Greenfield Seitz
CAPITAL MANAGEMENT

2018 Mid-Year Letter

July 16, 2018

Dear Investor,

The Greenfield Seitz Core Composite was up 0.7% (net-of-fees) for the first half of the year, versus 0.4% for the MSCI World index and 2.6% for the S&P 500 Index.[1]

Economic Update
Corporate earnings continue to grow as we enter the tenth year of this Bull market. The S&P 500 is expected to post 21% year-over-year growth in earnings for the second quarter.[2] Earnings have now grown for the past eight quarters. Boosted by tax cuts, earnings are expected to grow more than 20% for 2018 compared to 2017.

The Federal Reserve recently raised rates (now 1.75-2.0%) for the seventh time in three years. Since lowering rates to near zero in the 2008 financial crisis, the U.S. economy has added roughly 190,000 jobs per month and unemployment is now at just 3.8%.

The higher interest rates should boost profits for financial companies but the flattening yield curve is a concern. Currently, 10-Year/2-Year Treasury bond spreads are the lowest since 2007 at just 0.29%.[3] A flat yield curve compresses a bank's spread between borrowing short-term and lending long-term. Plus, an inverted yield curve has preceded nine of the last ten recessions.

FAANG (Facebook, Amazon, Apple, Netflix, Google)
We have written about FAANG before and will simply refer to this acronym for the handful of high-flying tech stocks that are dominating the market. In the first half of the year, Amazon, Microsoft, Apple, and Netflix accounted for 84% of the S&P 500's gain. Four stocks accounted for almost all the total gains of the 500 stocks in the S&P 500 Index. Amazon alone contributed to 36% of the S&P 500 Index gains YTD. The last time a handful of stocks dominated the market was 2000. We have never followed the herd and prefer to avoid popular/high-valuation stocks.

As seen by the massive inflows to passive investments like ETF's, investors believe passive indexes are the optimal strategy. As more money goes into ETF's, they increase in price. But we believe investors, caught up in the euphoria, are not aware of the risks they are taking. The popularity of FAANG today (15% weighting in the S&P 500) is like previous extremes (bank stocks were 23% of the S&P 500 in 2007, tech stocks were 34% weighting in 2000, and energy stocks were 30% in 1980). Index investors are now overexposed to the most popular momentum stocks just as they were in those previous manias. We know how this story will end but just aren't sure when.

Recent Purchases:

Express Scripts
Express Scripts is the largest pharmacy benefit manager (PBM) with over $100 billion in annual sales. It is a 3rd party administrator of prescription drug programs for commercial health plans and negotiates discounts with drug manufacturers for its customers.

In March, Cigna announced an offer to buy Express Scripts for $48.75 in cash and 0.2434 shares of stock. This amounted to roughly $91 at the time of our recent purchases of Express Scripts at prices around $73. Like past arbitrage spreads, this amounts to a 25% discount to the buyout price. The deal is expected to close by year end and there is a ~$2.50 per share back out fee if Cigna cannot complete the purchase.

Like our past merger arbitrage investments, we view this a way to make a healthy return by putting cash to work and yet limiting our exposure to the overall market.

Kinder Morgan
Kinder Morgan is the largest transporter of natural gas and oil in the U.S. It owns and operates a network of 70,000 miles of natural gas pipeline and 9,000 miles of crude pipeline. It is essentially operating toll roads and charges customers to transport natural gas/oil to market on its network. This makes for a stable business model and 92% of its cash flow is fee based on contracts.

In 2014, Kinder Morgan acquired all of Kinder Morgan LP and reorganized as a C-corp. This took away its tax-free (pass through) MLP status but also ended the incentive distribution rights to the General Partner. The company was paying $1.6 billion annually to the GP. Now the company is 100% self-funded.

The stock fell 65% from its 2015 high for a host of reasons (broad decline in energy stocks, lower natural gas/oil prices, higher interest rates, dividend cut, move to C-corp, etc). We believe the selloff was overdone and purchased shares. Kinder Morgan is raising its dividend to $1.00 this year so we purchased shares with a dividend yield above 5%. The company expects to grow its dividend to $2 per share in 2023.

Kinder Morgan is now reaping the benefits of $3 billion it recently spent on growth projects. Last month, the company sold its Trans Mountain pipeline to the Canadian government for $3.4 billion. We view this as a positive because it removes the legal battle with British Columbia and environmentalists, which was a major distraction and will likely take years to resolve.

Lastly, management owns 14% of the shares.

JM Smucker
JM Smucker manufactures and sells food and beverage products worldwide. Founded in 1897, Smucker is the market share leader in fruit spreads (Smucker's), peanut butter (Jif), coffee (Folgers & Dunkin Donuts), and pet snacks (Milk-Bone, Kibbles n' Bits, Meow Mix & 9Lives).

Over the past two years, the stock has fallen more than 30% as investors worry about changing consumer preferences towards organic foods and away from packaged foods. We believe this selloff is overdone and presents an opportunity to own a world class company at an attractive price. We also believe Smucker should be a defensive business in a recession. Management has adjusted to recent trends by selling off some packaged foods and making acquisitions in pet foods. Pet food is now the largest portion of sales (29%). The stock has a dividend yield of 3% and a P/E of 14.5x (excluding non-recurring tax benefit).

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, 2018.
2 Thomas Reuters. Lipper Alpha Insight. July 10, 2018.
3 FRED. St Louis Federal Reserve Economic Research. 10-Year Treasury Minus 2-Year Treasury

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