Greenfield Seitz
CAPITAL MANAGEMENT

2017 Annual Letter

January 16, 2018

Dear Investor,

The Greenfield Seitz Core Composite was up 16.8% (net-of-fees) for the year, versus 21.7% for the S&P 500 and 22.4% for the MSCI World index.[1]

2017 marks the 6th best year in our 20-year history of audited returns, which is surprising because we were cautiously optimistic coming into the year and still hold high levels of cash. Since the February 2009 low, the Greenfield Seitz Composite has returned 180%. We are thankful our investors didn't panic in 2009 and now have the gains to reward them for their patience during that Bear market. Last year was truly one for the records as the market went up every single month for the first time in history.

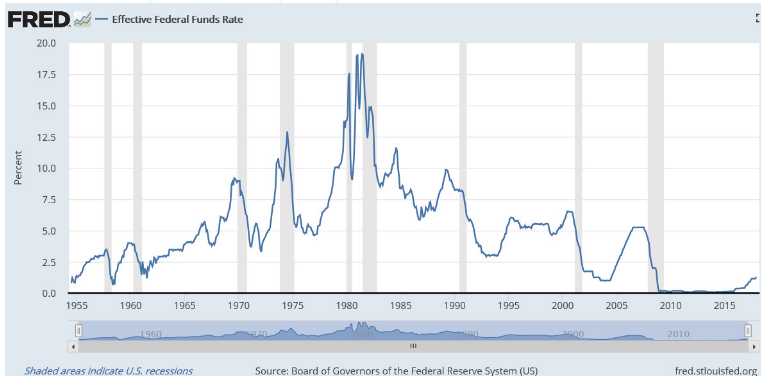
Our underperformance was mainly due to holding high levels of cash (averaged 11.3% of portfolios), which had almost no return. Using software to analyze our returns confirmed two interesting details. First, we had very good stock selection despite not owning the hot tech stocks (Facebook, Amazon, Apple, Netflix, Google, and Microsoft), which means our stocks had to perform very well to keep up. Second, the attribution analysis showed that our sector allocations were negative with our underweight the tech sector and overweight the energy sector. For 2017, our portfolios were only 11% invested in tech stocks (on average) compared to a 24% tech weighting for the S&P 500. Tech stocks were up 39% last year on average compared to an average loss of 1% for energy stocks. As a reminder, we had a similar underweight position in tech stocks during the 2001 Tech Bubble, which was rewarding.

Economic Update

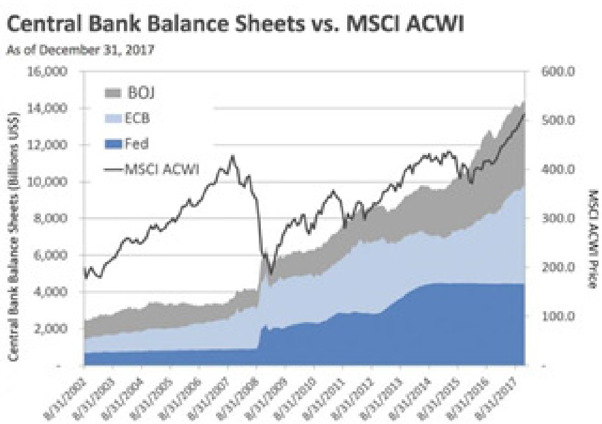
Corporate earnings continue to grow. The S&P 500 is expected to post 10.6% year-over-year EPS growth for 2017 and 14.7% in 2018.[2] Earnings have now grown for the past six quarters.[3] Furthermore, earnings growth is expected to speed up over the next year. The economy is growing with GDP growth above 3% and unemployment at a 44-year low.[4] We are optimistic that earnings growth will continue to support stock prices, but our enthusiasm is tempered by the Fed's increasing rates and stock valuations close to all-time highs.

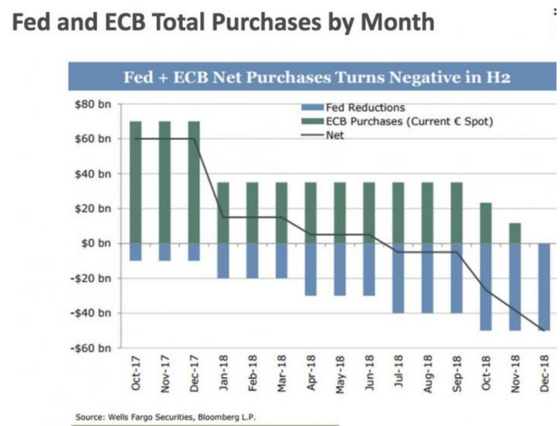
Congress passed a comprehensive tax overhaul before the year ended. One of the primary changes was to reduce corporate tax rates from 35% to 21%, which should boost corporate profits. It is estimated that the change will boost profits by $1.5 trillion over the next decade.[5] This will surely be a boost for corporations (Raymond James estimates tax reform will boost 2018 earnings by 8%) and many companies have already started to pass the savings on with employee bonuses. But we must remember that the lower tax rate will also increase government debt, which is already at a debt/GDP level that historically leads to problems.

Since the 2009 financial crisis, Central banks around the world have injected $11.3 trillion of liquidity.[6] This cheap money has increased the dollar value of just about everything to record highs, from stocks to real estate & fine art. Now that Central Banks are reducing their liquidity programs, it will be interesting to see if asset prices can keep rising. The Fed raised rates three times in 2017 (five times this cycle) to a current Fed funds rate of 1.25%-1.50%.



The chart below shows the three largest Central Banks (Fed, ECB, and BOJ) grew their balance sheets 7x as they provided liquidity (usually by buying bonds with newly created money).[7] You can see the correlation of this to global stock prices (ACWI). The second chart shows the planned reduction in liquidity from the Fed and ECB, which becomes worrisome in 2018.[8]

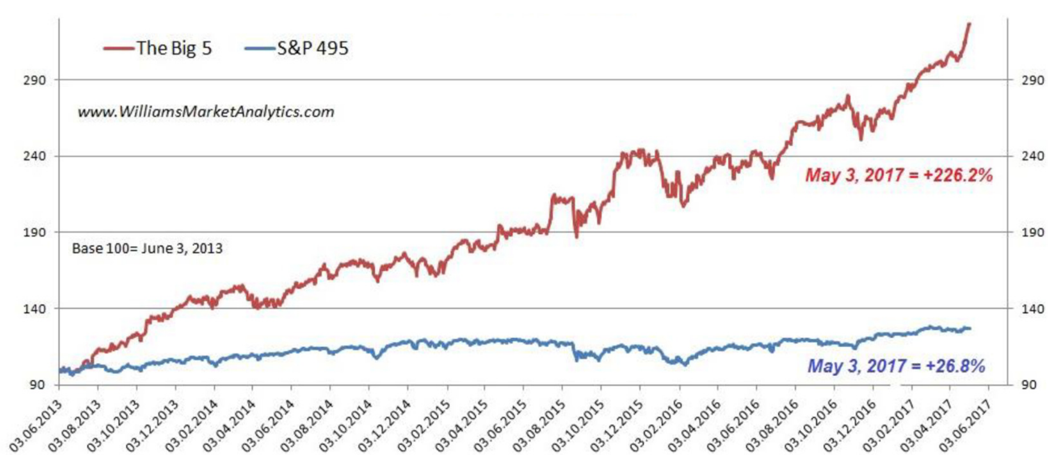




FANG (Facebook, Amazon, Netflix, Google)

We have written about FANG before and will simply refer to this acronym as the symbol for the handful of high-flying tech stocks that are dominating the market. For the year, Apple, Google, Microsoft, Facebook and Amazon climbed an average of 43% and accounted for 23% of the entire S&P 500's gain.[9] It continues to be a very concentrated Bull market with just five stocks contributing roughly a quarter of the entire S&P 500's gain. This reminds us of the Dot-com mania, which was the last time a handful of stocks dominated the market in 2000.

The chart below shows the performance of the top five names in the S&P 500 Index to an equally-weighted composite index of the other 495 stocks of the S&P 500 Index.[10] Since March 2013, the S&P 495 has grown at an annual rate of 6.1% compared to 57.3% for the Big 5.[10]



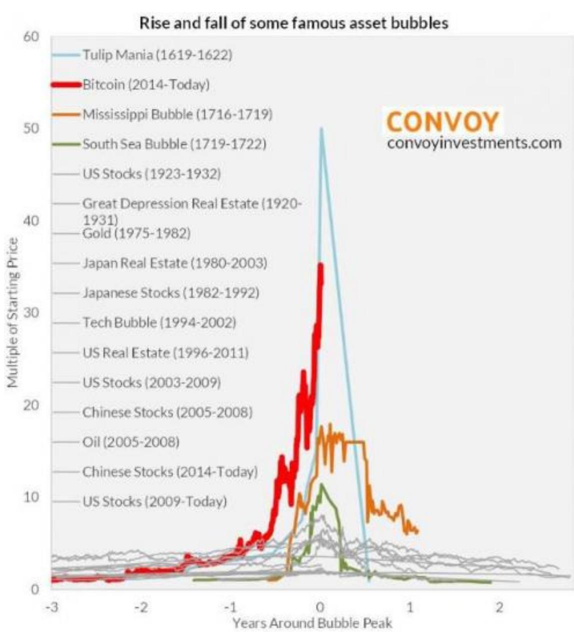
We believe in our process and have tried to avoid these stocks, which have an average P/E of 84x. Not owning these popular stocks has led Greenfield Seitz to trail our benchmark in recent years. The last time this happened was 1997-1999 when we avoided the Dot-Com hysteria, which ultimately rewarded our investors. The similarities now to the internet bubble seem clear with: new technologies, high growth, rosy forecasts, lack of earnings, and lofty valuations.

This questions the wisdom of passive investments like ETF's. Indexes such as the S&P 500 are simply forced to buy more FANG as those stocks rise. It looks like a huge momentum play as more investors plow money into the indexes via ETF's. Vanguard (the leader in index investing) is now receiving over $2 billion a day in new money. The more money it receives, the more FANG it must buy. This reminds us of 1999, when Janus Funds was popular with its Dot-Com holdings and received $37 billion of inflows for the year and the more money it received, the more Cisco it had to buy (pushing Cisco shares up). If you are curious, CSCO shares peaked at $82 in March 2000 and at the time of this writing was worth $40 (18 years later). At the peak of the Dot-Com Bubble, the tech sector was 35% of the S&P 500 and crashed to just 13% of the Index.[11]

To illustrate this phenomenon, we looked up the holdings of the ten largest funds today. Nine of the top ten largest funds had Apple, Microsoft, Amazon, and Facebook as their top four holdings![12] Congratulations to American Funds Income Fund for not following the herd (but it still had Microsoft as its largest holding). This is cause for concern because eventually investors will decide to sell these stocks. The last time we saw such concentration in fund holdings was 2000 when it seemed every mutual funds had Cisco as a top holding. In 1999, Microsoft, Cisco, Intel, Lucent, IBM, and America Online were six of the ten largest companies in the U.S. by stock market value.

Bitcoin and Gold

While we are reminiscing about the Dot-com bubble, we have been getting a lot of questions about cryptocurrencies, and Bitcoin in particular. As you might imagine, we are skeptical. It is fascinating if you study the last 400 years of investment bubbles, Bitcoin's 97-fold gain the past two years has now beaten the infamous Tulip mania of 1619-1622 as the greatest bubble in history.[13] Both manias have little to no real value but increased in price because someone was willing to pay more. Typically, these manias only occur around frothy tops when investors are jubilant and greedy.



We see the reasons cryptocurrencies are popular, such as an inflation hedge or for independence from governments. But we believe gold is a superior store of value. Coincidentally, the mining of Bitcoin and gold are both bad for the environment. It takes the same amount of electrical power to execute one

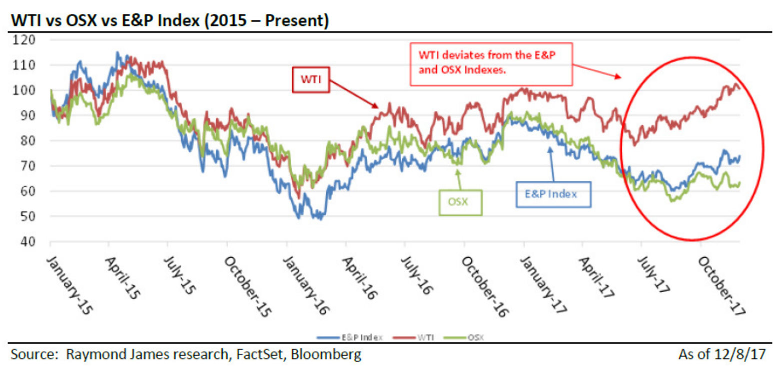
Bitcoin transaction as it takes to power nine homes![14] But gold's biggest advantage is its truly limited supply. Bitcoin originally stated its maximum supply was 21 million Bitcoins (of which 80% has already been mined) but it forked twice and effectively tripled the potential supply. The first fork was in August and created "Bitcoin cash" and again in November creating "Bitcoin Gold." This disproved the initial Bull case that the supply was fixed. On top of this, there are over 1,000 similar cryptocurrencies and are being created daily, which adds to supply. Gold will never have this problem of being created from thin air, which is the reason it has been a reliable store of value for over 2,500 years. On December 21st, The Long Island Tea Company, which produces iced tea, changed its name to Long Blockchain and its stock soared 500% in one day. This must be a sign of peak mania in Bitcoin.

International Stocks

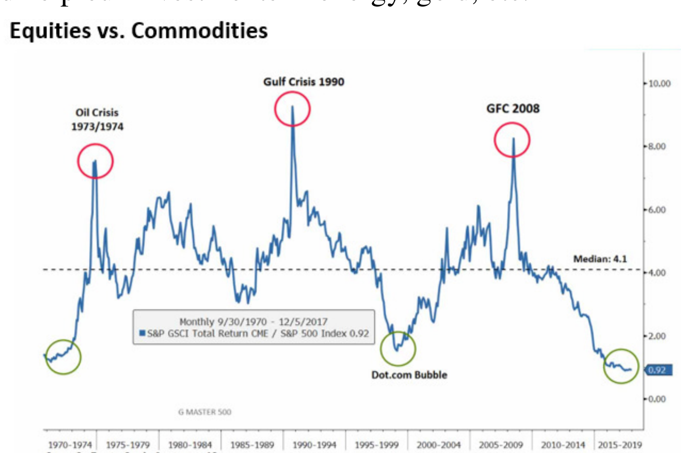
In 2015, we noted that International stocks had underperformed the U.S. for seven straight years and seemed relatively cheap when compared to domestic stocks (P/E of 15x vs. 26x). In 2017, international stocks returned 21% despite having lower tech exposure than U.S. Indexes. We have benefitted from this and it has allowed us to generate a nice return without owning FANG type stocks. Over the long-term, it is shown that adding international stocks to a portfolio, increases returns and lowers volatility.

Energy Investments

The Energy sector was down 1% last year. Our portfolios held a roughly 8% exposure to energy stocks throughout the year, which hurt returns but we believe will be rewarding longer term. Raymond James continues to call for $70/bbl oil in 2018 based on increased demand from the growing global economy and tighter supplies from international and domestic producers. The graph below shows energy stocks did not increase as WTI prices rebounded from $43/bbl in June to $57/bbl at year end. If oil prices continue rising, the stocks will follow.



The second chart shows stocks versus commodities, which illustrates that commodities have underperformed stocks for the past eight years. This relationship (S&P divided by commodity index) tends to move in reliable pattern and commodities are due to outperform. A broad-based commodity rebound makes sense with increased global GDP (demand) and tightening Fed/low unemployment (inflationary). This would help our investments in energy, gold, etc.



Holdings Update:

Suncor

Suncor is a leader in oil production from oil sands and is Canada's largest integrated energy company. We have owned shares of Suncor since 1996. Suncor produces over 700,000 bbl/day with a 99% weighting to oil. They now have a 50-year history in the oil sands. The company is comprised of: oil sands mining, in-situ oil sands, traditional oil, refining, wind farms, and retail gas locations.

We were originally attracted to Suncor for its massive reserves, which now total 7.7 billion barrels (over 30 years at current production) and its ability to lower the cost of production. In 2017, Suncor reduced production costs by 19% to just $19/bbl. There is little exploration risk for Suncor in the oil sands and therefore it is easier for Suncor to grow production. For the past five years, Suncor has grown oil production per share by 7% annually while the major E&P's have had an average 8% annual decline per share.

Outlook

Trump has brought a sense of optimism to consumers and businesses alike. Along with this optimism, we have reached new all-time highs in the stock market (S&P up 31% since he was elected 11/8/2016). The combination of historically low interest rates, renewed animal spirits, and broad earnings growth has resulted in new all-time highs for stocks.

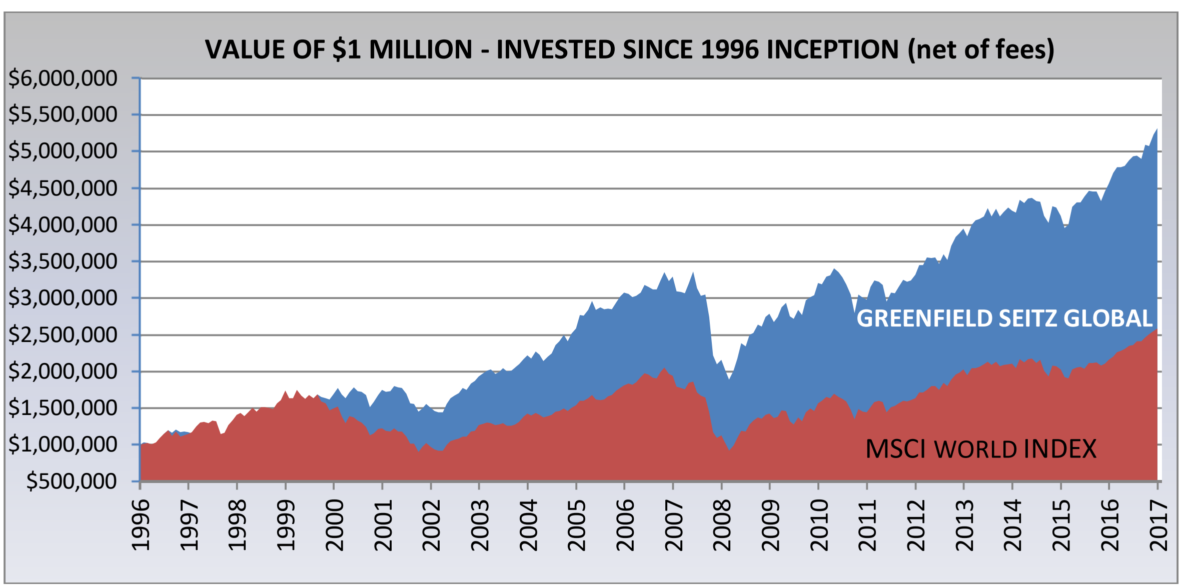
With news highs, come lofty expectations and high valuations. The S&P 500 is now trading at 23x trailing earnings (vs. historical average P/E of 17x). We realize high valuations reduce long-term returns. In fact, today's valuations have historically led to 10-year returns of -1.2%.[15] But we believe the earnings growth can support further gains in stocks and not all stocks appear expensive. We refuse to deploy your capital unless there is a margin of safety and an appealing investment opportunity. When there is not, we are content with holding higher levels of cash, which can be useful to buy stocks in a selloff. As such, we continue to avoid speculative stocks, favor international stocks, and keep investing in great businesses with excellent management.

Sincerely,

Greenfield Seitz Capital Management

GREENFIELD SEITZ CAPITAL MANAGEMENT

Past performance does not guarantee future results.



1 MSCI and Standard & Poor's. 2018.
2 Factset. 1/12/2018.
3 Bloomberg. January 2018
4 Department of Labor. 2018
5 Joint Committee on Taxation. 2018
6 BofA Merrill Lynch. 2017
7 Bloomberg. 1/9/2018
8 Wells Fargo 1/9/2018
9 Convex Capital Management. 1/2/18
10 Williams Market Analytics LLC. Seeking Alpha. 5/5/2017
11 Standard & Poor's Financial.
12 Morningstar. 2018
13 Convoyinvestment. 2017
14 Digiconomist CNBC. 12/13/2017
15 Hussman Funds. 2017

Net-of-Fee Performance: Net of fee performance shown reflects the deduction of actual fees. Actual fees are expected to be lower than the maximum scheduled rate of 1%. All charts and tables are shown Net of Fees.

Retail Fee Schedule: 1.00% on assets under management

Compliance Statement: Greenfield Seitz Capital Management claims compliance with the Global Investment Performance Standards (GIPS®). GSCM has been independently verified for the periods January 1, 1997 – December 31, 2017. The verification report(s) is/are available upon request.

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