Greenfield Seitz
CAPITAL MANAGEMENT

2013 Annual Letter

January 29, 2014

Dear Investor,

For 2013, the Greenfield Seitz Global Equities Core Composite gained 18.9% (net of fees), compared to a 32.4% increase for the S&P 500 Index and a 12.2% increase for the MSCI International Index.[1] Our allocation continues to be roughly 55% U.S. stocks and 45% international stocks.

Update

Stocks performed very well in 2013 led by U.S. markets. In last year's letter, we cataloged the reasons stocks, and the U.S. in particular, were positioned to do well. The rise in stock prices was fueled by steady improvement in the economy and increased corporate earnings. The improved outlook and reduced uncertainties drove investors into stocks. Much of this shift toward stocks was at the expense of bonds. The movement toward riskier assets was helped by the excess liquidity provided by the Federal Reserve.

Recent economic data have shown continued, gradual economic growth. Real GDP is growing at roughly 2.5-3%, which is near the long-term average of 2.9%. Consumer spending has increased steadily since 2009. The U.S. housing market continued to improve as average home prices increased 14% with the help of low mortgage rates.[2] Despite this, unemployment has remained high at 7% as corporations have been reluctant to increase headcount. Corporate earnings grew roughly 4% for the year. This is positive growth but also shows that much of the jump in stocks was due to multiple expansion as valuations became higher.

Performance

For 50 years we have stuck to our time-tested process of patiently investing in fundamentally strong companies with outstanding management. This has allowed us to deliver attractive results in many different markets, geopolitical and economic environments. In fact, Greenfield Seitz, through periods of inflation, deflation, and bull and bear markets has outperformed the S&P 500 Index for every 10-year period since inception.

GSCM has underperformed the S&P 500 Index for the past three years. This is primarily due to our 45% exposure to international stocks, as well as our bias towards high-quality companies. We have underperformed the U.S. index by 23% (2,300 bps) over the last three years. The last time this happened was 1997-1999 when we sat on the sidelines of the tech mania. Over the next 11 years, GSCM outperformed the S&P 500 every year, achieving a total outperformance of 114% (11,400 bps). We believe markets are mean reverting and that our style will return to favor as it did following the dot-com bubble.

We are not alone, in that many of the best performing managers have struggled recently. This is to be expected with the recent outperformance of low-quality as well as the fact the best managers don't outperform every year as they stick to their style even when it is out of favor. Studies show that 93% of the top quartile large-cap managers over a 10-year period spent at least one 3-year period in the bottom half of their peer group and 31% spent at least a 3-year period in the bottom decile.[3]

High Quality Companies: Out Of Favor But History Suggests Not For Long
In recent years, low-quality companies have outperformed the shares of high-quality companies. Almost anyway you define low-quality, such as negative earnings, low margins, or high debt, it has outperformed. S&P actually tracks this dynamic based on the growth and stability of earnings, with the S&P 500 Low Quality Index and the S&P 500 High Quality Index.

Over the past five years, the Low Quality Index has returned 25% annually, compared to only 18% annually for the High Quality Index.[4] Coming out of the recession, it was understandable that surviving shares of the most beaten up and lowest-quality companies would rebound more than the blue chips. This outperformance was prolonged by the Fed's quantitative easing, which benefited the riskier segments of the market. But we believe we are well past the rebound from the 2008 recession and the days of quantitative easing are fading.

The relative outperformance of low-quality companies is strange because for the past 35 years companies that are losing money have underperformed the market by an astounding 8% annually.[5] We believe this recent anomaly of the low-quality segment winning has gone too far. Studies show that high-quality outperforms over the long-term. In fact, this has been a cornerstone to our investment thesis for the past 50 years.

Ultimately, returns (or lack thereof) are driven by the underlying earnings of the stocks in a portfolio. Over time, the companies with growing earnings will deliver returns to investors and the volatility will net out.

Interestingly, companies with high and stable profits continue to generate superior returns for decades.[5] This runs counter to the modern finance theory that companies with high margins will attract competitors that will squeeze industry profitability. Companies with superior branding, intellectual capital, and barriers to entry tend to keep these advantages over time. Warren Buffett describes this as a "corporate moat." Over the past 45 years, companies with the highest profitability maintained that advantage over every 5-year period.[5]

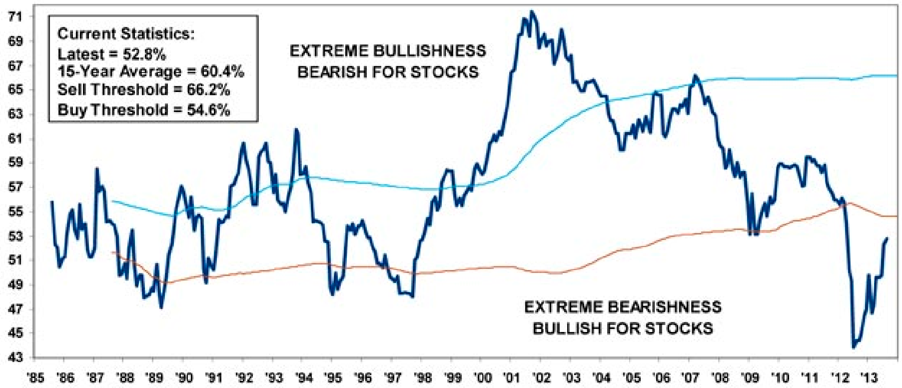
The recent phenomenon has gone so far that the Low Quality Index now trades at a premium P/E to the High Quality Index.[6] This is extremely rare. We can now buy shares of higher earnings growth companies for a lower price than companies with low or no earnings.

There are countless studies showing high-quality outperforms over time and we have certainly experienced it first hand at Greenfield Seitz. If the high-quality companies consistently generate more earnings and earnings drive returns, then we believe our strategy will pay off over time.

Our Favorite Stock Market Indicators Are Still Positive, But Less So

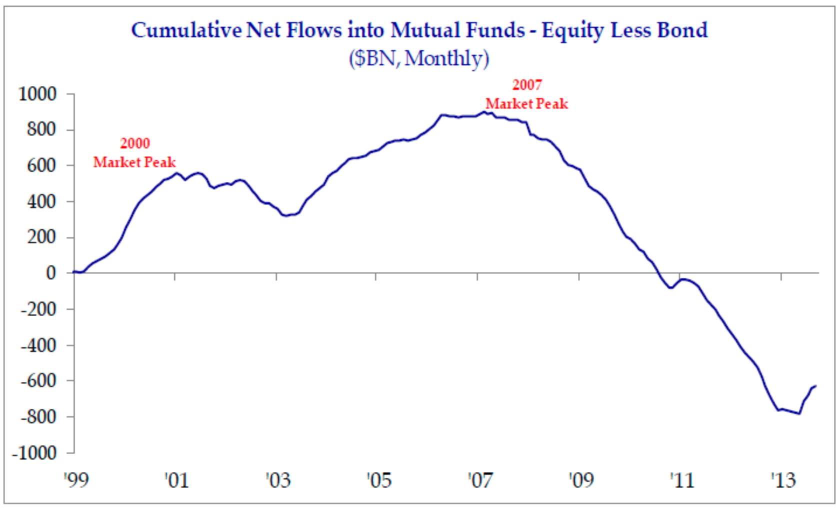
1. Wall Street Strategists Recommendations. The consensus recommendation from Wall Street strategists is statistically one of the most accurate contrary indicators. When strategists recommend stocks, it is usually time to sell and when they recommend selling stocks for bonds, it has been a great time to buy stocks.

This time last year, Wall Street strategists were recommending their lowest allocation to equities in the 30-year history of the data. Not surprisingly, stocks went on to have an outstanding year at the expense of bonds. So once again the strategists at the major banks were bearish when they should have been bullish. Now that stocks are up, they are less bearish, recommending a 53% allocation to stocks up from a 44% recommendation last year. This is moving according to our expectations as others get on the bandwagon. The good news is the 53% recommended allocation to stocks is still considered an "underweight equities recommendation" and it is below the long-term average of a 60% allocation, so according to the contrarian theory we should expect continued strength in stocks.



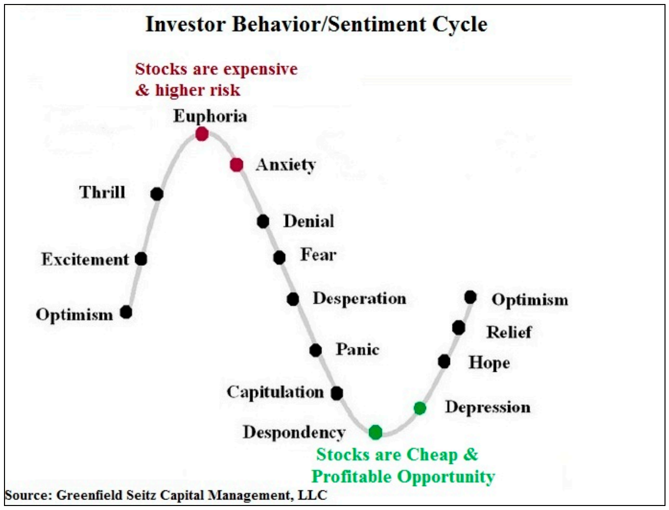
2. Mutual Fund Flows. Our second favorite indicator is mutual fund flows, which are only slightly less accurate as a contrarian indicator than Wall Street strategists. As investors put money into equity mutual funds, it has historically been a good time to sell and vice versa. The chart below shows mutual fund investors have switched to buyers of stocks after five years of consistent selling. While the reversal of investors out of bonds and into stocks is an inflection point, we think this is just the start of a long-term trend out of low-yielding bonds and into stocks. Thus, we believe stocks have more room to run.

In the five years prior to 2013, bond funds took in over $1.1 trillion dollars while stock funds had five straight years of net withdrawals totaling more than $500 billion.



3. Investor Sentiment. Trying to gauge investors' risk appetite is critical in attempting to predict stock market returns. Unfortunately, this is more art than science. We can use many tools to help get a feel for investor sentiment such as: (1) valuations; (2) mutual fund flows; (3) investor sentiment polls; and (4) margin debt. As expected, all of these factors moved up last year. The current trailing P/E for the S&P 500 is 18.2x compared to a long-term average of 15.5x. Margin debt now stands at an all-time high and fund flows are also pointing to an increasingly bullish attitude for investors. Lastly, Vanguard recently reported that investors' equity allocation was 57% and has only been higher twice in the last 20 years.

Using all our available information combined with conversations with investors, we believe we are somewhere near the "optimism" stage (see chart below). Thus, stocks are not widely owned but investors are feeling good about the future and more investors are moving into stocks. After a 128% rebound from 2008, investors seem to be getting more interested in stocks. But there are so many legitimate questions keeping investors doubtful.



Federal Reserve's Quantitative Easing and Tapered Exit
In December, the Federal Reserve Bank announced it will reduce its monthly bond purchases from $85 billion to $75 billion. Today, the Fed announced it will continue tapering its monthly purchases to $65 billion. The $85 billion monthly purchases began in 2012 as another step of quantitative easing to help stimulate the economy by lowering interest rates. It was dubbed "QE3." Investors are concerned that the Federal Reserve might begin withdrawing monetary support before the economic recovery is self-sustaining.

On February 1st, Janet Yellen will take office as the new Federal Reserve Chair. She will be given the unenviable task of tapering bond purchases and generally weaning the economy off stimulus. Since the 2008 financial crisis, the Fed's various stimulus programs have caused its balance sheet to quadruple to more than $4 trillion today. This massive support concerns us and most investors that the added liquidity has inflated asset prices (stocks, real estate, etc) and made the economy appear healthier than reality. We anticipate that despite the tapering of QE3, the Fed will continue its extremely accommodative monetary policy of keeping the federal funds rate near zero.

Outlook
Since 2008, the S&P 500 Index is up 128%. Following these strong returns, we remain positive on equities but believe a short-term pullback is likely.

Many of the factors driving increased confidence and increased stock prices should continue, such as earnings growth, accelerating GDP growth, improving job market, and companies using their cash for capital investments. At year end, companies in the S&P 500 had record cash of $1.25 trillion.[7] So far, companies have been reluctant to increase capital spending with uncertainties about their future. But companies have spent their cash on dividends which increased to a record $300 billion last year, and share buybacks which hit a record $118 billion.[7]

We believe the new trend favoring stocks over bonds will continue for many years. Stocks should benefit significantly over the long-term as investors move out of low-yielding bonds and back into stocks. Last year, the U.S. bond market declined 2% as rates began to rise.[8] This was the worst year for bonds since 1994. Since 2008, the S&P 500 has posted an 18% compound annual return compared to just a 3% annual return for 10-Year Treasuries.

Last year's gain of 32.4% was the best year for the S&P 500 Index in the last 16 years (+33.3% in 1997). After such a big move in stocks, you can imagine we are less bullish as valuations are higher. The P/E for the S&P 500 based on trailing 12-months earnings is high at 18.2x, compared to the historical average of 15.5x. Warren Buffett has stated "total market cap to GDP is probably the best single measure of where valuations stand at any given moment." This gauge is simply the market value divided by sales for the entire economy. Today, total market cap/GDP is 112% which is well above the historical median of 65%. More troubling is the fact that the only other times since 1950 that total market cap exceeded GDP was in 2000 and 2007. With all of this in mind, we believe we are due for a pullback, but after years of investors moving out of stocks, we surely have a long way to go before reaching the next "stock mania" stage of investor sentiment.

We expect Washington D.C. to continue to dominate the headlines this year with another debt ceiling deadline quickly approaching and mid-term elections in November.

We believe the companies in our portfolio have excellent management and a strong outlook for continued earnings growth. Despite the recent underperformance, GSCM has still returned 83% over the last five years. We believe international stocks add value to a portfolio and are now at their largest discount to U.S. stocks in years. In our opinion, this is an excellent time to invest with GSCM because it is a rare opportunity to buy high-quality stocks at a discount to low-quality. Additionally, our past periods of relative underperformance have been followed by even greater periods of outperformance.

We appreciate the trust you place in us to manage your investments. Please contact us anytime if you have any questions.

Sincerely,

Greenfield Seitz Capital Management

GREENFIELD SEITZ CAPITAL MANAGEMENT

1. MSCI All Country World Ex U.S. Index.
2. S&P Case-Shiller 20 City Index. January 28, 2014
3. eVestment Allice Large Cap Universe 10-yr. Davis Advisors. 2011.
4. Standard & Poor's Dow Jones Idices. S&P 500 Low Quality Index vs High Quality Index. 2014.
5. "Profits for the Long Run: Case for Quality." GMO 2012
6. "High Quality Stocks." Fayez Sarofim & Co. 2013.
7. "What's a Compnay To Do With All That Cash." *Barron's.* December 17, 2013.
8. Foley, Steven. "Pimco's Bill Gross suffers tough 2013." *Financial Times.* January 3, 2014.

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Greenfield Seitz Capital Management has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®). Please visit our website for full GIPS presentation

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GIPS® Compliance Verification Statement

Greenfield Seitz Capital Management, LLC
Issued January 23, 2014

The following report issued by ACA Performance Services, LLC ("ACA") is for a firm-wide GIPS Verification of Greenfield Seitz Capital Management, LLC's ("Greenfield Seitz") claim of compliance with the Global Investment Performance Standards ("GIPS standards") for the period January 1, 1997 through December 31, 2013.

We have examined whether Greenfield Seitz (1) complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) designed its policies and procedures to calculate and present performance results in compliance with the GIPS standards for the period January 1, 1997 through December 31, 2013. Greenfield Seitz's management is responsible for compliance with the GIPS standards and the design of the policies and procedures that present the firm's performance results in accordance with the GIPS standards. ACA's responsibility is to express an opinion on Greenfield Seitz's compliance based on its verification procedures.

ACA has completed this firm-wide GIPS Verification in accordance with the required verification procedures set forth in the GIPS standards. It is ACA's opinion that Greenfield Seitz has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis. Furthermore, it is ACA's opinion that Greenfield Seitz's policies and procedures were designed to calculate and present performance results in compliance with the GIPS standards for the period January 1, 1997 through December 31, 2013.

In performing the firm-wide verification addressed above, it is not ACA's responsibility to express an opinion on any particular composite presentation nor does verification ensure the accuracy of any specific composite presentation. Greenfield Seitz is responsible for the production and distribution of materials presented in conformity with the GIPS standards.

ACA Performance Services, LLC

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