Greenfield Seitz
CAPITAL MANAGEMENT

2018 Annual Letter

January 25, 2019

Dear Investor,

The Greenfield Seitz Core Composite was down 7.9% (net-of-fees) for the year, versus -8.7% for the MSCI World Index and -4.4% for the S&P 500 Index.[1]

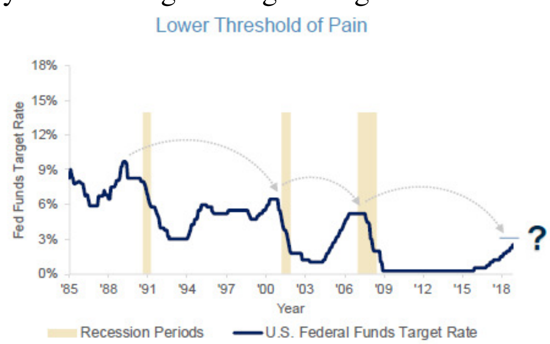
Economic Update

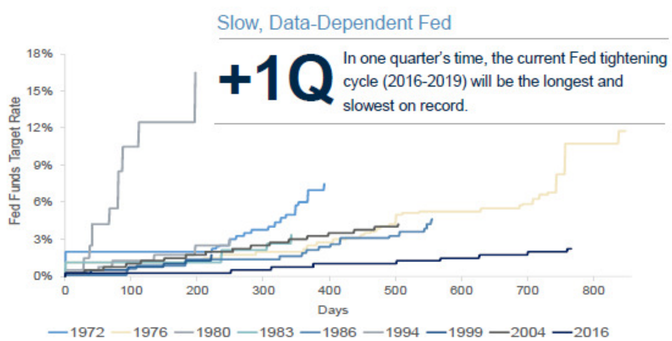
GDP growth remained strong at 3% in 2018 and has now grown for 115 months, which is the second longest economic expansion in history. The economy has entered the late phase of the business cycle. Investors fear the end of the cycle and such fears have stoked the return of volatility recently. We believe the late cycle environment means slower GDP growth but not the end of the cycle.

The S&P fell 20% from its September peak to its December low last month. It seems investors switched from seeing all the positives to seeing all the negatives. There are many negatives for the economy and stocks that recently came into focus, but we believe the economy will continue growing (at a slower pace).

Economic & Market Negatives

First and foremost, after years of historically low interest rates, the Federal Reserve raised rates for the 9th time to a range of 2.25%-2.5%. This range is still low by any long-term measure. Additionally, the new Fed Chairman, Jerome Powell, seems more open to future rate increases than his predecessor, Janet Yellen. Also, the U.S. ended its quantitative easing program, which was buying $50 billion a month of bonds. The ECB and BOJ also began winding down their quantitative easing programs, which has become a synchronized global tightening.



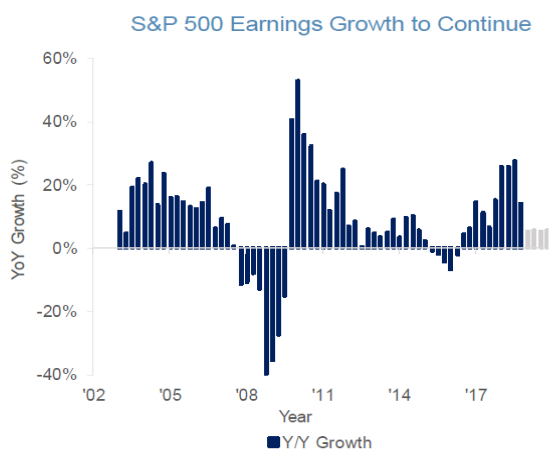


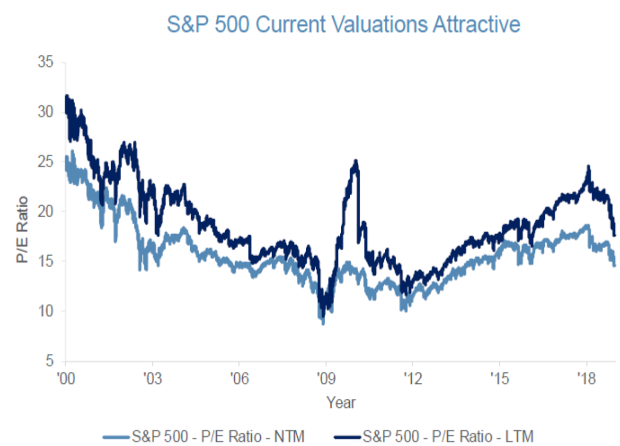
There appears to be a slowdown in GDP growth not just in the U.S. but globally. Raymond James expects GDP growth of 2.4% in 2019 down from an estimated 3% in 2018, but still a healthy level. The trade war between the U.S. and China is another important issue that has gained much attention. The short end of the yield curve has inverted with the 3-year rate higher than the 5-year rate. Earnings growth is slowing (S&P 500 earnings growth is expected to be 6% in 2019 vs. 22% in 2018.[2]) while valuations are near historic highs.

Lastly, investors are keenly focused on the current fundamental problems with FANG companies, which had been loved by speculators regardless of fundamentals. For example, Apple shed 40% of its market value after slashing iPhone sales estimates. Facebook's stock fell 40% too, as it was hit with privacy issues, increased costs, and a significant slowdown in user growth and revenue growth.

Economic & Market Positives

We would like to highlight the many positives in the economy that we believe are currently out of focus with investors. First, corporate earnings continue to grow as we enter the tenth year of this economic expansion. The S&P 500 is expected to post 6% year-over-year earnings growth this year.[2] Earnings have now grown for the past 10 quarters. The unemployment rate is at a 50-year low of 3.7% and consumer confidence is near record highs. This combination should keep consumers and businesses inclined to spend. Another positive is that inflation remains tame at 1.9%. Lastly, valuations contracted significantly last year because earnings growth was more than 20% but stock prices were down. The trailing 12-month P/E on the S&P 500 fell from 25x at the peak last year to 19x now.





Key Holdings Review:

Dexcom

Dexcom, headquartered in San Diego, makes continuous glucose monitoring systems for use by people with diabetes.

Dexcom reminds us of Resmed (a successful holding we first bought in the 1990's) because the diabetes market is so large, which is similar to the sleep apnea market. The number of people worldwide with diabetes has risen from 108 million in 1980 to 422 million now, with a global prevalence of 8.5%.[3] The global diabetes market is projected to grow 6% annually to reach $95 billion in 2023, largely due to obesity and sedentary lifestyles.[4]

Dexcom provides the patient with continuous updates on their glucose levels, unlike fingersticks which only give a static snapshot. This has numerous advantages. Additionally, the sensor lasts 10 days which is much more convenient than pricking your finger multiple times per day. Continuous glucose monitoring is not only much more effective but also more user friendly. For these reasons, it has been in high demand by patients. There are now an estimated 1.2 million users of continuous glucose monitoring systems, which also means it is still an underpenetrated market of 422 million worldwide.

Last year, Dexcom grew its sales 42% and received FDA approval for its iPhone compatible glucose monitor. Patients no longer need to carry a receiver because the information goes to an app on their iPhone.

Bank OZK

Bank OZK is a regional bank headquartered in Little Rock, Arkansas. We have owned shares of Bank OZK since 1997 and it is one of our largest positions. It has an impressive history (39 consecutive years of profitability) since its CEO (George Gleason) took control in 1979. S&P has ranked OZK the #1 regional bank in the U.S. the last eight years in-a-row (based on asset quality, loan growth, ROE, net charge-offs, and net interest margin). The stock was up significantly (roughly 10x in the previous 10-years and 45x in the last 20-years)

Last year, Bank OZK shares fell 60%. As one of our largest holdings, this loss hurt our returns for the year and we wanted to address it. With the stock's run up, short sellers began to focus on Bank OZK entering new markets such as New York City (it's largest real estate loan market) and Miami. Their thesis questioned OZK's ability to manage real estate loan risk in these new markets (8% short interest). In October 2018, OZK announced it incurred a $45.5 million charge-off related to two bad real estate loans. This was the biggest charge-off in its history and actually larger than all its previous charge-offs combined. This gave the negative investment case credibility and the stock fell 30% that day. We would like to point out this is $45.5 million of bad loans on a $17 billion loan portfolio. These two loans were made in 2007/2008. One was a regional mall in South Carolina (anchored by now bankrupt Sears) and the other was residential construction loan in North Carolina that suffered due to local supply/demand dynamics after the housing boom.

We believe OZK is continuing its history of prudent lending. For the past 20 years, its net charge-off ratio has been less than half of the regional bank average. It's current credit quality is evidenced by its 0.23% nonperforming loan ratio and 49% loan/cost average last year. Which means for a $1 million construction project, OZK is only lending $490,000. This is not market value but actual cost so they, theoretically, would do well in a default scenario.

On January 17, 2019, OZK reported earnings and investors were eager to see if the credit issues would continue. Bank OZK reported EPS of $0.90 versus consensus estimate of $0.82. More importantly credit trends returned to more normal levels. The company posted lower than forecasted loan loss provision and non-performing assets fell to just 0.30%. OZK stock is now up 50% from its December lows.

We believe Bank OZK will continue its leadership in quality lending and growth. The recent selloff is an excellent opportunity to buy an outstanding bank at a rare discount.

Skyworks Solutions

Skyworks Solutions is a maker of analog semiconductors for wireless networks. Wireless platforms are increasingly vital with e-commerce, social media, gaming, entertainment, shopping, and location services. As a result, semiconductors are more relevant than ever to support the network. Skyworks facilitates data creation, delivery, and storage as smartphones transmit and receive immense amounts of content.

As the industry migrates to more complex 5G architectures, Skyworks is well positioned to help mobile phone makers handle the complexity. For example, an average 4G phone currently holds $18 in Skyworks products but a 5G phone holds $25 in Skyworks products. Additionally, Skyworks should benefit as more devices become connected in the IoT (internet of things). For example, your smart home (Nest and Ring), your wearable device (Apple watch and Fitbit), your smart car, smart industrial equipment, etc are all requiring more semiconductors.

Skyworks gets about half its sales from Apple and another 20% from Samsung and Huawei. This customer concentration is usually a negative for companies, but we believe this is simply the dynamics of the mobile phone market. Skyworks EPS growth has recently slowed with the overall semiconductor market. But with this slowdown, the stock has sold off significantly causing the trailing P/E to fall from 18x last year to 13x today. We believe the company has a bright outlook, capable management, and a below market multiple.

Outlook

We believe the positives outweigh the negatives and there is still more room to run in the 11th year of this Bull market. In our past, periods of relative underperformance have been followed by even greater periods of outperformance. We believe the companies in our portfolio have a strong prospect for future growth, solid leadership, and attractive fundamentals.

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. January 11, 2019.
2 Yardeni Research. YRI S&P 500 Earnings Forecast. January 21, 2019.
3 World Health Organization. Diabetes. October 30, 2018
4 Research and Markets. Global Diabetes Market. June 1, 2018
5. All company specific facts and figures are from company reports.