Greenfield Seitz
CAPITAL MANAGEMENT

2020 Mid-Year Letter

July 14, 2020

Dear Investor,

The Greenfield Seitz Core Composite was down 5.2% (net-of-fees) for the first half of 2020. This compares to a 5.8% loss for the MSCI World Index and a 3.1% loss for the S&P 500 Index.[1]

Prior to the COVID-19 selloff, we sold stocks to build cash. Greenfield Seitz Composite had a ~25% gain last year and the market hit an all-time high in February. We believed many of our stocks were fully valued. On average, cash was 15% of our portfolios. During the ensuing 35% market selloff, we were able to put this cash to work buying many stocks at deep discounts.

Having cash during the selloff insulated our losses and allowed us to buy stocks when others were panicking. The market rebounded 48% from its March lows!

COVID-19: Market Selloff and Recovery

In late 2019, a novel virus named COVID-19 was discovered, and January the first case surfaced in the U.S. Public health officials were concerned about the spread of the virus and instituted limits to social contact to slow the rate of infection and "flatten" the epidemic curve through social distancing. More than one-third of the world's population was placed on lockdown.

The result of closing businesses, schools, sports, and all large gatherings was an abrupt idling of the global economy. The shutdown caused the nation's first recession since 2009. U.S. unemployment jumped from a 50-year low of 3.6% to 14.7%. With consumer spending driving 70% of the economy, the combination of sudden unemployment and the closing of businesses was devastating to the economy. The IMF said the "coronavirus recession will be the most severe global economic downturn since the Great Depression and far worse than the Great Recession of 2009."[2]

From February 24-28, the S&P 500 Index fell 10%. The four-day selloff was the fastest selloff in history from an all-time high to an official correction. As investors struggled to value stocks in such uncertain times, volatility skyrocketed. This was exacerbated by the rise of ETF's as people rent a basket of stocks, rather than owning a company for the long-term. The VIX Index, a measure of market volatility, hit an all-time high in March. Of the 20 biggest daily percentage moves in the past 90 years, four occurred in the first half of 2020.[3] Ultimately, the market fell 35% in just one month from February to March!

The government took quick action to fight this recession. The Federal Reserve's playbook from the 2009 Financial Crisis was put into action. The Fed cut its Fed Funds Rate by 1.5 percentage points to 0.00% - 0.25%. It also grew its balance sheet by 70% buying more than $3 trillion in assets in just three months. Additionally, Congress passed the $2 trillion CARES Act (Coronavirus Aid, Relief and Economic Security Act) to help the economy. The aid package to businesses and individuals was equivalent to 10% of annual GDP.

The market reacted positively to this unprecedented stimulus and rebounded from over-sold conditions. From the March 23rd low to June 8th, the S&P 500 Index rallied 48%! This put it back within 5% of its all-time high. The second quarter of 2020 was the best quarter for stocks since 1998.

2020 Performance Attribution

As discussed, our first-half performance was enhanced by taking profits prior to the selloff and then buying stocks during the depths of the Bear market. But our returns were also hurt by avoiding hot technology stocks such as Facebook, Amazon, Apple, Netflix, Microsoft, Google. These six stocks comprise 25% of the S&P 500 Index and were responsible for one-third of the entire market's rebound off the Bear market lows.[4] We have discussed our rationale for avoiding these in past letters.

We were also overweight Energy stocks (10% portfolio weighting vs. 4% weighting in S&P 500 Index), which hurt our performance. We believe our thesis of looming supply/demand imbalance is intact, but the pandemic lockdown caused an oil price collapse (from $62/bbl in January to negative $37/bbl on April 20th) and sent the S&P Energy index down 62%.

Despite avoiding many technology stocks and owning energy stocks, we were only down 5.2% in the first half of the year. The performance was attributable to:

(1) Quality and defensive stocks were not hit as hard (examples: Dexcom +100% YTD, Barrick Gold +50% YTD, and Resmed +25% YTD)
(2) Having built up cash just before the Bear market
(3) Buying stocks on the dip
(4) Our portfolios returned 21% (net of fees) in the second quarter as the market rallied
(5) We bought Mellanox shares after Nvidia announced a $125/share cash buyout. The spread widened to 30% as investors doubted Nvidia could complete the purchase of Mellanox. Additionally, there was forced selling by investors who needed cash or just wanted out of stocks during the COVID-19 selloff. Mellanox shares hit a low of $96 in March despite the pending $125/share acquisition. The deal closed on April 27th at $125 per share (cash) and we profited.

Gold

This is the perfect scenario for gold with uncertainty, money printing, a stock market selloff, and a global pandemic. This year gold is up 20% to roughly $1,800/oz and Barrick Gold (a miner we own in portfolios) is up 50%. This hedge has served us well in down markets. We expect gold to continue to increase in price as sovereign banks around the world continue to debase their currencies as they print money to fight a pandemic induced recession.

Outlook

We realize this pandemic will pass and the government stimulus is unprecedented, but we still question the incredible rebound in stocks from the March lows.

There are several reasons stocks have rallied. First is simply that they were oversold, and later momentum investors started buying stocks as they saw the market going up. More importantly, there is a 90% correlation between the Federal Reserve's balance sheet and stock prices (stocks move higher with Federal Reserve lowering interest rates and expanding balance sheet - creating money). We have discussed "Don't Fight the Fed" in previous letters. In addition to the $3 trillion created by the Fed, it has also lowered the Fed Funds rate to 0.0-0.25, the lowest in history. This has helped business and homeowners refinance with 10-year treasury yields at 0.69% (down from 2.04% a year ago).

We also think these historically low rates have forced investors into stocks ("There Is No Alternative"). The S&P 500 currently has a divided yield of 1.9% and these companies should grow their dividends over time, unlike bonds. Furthermore, the Fed "printing" $3 trillion in new money combined with the $2 trillion in new government debt (CARES stimulus) should cause inflation. A final driver of the recent surge in stocks is a hedge against inflation. Companies are able to raise their prices of goods and services to keep track with inflation and thus raise their dividends or at least offset rising costs. Whereas cash/bonds take a serious hit from inflation.

These are some of the reasons we bought stocks during the selloff. After the market rebounded 48% from the low in just 30 days, we have been selling. It's amazing the stock market is back to its December price level and still at an extremely high P/E of 23x (vs. long-term average of 15x) when we look at the damage the pandemic did to the economy.[4]

The damage was much worse than the 2009 Financial Crisis, which took the stock market roughly four years to recover. It's hard to believe the rebounds in stocks given: (1) unemployment rate jumped from 3.6% to 14.7% as 21 million people lost their jobs, (2) S&P 500 earnings estimates fell 31% from $180 to $124, (3) estimated Q2 GDP down 30-40%, and (4) consumer spending down 14% in March.

> *"The current P/E on the U.S. market is in the top 10% of its history. The U.S. economy in contrast is in its worst 10%, perhaps even the worst 1%. This is apparently one of the most impressive mismatches in history. In addition, everything is uncertain. The markets have historically loved stability and low levels of uncertainty." -Jeremy Grantham June 4, 2020*

GSCM Firm Update

One of cornerstone principles at Greenfield Seitz has been a family-like relationship with our clients. We hope each of you have been healthy during this pandemic and want you to know our staff and firm are doing well. Greenfield Seitz and our primary custodian (Raymond James) have invested heavily in technology and disaster preparedness for more than a decade. We have constructed an information technology architecture and business process design that enabled us to operate seamlessly in the event of a disruptive business environment. In fact, every year we test this redundancy and our remote workplace. These investments and practice drills have paid dividends this year as we have been able to practice social distancing while caring for our clients with the same capabilities and focus, we have always had.

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 outlook for each company. The prudent investor stays true to the discipline of a successful long-term approach.

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, 2020.
[2] International Monetary Fund. April 14, 2020.
[3] Dow Jones Market Data. June 2020
[4] Yardeni Research. July 2020
All company information is from company filings

Past performance does not guarantee future results. This performance report should not be construed as a recommendation to purchase or sell any particular securities held in composite accounts. The market value of securities fluctuates and you may incur a profit or a loss. This analysis does not include transaction costs and tax considerations. The material included in this presentation is for informational purposes only, and is not intended as an offer or a solicitation to buy or sell any securities. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. You should consider our investment objectives, risks, and fees carefully before you invest.

Any views or opinions presented in this presentation are solely those of GSCM. While the information contained in this presentation is believed to be reliable, no representation or warranty, whether express or implied, is made and no liability or responsibility is accepted by GSCM as to the accuracy or completeness thereof.

Special risks are involved with global and international investing related to market and currency fluctuations, economic and political instability, and different financial accounting standards. These risks are magnified by emerging markets.

Please visit www.gscapital.net for additional disclosures or to view our updated Form ADV.