Matarin Capital

Investing with Insight and Integrity

Get Comfortable with Being Uncomfortable

June 2016

Where the Magic Happens

In order to find unique return opportunities, sometimes it pays to 'get comfortable with being uncomfortable.' This is because the comfortable decisions will often be discounted in prevailing prices – investors will have already made the easy choices. By contrast, 'uncomfortable' situations cause many investors to turn away for the wrong reasons, creating pricing inefficiencies and attractive investment opportunities.

Volatile markets can be a valuable driver in creating uncomfortable situations, but the truth is that in every type of market, you will find that many investors are fearful, greedy, and biased, and these traits can always benefit a cool-headed, long-term focused investor.

What Types of Uncomfortable Situations Create Attractive Investment Opportunities?

At Matarin, when we are buying uncomfortable stocks, we want them to be uncomfortable from a sentiment standpoint, but not from a fundamental standpoint.

Unpopular Lines of Business

Often, opportunities can be found in the stocks of companies that make something boring, morbid, or harmful, such as tobacco stocks. Unloved stocks often get overlooked and undervalued. For example, when Matarin launched its North America Small Cap strategy in December 2010, stocks related to housing and construction were unpopular due to the role that these industries played in the financial crisis of 2008. People tend to prefer stocks that they can feel good talking about at a cocktail party, and these industries were just the opposite! However, in 2010, Matarin began purchasing unloved stocks such as US Concrete and furniture maker American Woodmark. Construction materials, housing products, and building products went on to be three of the top ten performing industries in the US Small Cap space from December 2010 to the time of this writing.

Annual GICS Industry Returns	
12/31/2010 to 6/30/2016	
Construction Materials	29.8%
Household Products	23.0%
Building Products	17.3%

Source: iShares Russell 2000 ETF

(Behavioral Heuristic: Fluency – Bias causes that which is easier to mentally process to be valued more highly.)

Weak Stock Price Performance

Price momentum is perhaps the most direct measure of how much the market likes or dislikes a stock – how popular or unpopular it is. But there can be good opportunities in stocks that have weak stock price momentum, if the fundamentals are good enough to weather the storm. For example, at Matarin in terms of good fundamentals, we consider balance sheet strength, shareholder friendly management, and share price valuation.

(Behavioral Heuristic: Availability — Bias leads to overemphasizing recent information.)

Broken Growth

When a growth stock begins to underperform its high growth expectations, it loses a large component of its natural investor base and can tend to undershoot on the downside and become underpriced. When companies that were once market darlings and trading at premium multiples are no longer 'growth-y' enough to be attractive to growth investors, and yet are still not 'value-y' enough to catch the attention of value investors, they can become 'orphaned' and overlooked.

(Behavioral Heuristic: Anchoring — Bias leads to a failure to see changing circumstances with a fresh eye.)

Low Expectations

Low expectations lead to low valuations. An investor pays a high price for a cheery consensus. If a stock that is "priced for perfection" does not achieve perfection, its shares may be heavily punished by the market. But for a stock which has low expectations and disappoints, the punishment will be much less severe. And for a low expectation stock, even if there is minimal or declining growth, but the decline is less than expected, the reward is often very large. Investors don't need low-expectation stocks to go from bad to great to earn an attractive return, they just need them to go from bad to average.

(Behavioral Heuristic: Herd Behavior — Bias leads to extraordinary popular delusions and mad crowds.)