Greenfield Seitz
CAPITAL MANAGEMENT

2019 Mid-Year Letter

July 31, 2019

Dear Investor,

The Greenfield Seitz Core Composite was up 15.9% (net-of-fees) for the first half of the year. This compares to a 16.9% gain for the MSCI World index and an 18.5% gain for the S&P 500 Index.[1]

We were aggressive buyers of stocks in December 2018 after the S&P 500 sold off 19% in the fourth quarter. With the market now up 29% from those December lows and at an all-time high, we have been taking profits recently.

Economic Update
After growing consistently for much of this 10-year bull market, corporate earnings are on track to be down 2.6% for the second quarter.[2] This will be two consecutive quarters of earnings declines because the S&P 500's earnings were also down 0.4% in 1Q19.[2]

Earnings were hurt by the trade war with China and a global economic slowdown. Exports were down 5.2% and manufacturing costs were increased by tariffs on imported goods. The tax cuts that boosted earnings in 2018 were a one-time benefit to growth that is now behind us. Additionally, it could be that after twenty years of cost reductions from technological innovation and globalization, profit margins have peaked. Lastly, the benefits from low borrowing costs are wearing off as we have been in a low rate environment for 10 years.

Overall, the economy appears healthy but slowing. GDP growth is still averaging around 2-3% and unemployment is at a 50-year low of 3.8%.[3]

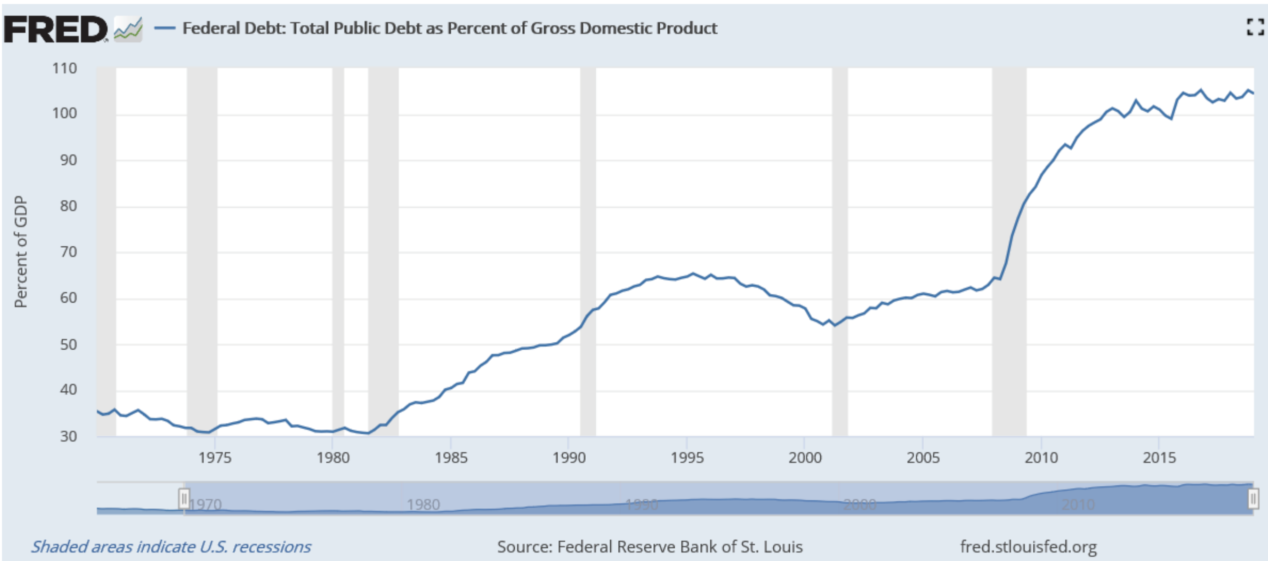
Fed Funds Rate
The Federal Reserve cut the federal funds rate target this week (now 2.0-2.25%) for the first time since the 2008-2009 financial crisis. This preemptive move is seen as an insurance policy to offset the trade war and global slowdown in demand. Typically, the Fed starts lowering rates during a financial crisis or as a response to an economic downturn. But this time is unique because GDP is still growing at 2.1% and consumer spending, which accounts for 70% of the U.S. economy, grew 2.9% in the most recent quarter.[3]

We believe much of the rebound in the market this year is the excitement about the Federal Reserve switching to an easing mode. "Don't fight the Fed" has been historically true with the S&P 500 gaining in 11 of 14 easing cycles with an average annualized gain of 20%.[4] But the Fed easing is usually correlated with recessions. Apart from 1967 and 1996, every Fed easing has been associated with a recession.[5] We wonder with everyone buying stocks in front of the easing cycle, if they have already priced in the gains that would normally happen during the easing period. The market may have pulled forward the future gains.

Debt Fueled Speculation
It appears investors are overly focused on the fed funds rate and the idea that lower rates equal a continued bull market. It is a common narrative that the Fed's rate increases last fall led to the 19% market decline. You could assume the Fed "pivot" in January led to the market's 29% advance from there. Why would a

fed funds rate of 2.5% be too high but 2.25% is fine? Is the economy so weak that a fed funds rate above 2.5% risks bringing us into a recession? This minor increase in rates caused a $7 trillion decline in U.S. market values in the fourth quarter sell-off. We believe this is an overly simplistic view of the stock market and that it may lead to investors being overly optimistic now that we are in an easing environment.

We wonder if the low rate environment caused the world to take on too much debt. If this is true, it may be the idea that higher interest rates would lead to painfully higher debt service costs. Additionally, most assets have been propped up by investors willing to buy them with borrowed money because of such low borrowing costs. It could be that higher interest rates would remove the leveraged buyers, thus taking away the marginal investors that are propping up so many asset classes to record highs (stocks, $13 trillion in negative yielding bonds, real estate, art, cryptocurrencies, etc). The driver of these historic prices is record low interest rates.



As long-term investors, we aim to invest in great companies at an attractive price (valuation). This process is determined by current fundamentals, valuations, and the future outlook for each company.

Market gains have rewarded speculative investors recently, which is typically a sign we are in the late stages of a market cycle. It appears speculators have been lured in by the ongoing bull market and trained that every dip is a buying opportunity. Now they are trying to chase the last returns out of a 10-year bull market. As evidence, we see almost all valuations are at historical extremes and unreasonable investor enthusiasm for fad investments like cryptocurrencies, cannabis stocks, and FANG. The most recent fad stock is Beyond Meat, which is a vegetable burger maker with a $13 billion market cap and only $260 million in annual sales (current run rate).[6] By comparison, Expeditors International also has a $13 billion market cap but generates $8 billion in annual sales.[6]

The prudent investor stays true to the discipline of a successful long-term approach and we continue to invest in quality companies with a long-term outlook.

As always, please contact us anytime if you have any questions.

Sincerely,

Greenfield Seitz Capital Management

GREENFIELD SEITZ CAPITAL MANAGEMENT

Past performance does not guarantee future results.
1 MSCI and Standard & Poors. June 30, 2019.
2 Factset Earnings Insight. July 26, 2019.
3 FRED. St Louis Federal Reserve Economic Research.
4 Strategas. July 30, 2019
5 Hussman Investment Trust. July 14, 2019
6 Company filings. July 2019

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