MATARIN CAPITAL

Investing with Insight and Integrity

Q3 2017 Newsletter

Matarin Capital Management, LLC aspires to be a symbol of stewardship within the investment management industry. We are dedicated to delivering excellent investment performance through insight, passion, and diligence. We aim to build strategic alliances with our clients based on the highest ethical standards. Please refer to the last page for important disclaimers.

The World According to GARP

Investing in the stocks of very rapidly growing companies can often be a money losing proposition. Investors (speculators) can become overly enthusiastic about growth potential, often simply extrapolating the most recent year's sales growth indefinitely into the future, which can lead to very expensive stock prices and significant mispricing. As a result, the stocks of these companies have a tendency to significantly underperform on average. Essentially, value trumps growth.

Go Big or Go Home

While the subsequent returns of stocks with high prior year growth tend to be particularly poor, large cap positive free cash flow generators within that group perform much better than the cash burners. Large cap stocks tend to be of higher quality, and for these mature companies, expectations for the future are often more reserved. Small cap growth companies, on the other hand, tend to underperform regardless of cash flow. You can see the long-term benchmark relative returns by market cap of the top 20% of companies based upon prior 1-year sales growth in the upper table on the right. Moral of the story: it's best to stay away from the stocks of high growth cash-burning companies.

1994 to Present

	LARGE CAP STOCKS			SMALL CAP STOCKS	
	Positive FCF	Negative FCF		Positive FCF	Negative FCF
High Growth	0.2	-9.7	High Growth	-1.4	-9.5

Not This Year, However

High revenue growth stocks have raced ahead of the market, and cash burners – expensive to the point of having negative free cash flow yield – have taken the lead. In the subsequent table on the right, you can see how dramatically the relative performance of high growth stocks during 2017 has diverged from what it had been over the past 22 years.

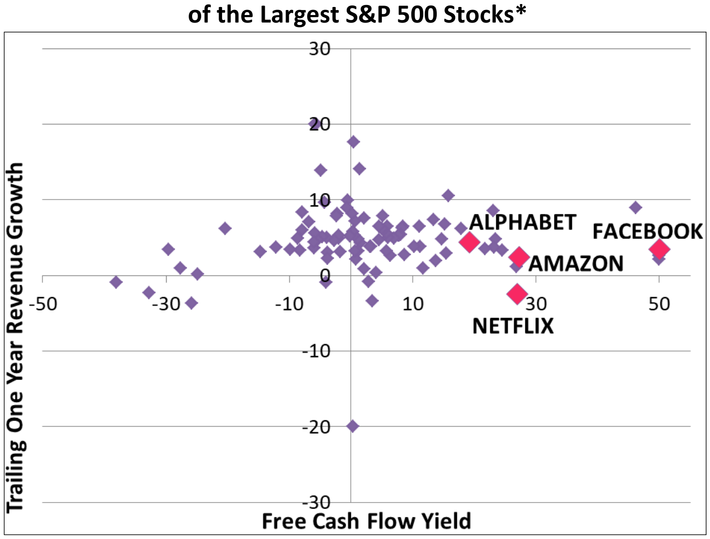
2017 Year To Date

	LARGE CAP STOCKS			SMALL CAP STOCKS	
	Positive FCF	Negative FCF		Positive FCF	Negative FCF
High Growth	7.4	11.3	High Growth	5.9	30.0

Tooth or Dare?

The well-known "FANG" stocks are for the most part large cap growth companies with positive cash flow, which is a positive attribute versus some of their growthy peers. In the group, Netflix is the only cash burner. However, while Facebook, Amazon and Google (now Alphabet) may be generating cash, their valuations relative to cash flow are on the high side, which should be still considered a warning sign.

Trailing 1 Yr. Revenue Growth vs. Free Cash Flow Yield of the Largest S&P 500 Stocks*



Some Growth Stocks Can Be Good Investments

At Matarin, we like to invest in growth, but we focus on longer-term, measured, sustainable growth trends and look well beyond just growth alone in our analysis. A stock must demonstrate other positive attributes such as strong cash flow, attractive valuations or managements who have demonstrated an ability to enhance shareowner value to be bought in our portfolios. In fact, we own very few negative free cash flow, high growth stocks across our portfolios. In most environments, this adds to returns, but in 2017 so far under-owning high growth cash burners has been a big detractor to returns, especially in small cap where these stocks have outperformed their universe by 30%.!

Growth at a reasonable price (GARP) investment strategies are popular for a reason. Combining analysis of growth with analysis of quality or value is one way to win at growth investing in the long run. But so far this year many GARP investors may be starting to feel quite unpopular – the 2017 markets have definitely not been a 'World According to GARP'! Moments when long-term investment wisdom becomes forgotten and mispriced can create both the greatest potential and the greatest discomfort at the same time. At Matarin, we believe that this discomfort actually helps to create potential, and as more and more investors capitulate and throw in the towel — buying growth at *un*reasonable prices, we see the markets becoming ever more ripe with opportunity.

*Data Source: FactSet , Compustat, & S&P; *Largest 100 Stocks in the S&P 500 with FCF Yield capped at +/- 20% and Revenue Growth at +/-50%*

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