Greenfield Seitz
CAPITAL MANAGEMENT

2022 Annual Letter

January 19, 2023

"Rule No. 1: Never lose money. Rule No 2: Never forget rule No. 1" -Warren Buffett

Dear Investor,

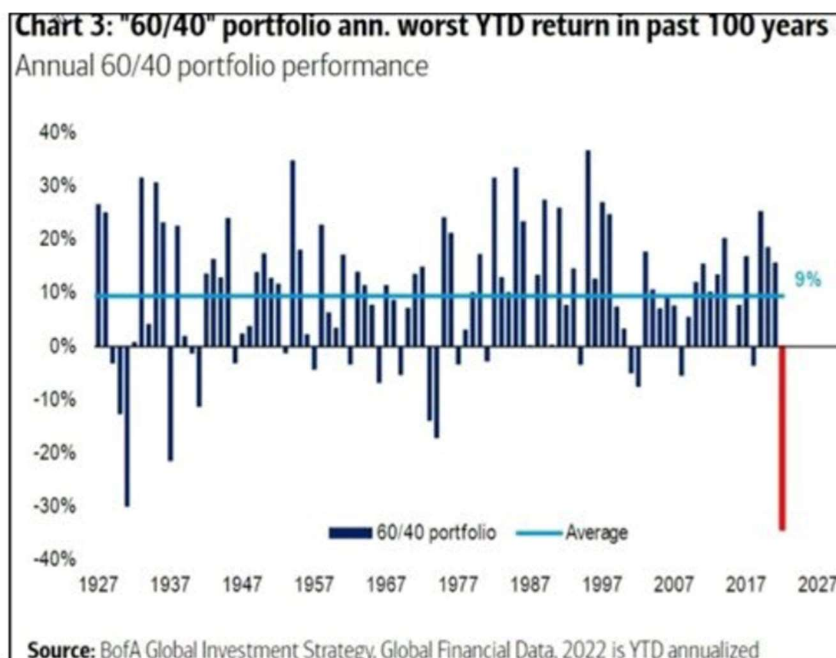
In 2022, the Greenfield Seitz Composite declined 7.9% (net of fees) while the S&P 500 fell 18.1%. This brings our return to 55.7% over the last four years (net).

2022 Review

We did our homework and positioned our portfolios accordingly. This strategy rewarded our investors. This was our 4th best year of outperforming the market since we began auditing our returns in 1996.

2022 was the worst year for the S&P 500 since the 2008 Great Financial Crisis. There was nowhere to hide with stocks down 18% and bonds down 16%.[1] This was the worst year for bonds in 40 years. It was the worst year for the typical 60/40 equity/bond portfolio since recording began in 1872 (chart below).[2] The NASDAQ was hit hardest, falling 33%. Inflation jumped to a 41-year high of 9.1% in June and the Fed was forced to increase its fed funds rate from 0% to 4.5%. Higher interest rates helped pop the latest speculative bubble (future cashflows now discounted at higher rates) and crushed bonds. Fortunately, energy stocks were one of the few bright spots, gaining 58% for the year and we were heavily exposed to the outperformance.

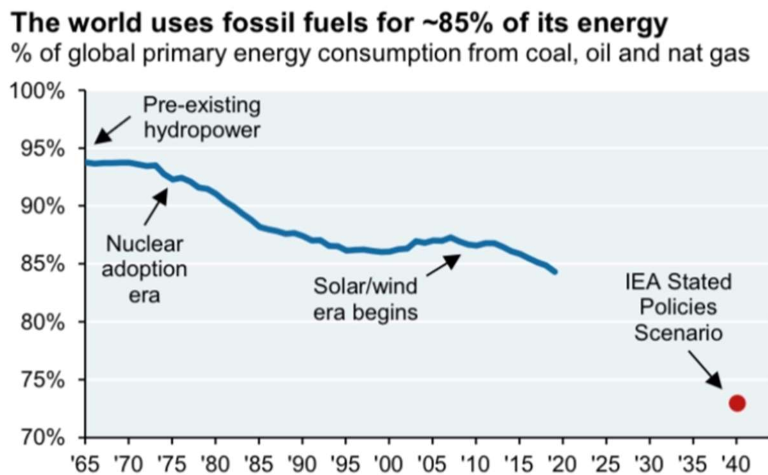
The number one rule of portfolio management is to mitigate risk. 2022 was a great example of Greenfield Seitz ability to compound your assets over the long-run, while limiting the risk of a permanent loss of capital. We have worked hard at this while many investment management firms have been focused on gathering assets and fees. Since 1996, Greenfield Seitz has outperformed the market in 5 of the 6 down years.



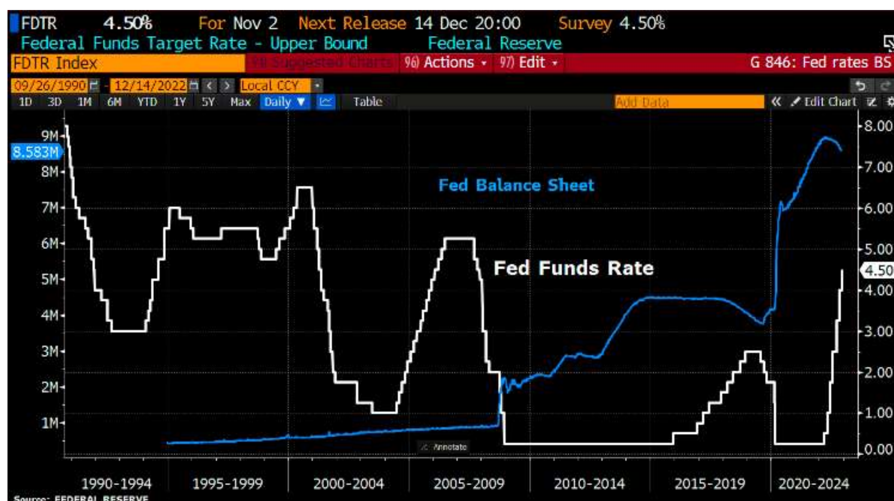
We made several bold and contrarian calls last year:

First, energy was very unloved and energy stocks had fallen from comprising 16% of the S&P 500 in 2008 to just 2% of the index in 2022. The world runs on energy and these companies' stocks were only 2% of total stock market cap! They were trading at historic discounts as most investors thought it was a dying industry with the advent of electric vehicles, alternative energy, etc. A year ago, Ark Innovation investor, Cathie Wood infamously said "oil prices will suffer the same fate as whale oil" and predicted oil to fall below $12 a barrel (WTI finished the year at $80). We knew this forecast by investors was incorrect as alternative energy sources have only grown from 7% of energy to 15% over the past 50 years (chart below) and EV's represent less than 1% of transportation. As investors shunned energy stocks, their fundamentals became attractive. We positioned our portfolios with a heavy allocation to oil & gas stocks. Energy stocks were up 58% last year and were one of the only places to profit.

Last year, the market cap of Tesla was larger than the entire Energy sector. It's hard to believe one EV car maker was valued at more than the 23 largest U.S. energy companies. This phenomenon probably says as much about investors' dislike of oil & gas stocks as it did about their love of speculative stocks. The fear of missing out (FOMO) was real.



Second, we predicted that the Fed printing $4 trillion in new money in the past two years would cause wild inflation. Milton Friedman said, "Inflation is caused by too much money chasing too few goods." Yet, most experts and the Fed kept saying inflation was "transitory." But inflation eventually hit a 41-year high of 9.1% in June. Our portfolios were prepared with gold and commodity producing companies (like oil & gas) posting gains. In past letters, we have shown how commodities historically do well in inflationary environments.



Third, our year end letter last year predicted outperformance from value stocks (essentially low P/E). After tech stocks had run up for 13 straight years, everyone was on the growth bandwagon. But in the process, popular growth stocks became expensive and value stocks became even cheaper. In 2022, the S&P Value Index only fell 5.2% while the S&P Growth Index fell 30%. We believe value will continue to outperform. It is important to remember that since 1960 value stocks have outperformed growth stocks by 4.4% per year on average.[3] In fact, the only two periods growth outperformed value were in the 1990's tech stock mania and the most recent speculative mania.

Source: MSCI, Refinitiv Datastream, J.P. Morgan Asset Management. Past

Fourth, we largely avoided outrageously expensive growth/tech stocks. The NASDAQ100 was up 13 years in-a-row, and most investors were lured in and assumed these stocks would continue their run, regardless of valuation. A generation of investors were trained to buy these high growth compounders without any regard for valuation. They were "Bull market geniuses." The P/E of the NASDAQ hit 30x compared to a historical average for stocks of roughly 15x. Eventually, it corrected with the NASDAQ down 33% last year. Even the mega-caps were hit hard (AAPL -29%, AMZN -51%, GOOG -39%, META -65%, NFLX -51%, and TSLA -69%). We owned none of these popular growth stocks despite them all being in the top 15 largest companies in the world. Avoiding these stocks was a bold and contrarian call. Looking back, it's hard to imagine avoiding expensive stocks and unprofitable businesses was a difficult decision. 2022 was the worst year ever for total loss in stocks at $18 trillion globally.

Company	Current value of 10'000$ invested	Performance since peak
CARVANA	103 USD	-99%
PELOTON	503 USD	-95%
BEYOND MEAT	519 USD	-95%
coinbase	798 USD	-92%
TELADOC.	765 USD	-92%
Lemonade	743 USD	-93%
robinhood	931 USD	-91%
Snap Inc.	1'030 USD	-90%
zoom	1'108 USD	-89%
DocuSign	1'686 USD	-83%
Spotify	1'956 USD	-80%
TESLA	2'776 USD	-72%
NETFLIX	4'147 USD	-59%

The WSJ had an article (*Rookie Traders Are Calling It Quits* 1/1/23) on amateurs that quit their day jobs to trade stocks the past several years. We believe this began in the pandemic as many were out of work

and had stimulus checks to gamble on fad stocks. In aggregate, these investors helped pump speculative stocks to unimaginable highs. But it ended badly as higher interest rates and lack of easy money eventually exposed most of these businesses.

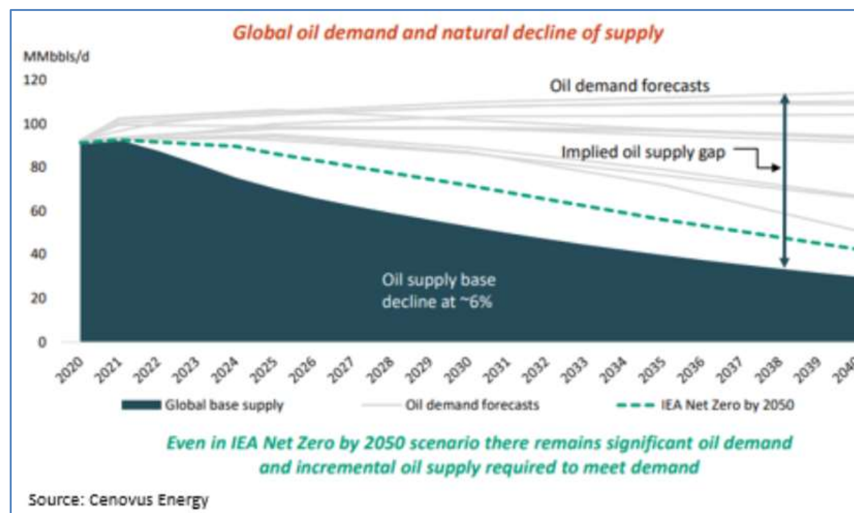
As an aside, there were 52 analysts covering Amazon in January 2022 and all of them rated it "Buy." Despite all their spreadsheets and teams of junior analysts, not one of them had a "Hold" or "Sell" rating on the stock. The stock of the second largest company in the world fell 51% last year. This herd mentality is common in human nature, and we hope we have removed our investment style from it and are able to profit accordingly.

Energy

We believe there is a supply/demand imbalance in oil that will cause a third straight year of rising prices. Simply put, there has been less spending on oil exploration and development, but demand almost always goes up. After a decade of their stocks underperforming, most energy companies have lowered their exploration budgets to focus on profits. The days of drilling at all costs are gone as investors now focus on profits and not on growing reserves. The management of energy companies got the message loud and clear from investors. On the demand side, the emerging world is still increasing oil consumption with improvements in their quality of life (think getting a motorcycle, refrigerator, etc in India).

This supply/demand imbalance should be exacerbated by Russia and the Strategic Petroleum Reserve (SPR). After the Ukraine invasion, all western oil companies left Russia. Russian oil production will suffer without the expertise, technology, and capital of Schlumberger, BP, Exxon, etc. As a reference, Venezuelan oil production fell 90% after international companies left following their nationalization. Remember Russia is the 2nd largest oil producer in the world and even a small decrease in production will affect prices. Russian production may be on autopilot in the short-term, but the absence of western oil companies will eventually create problems as less wells are drilled, efficiency of wells declines, equipment needs replacing, etc.

Lastly, the government released 180 million barrels of oil from our SPR in 2022. This reserve was setup for emergencies such as war, but it was used to lower oil prices after the Ukraine invasion and to assuage voters with lower fuel prices before the election. The release was roughly 800,000 barrels a day for six months. This was like creating a massive oil producing company. EOG only produces 700,000 barrels a day despite 3,000 employees and an annual spending budget of roughly $5 billion. We think the end of SPR release (this month) and the upcoming decline in Russian production should benefit oil prices.



Cenovus Energy

Cenovus Energy is our largest holding. The stock is now our second largest dollar gain in GSCM's 58-year history. Cenovus is a Canadian energy company focused on oil sands that produces 800,000 barrels a day. CEO, Alex Pourbaix has done a masterful job of growing production from 300,000 bpd

to 800,000 bpd in the past five years through well timed acquisitions and internal expansion projects. The company has a reserve life of 35 years and an average production cost per barrel of $14. Cenovus has paid down debt from $11 billion to $3.9 billion (USD). Last year, Cenovus began returning 50% of its cashflow in the form of share buybacks (bought roughly 10% of total shares in 2022) and dividends. The company has instituted a plan to return 100% of free cashflow through share buybacks and dividends once its debt goes below $3 billion USD which should happen this quarter.

We added shares over the past two years while Cenovus had a 35% free cashflow yield. By comparison, Google had a 2% free cashflow yield at the same time. At the end of the day, each stock is just a claim on the future cashflows of the company and we like the prospects for Cenovus's cashflows.

Outlook

We expect more of the same in 2023. Since the 2008 financial crisis, investors have experienced 13 years of low interest rates and increasing money supply. This tailwind helped produce the longest Bull market in history. This era likely ended last year with inflation forcing Central Banks to raise interest rates. After this historic run, we think it may take longer than one year to let the air out of stocks. As we enter a new era of higher inflation and higher interest rates many of the old strategies may no longer work for investors.

Legendary investor, Stan Druckenmiller, recently said "once inflation goes above 5% it has never come down unless the fed funds is higher than CPI." We don't think investors are prepared for inflation or a world with significantly higher interest rates. Just raising rates to 4.5% last year crushed the speculative mania in most growth stocks. In 1980, Paul Volker raised the fed funds rate to 20% to fight inflation that had jumped to 13.5%. It worked and inflation fell over the next several years. Since then, we have enjoyed 40 years of falling interest rates. This era of low interest rates appears to be ending.

It's fascinating that investors are still confidently chasing many growth stocks. U.S. stock ETF's took in $580 billion in net inflows last year, which was the second most ever behind 2021.[4] The poster child for speculative stocks with wild valuations is Ark Innovation. Despite the ETF falling 69% last year, it still took in $1.6 billion in new money last year as investors are hoping the speculative stock mania will return.

Value stocks and Energy stocks have underperformed for 15 years, and it would be naïve to think their outperformance would end after just one year. As a reminder, Greenfield Seitz Composite outperformed the S&P 500 for 10 years in-a-row following the 2000 Dot-Com bubble and was named the top performing manager out of 3,000 investment managers.[5] We continue to avoid speculative and non-profitable companies. We believe value stocks offer tremendous opportunity here and will continue to outperform, which just started recently. The supply/demand imbalance in oil and gas should continue to reward energy stocks with increasing profits. Lastly, stock market returns are highly correlated to money supply (M2) and the fact that money supply is contracting for the first time since 2007 should be a warning for caution.

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.

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 Blooomberg Aggregate Bond Index. January 2023
2 Bianco Research. January 3, 2023
3 Real Investment Advice. Michael Lebowitz. December 8, 20212
4 Morningstar. "A Brutal Year in the Markets Doesn't Rattle ETF Investors" January 3, 2023
5 PSN Informais. Top Gun Manager of the Decade Award. 2010
All company information is from company filings

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