HOLDING ON TO OUR MARBLES

MARCH 31, 2019

DEAR FELLOW PARTNERS & FRIENDS,

Judging by the continued equity redemptions since last fall, Main Street continues to treat the market with caution. It is no wonder that many are simply taking their marbles home unless of course they already lost their marbles, which seems increasingly to be the case with the overall stock market. In which reality, other than that of Wall Street, can the value of global equities be equal to $85 trillion in one month, $70 trillion the next and then back to almost $85 trillion a few months later? That was essentially what happened between November 2018 and this March. With virtually no fundamental change in most companies that we follow, we can only attribute this latest bout of extreme moves to the ongoing debate over recession risks, for which we have nothing much to contribute other than to note that we are not currently in one. Whenever someone wonders if we are in a recession, ask yourself two questions: 1) Why do I still have to wait in line to get into my favorite restaurant? 2) Why do these restaurants have help wanted signs in their windows?

This reminds me of a macro version of our third quarter 2017 commentary titled *Operating in the Grey Area*. In that commentary, I explored how difficult it was for the investment community to get its head around situations without a binary outcome and how it often shoots first and asks questions later. Case in point was the groups of companies that were targeted by Amazon and digital disintermediation, generally. We made the distinction that many of the punished companies were actually much stronger than their digital competitors.

In this case, it seems that investors are living with the memories of the last economic crisis in mind and are worried that the next recession will replicate the damage of the last one. My opinion has been that there are few reasons to worry over a global recession because there are few common cause variables that affect all economies across the world. Clearly, a financial crisis which eliminates the ability of companies to finance daily operations is one of those variables. Outside of that and obvious *force majeure* variables, there are not that many other things that can bring down the whole global economy, or the entire US economy for that matter. The most likely path is that global growth settles back into the slow-growth "muddle through" pattern that it has been in since the end of the last era. This is the grey area for the market to become accustomed to again and hopefully allow Wall Street to find its marbles again.

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In the meantime, as I mentioned last quarter, the Centerstone Funds have become meaningfully invested and currently have reserve* positions of 12.83% and 13.19% for the Centerstone Investors Fund (CENTX) and the Centerstone International Fund (CINTX), respectively. We have been favoring some more cyclical names which, although leaders in their respective industries, often do have volatile end markets and therefore volatile results over time. However, we have chosen those that we believe will either maintain or grow their market shares,

*Reserve positions are cash & cash equivalents, treasury securities and short-term high quality bonds have decent balance sheets and management teams that are working in your favor. The result of this is that since the Funds have less ballast, they will likely find themselves more exposed to market volatility. This dynamic is part of our absolute value-oriented approach in that our reserves will tend to move counter to the size of the opportunity set. At this point, despite the strong start to the year, the stocks we picked up last year remain well below their highs (with one exception discussed below) and our reserve levels remain near where they were at the end of 2018.

Skating To Where The Puck Will Be

Semiconductor stocks were under a great deal of pressure for much of the last half of 2018. As often happens, the good gets dragged down with everything else as the market gets confused about the stocks in the grey area. In this case, our team discovered a recent spinoff of a mid-cap company that provides products and services to the semiconductor industry—a sort of "toll road-like" business.

Versum Materials** is a US company with global operations headquartered in Tempe, Arizona. The company's primary business is selling specialized—often proprietary—chemical compounds that are used in various phases of the chip manufacturing process. While these compounds represent just a tiny percentage of the total chip production cost, the requirements for chemical purity and performance are extremely high. This puts a reputable supplier like Versum, one of the earliest players in the industry, in a position to command strong pricing power. The business is "toll road-like" because the chemicals are a critical step in the production of each and every chip. This means the business is tied to the total volume of chips produced, which is growing strongly given the proliferation of connected devices—everything from mobile phones to automobiles to industrial robots and machinery.

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We were not the only ones to find the business attractive as Versum attracted two takeover offers for substantial premiums to our purchase price. As of this writing, the takeover battle for this fine little business is unsettled. Either way, though, Versum shows the value of looking where others are not looking and having a fundamental understanding of the drivers of businesses and the incentives of management teams. Importantly, it is another example of the benefit of "skating to where the puck will be."

Similarly, I have been making the case for international investing, on and off, for almost 30 years and have watched as market leadership has shifted from US to non-US equities many times over my career. At the same time, I managed or worked as an analyst for global funds (which own both US and non-US stocks) for most of that time. In other words, regardless of my preference for non-US stocks or US stocks at any given time, I have always found it prudent to diversify my basket amongst both, for somewhat obvious reasons. For instance, the US for most of its history was the world's leader when it came to corporate governance, shareholder protection, property rights and of course innovation. The developed non-US economies have mostly caught up and now much of the developing Asian market economies are closing the gap. It is becoming harder to justify valuation gaps based on historic reasons, which conflicts with our calculations that show a historically wide gap between US and non-US valuations (favoring US stocks). Regardless though, in hindsight, the diversified approach I have taken helped to offset, for example, the rather tepid US stock market recovery after the bursting of the technology bubble in 2000, as non-US stocks greatly outperformed US stocks right until the financial crisis. It is just one example but there have been enough others to suggest that it is always good to be diversified across asset classes and geographies despite what popular opinion might suggest or what trailing numbers say.

**1.19% position in the Centerstone Investors Fund as of December 31, 2018

"As long as we are doing our job from a bottom-up perspective, the Funds' long-term returns should track that of the operating performance of their underlying holdings."

In as much as Centerstone plays a role in all of this, our Funds are managed with an eye towards capital preservation. As such, I would not expect us to be the talk of the cocktail party in any given year. As I sometimes joke, when we should be the talk of the cocktail party, there is no cocktail party. The Funds, although benchmarked to various fully invested equity indices, are not built to outperform them in bull markets but should hopefully hold up better in down markets. As long as we are doing our job from a bottom-up perspective, the Funds' long-term returns should track that of the operating performance of their underlying holdings. Well-managed companies purchased at discounts to intrinsic value have tended to compound at meaningful rates over time, but I always try to emphasize the "over time" component, because we measure ourselves over full market cycles. The keys being—what did we deliver and at what cost. The cost (performance cost) being a function of the errors we made—the permanent loss of capital. Provided we minimize those errors, I believe we have a good chance at reaching our overall goal of equity-like returns, with less risk over a full market cycle.

"I am sure the year will have many surprises but we are optimistic that Centerstone Funds will continue to rise to the challenge and hold on to their marbles."

Pop Quiz

Just to review, let us reach back to a song from my youth by Country Music legend, Kenny Rogers. As undoubtedly one of the only Indian-American country boy long-term investors around, I am in a unique seat to see the link between country music and long-term global investing. So, here is a quiz, pick one answer:

You got to know when to:

1) Hold 'em
2) Fold 'em
3) Walk away
4) Run

The way I see it, in gambling (the song was named The Gambler), each of the above represents a distinct choice. But in investing, the only probable choice is 1) Hold 'em, because the other three are basically the same choice which is to quit, either voluntarily or not and suffer a permanent loss of capital. He also said to not count your money at the table because there will be plenty of time to count later. Basically, he said to have patience and hold 'em too.

As our young Funds approach their 3-year birthdays this May, let me again take this opportunity, on behalf of all of us at Centerstone Investors, to thank you for your support in these early days. It is because of you that our Fund flows have been steady and we have been able to grow through this tumultuous period. I am sure the year will have many surprises but we are optimistic that Centerstone Funds will continue to rise to the challenge and hold on to their marbles.

Sincerely,

Abhay Deshpande, CFA
CHIEF INVESTMENT OFFICER

Important Risk Information and Disclosure:

The commentary represents the opinion of Centerstone Investors as of March 2019 and is subject to change based on market and other conditions. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Any statistics contained here have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed. The views expressed herein may change at any time subsequent to the date of issue hereof. The information provided is not to be construed as a recommendation or an offer to buy or sell or the solicitation of an offer to buy or sell any fund or security.

An investment in the Funds entails risk including possible loss of principal. There can be no assurance that the Funds will achieve their investment objective.

Value investing involves buying stocks that are out of favor and/or undervalued in comparison to their peers or their prospects for growth. Our value strategy may not meet its investment objective and you could lose money by investing in the Centerstone Funds. Value investing involves the risk that such securities may not reach their expected market value, causing the Funds to underperform other equity funds that use different investing styles.

Investments in foreign securities could subject the Funds to greater risks including, currency fluctuation, economic conditions, and different governmental and accounting standards. Foreign common stocks and currency strategies will subject the Funds to currency trading risks that include market risk, credit risk and country risk. There can be no assurance that the Funds' hedging strategy will reduce risk or that hedging transactions will be either available or cost effective. The Funds use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investing directly in securities and other traditional investments.

Domestic economic growth and market conditions, interest rate levels, and political events are among the factors affecting the securities markets in which the Funds invest.

Large-cap company risk is the risk that established companies may be unable to respond quickly to new competitive challenges such as changes in consumer tastes or innovative smaller competitors. Investments in lesser-known, small and medium capitalization companies may be more vulnerable than larger, more established organizations.

In general, a rise in interest rates causes a decline in the value of fixed income securities owned by the Funds. There is a risk that issuers and counterparties will not make payments on securities and other investments held by the Funds, resulting in losses to the Funds. The Funds may invest, directly or indirectly, in "junk bonds." Such securities are speculative investments that carry greater risks than higher quality debt securities.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Centerstone Funds. This and other important information about the Funds are contained in the prospectus, which can be obtained by calling 877.314.9006. The prospectus should be read carefully before investing. For further information about the Centerstone Funds, please call 877.314.9006. The Centerstone Funds are distributed by Northern Lights Distributors, LLC, Member FINRA/SIPC. Centerstone Investors, LLC is not affiliated with Northern Lights Distributors, LLC.