt. to Cap.	36.2	30.5	24.8	32.3	30.6
Benchmark relative	1.03x	0.83x	0.71x	0.97x	0.91x
*Historical 3 year Source: Factset					

As value investors, we buy only stocks 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 slightly better than the Russell 2000.

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 down -1.6% after fees, outperforming the Russell 2000 return of -2.4% but slightly worse than the Russell 2000 Value return of -0.6%.



**Third
Quarter
2019**

Three 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 relative rebound for the third quarter in a row.

Given our performance in 2018, our year-to-date 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 the 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

CoreLogic (CLGX) – The company operates in the property intelligence, risk management, and underwriting solutions areas of the real estate markets in North America, Western Europe, and Asia Pacific. The company has an attractive valuation, with a forward P/E of 15.6x and a double-digit ROE of 20.4%. Earnings growth estimates are positive with growth being estimated at more than 10% for next year. Currently analysts continue to revise estimates upward and there is little short interest.

Deluxe Corporation (DLX) – Deluxe corporation was originally known for providing checks. We owned this company for more than a year between 2016 and 2018. We took profits in the \$65 range. This stock has sold off significantly since then. We re-purchased the position again at \$44.75. The company has created a service segment for small businesses that includes everything a small business would need to operate. Accounting and presentation software and physical supplies including a direct sales force. The stock looks very attractive again. It is trading at less than 7x forward earnings and has a 25% return on equity. It does have slow growth, however, over the last 2 months analysts have increased their earnings estimates for this year and next year by more than 10 percentage points and short interest has dropped dramatically and back below 5%. The company has had positive earnings surprises in all 6 of the previous quarters.

Malibu Boats (MBUU) – Malibu Boats designs, manufactures, and markets recreational powerboats. its Brands are Malibu, Axis, Cobalt, and Pursuit. The company sells in North America, South America, Europe, and Asia. We have wanted to buy this stock for a long time but it has been too expensive. We purchased MasterCraft instead. With a selloff beginning in the fourth quarter of last year, we believe it is a good time to swap out MasterCraft for Malibu. The stock trades below eight times forward earnings with a reported 2019 ROE of 39%. There is very low debt and very low short interest. We think that as the fear subsides headed into the election recreational boating sales will remain robust.

Portfolio Review (Continued)

Stocks Sold

Delphi Technologies (DLPH) – 25% of revenue comes from mainland China. Even though the company is trading at very low multiples with higher profitability this year and next year are going to be severely impacted by the trade war situation. There also is a very sharp slowdown in auto sales in China. Short interest has been rising and estimates continue to be lowered. The near-term outlook is challenged, so we exited the name.

Great Western Bancorp (GWB) – We took profits at Great Western Bancorp. There are too many banks that are doing well to stay invested in one that is not executing. Profitability is in single digits, earnings growth is negative for this year, and estimates continue to be revised downward.

Mastercraft Boat Holdings (MCFT) – As we stated above we sold the stock to capture our loss. We still like Mastercraft, but like Malibu better and believe it is a good time to switch out these very similar names. Since the switch Mastercraft has continued to deteriorate while Malibu has appreciated.

Spirit AeroSystems (SPR) – Spirit mainly builds fuselages for Boeing. We bought the stock at \$46 and exited at \$79. We still like the stock but feel like it is dead money for the next few months or quarters. We will revisit the name when the 737 Max goes back into service.

Quarterly Attribution:

We had a good quarter on a relative basis. The next page includes a list of 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. Similar to last quarter 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. Another driver was the sell-off in Biotech, with the Russell 2000 Health Care sector down during the quarter and our one holding in the sector Prestige Health Care was up.

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
3Q 2019	-1.6%	-2.40%	-0.60%
1 Year	-8.2%	-8.90%	-8.30%
3 Year	3.2%	8.20%	6.50%
ITD*	3.9%	8.00%	7.60%

Top/Bottom 10 Contributors to Return

High/Low

28-JUN-2019 to 30-SEP-2019

Ticker		Average Weight	Total Return	Contribution To Return
	Total	100.00	-1.48	-1.48
	5 Highest	14.43	17.89	2.45
CCMP	Cabot Microelectronics Corporation	2.77	28.28	0.72
ATKR	Atkore International Group Inc.	3.47	17.32	0.57
CCS	Century Communities, Inc.	3.29	15.24	0.45
UCFC	United Community Financial Corp.	3.19	13.56	0.39
DLX	Deluxe Corporation	1.70	11.96	0.33
	5 Lowest	13.31	-22.04	-3.48
MTOR	Meritor, Inc.	3.18	-23.71	-0.93
DLPH	Delphi Technologies Plc	2.24	-28.20	-0.83
VPG	Vishay Precision Group, Inc.	2.62	-19.42	-0.62
BCOR	Blucora, Inc.	1.65	-28.75	-0.59
PRGS	Progress Software Corporation	3.62	-12.39	-0.51

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	-25.6	-26.4	-11.0	-12.8	8	0.05	2.4	5.4	6.3	9.3
YTD	19.1	18.2	14.2	12.8	8	0.07	2.7	3.6 ¹²	6.8 ¹²	7.7 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 September 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 October 31th.