MATARIN CAPITAL

Investing with Insight and Integrity

2015 Year-End Newsletter

Matarin Capital Management 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.

The Periodic Table of Matarin

The stock markets were volatile during 2015, an attribute which made the year quite interesting but certainly not unique. In the current environment, we've been communicating regularly with clients about what it takes to produce stable active returns in turbulent times. In the markets, you will find some investors who focus on a single investment style throughout the market cycle, and they add value by offering their investors exposure to that one style whether the style is in favor or out. At Matarin, our focus is on offering clients a stable pattern of active returns regardless of the market cycle. It is more of an "all weather" approach. In order to do this, we have to do two things: be adaptive and change our focus a little as the environment changes, and even more importantly, have diversity in our areas of focus. Understanding that there is no one investment approach that will work all the time, we call on information from a number of investing styles, which combine to form a well-balanced view. This allows us to have a high conviction in our work, regardless of the timing.

Specifically, Matarin forecasts stock returns by focusing on four broad investment "concepts": Business, Price, People, and Catalyst. The table presents a history of the annual returns of the top 150 forecasted return stocks in each of these four concepts relative to the S&P Composite 1500 Index.

Matarin's Four Broad Concepts Returns Relative to the S&P Composite 1500 Index

2015	8% Business	2% Catalyst	-2% People	-5% Price
2014	6% Catalyst	4% Business	3% People	3% Price
2013	14% Price	6% Catalyst	5% Business	3% People
2012	4% Business	0% Catalyst	-2% People	-2% Price
2011	5% Business	0% Catalyst	-1% Price	-1% People
2010	5% People	3% Business	-2% Price	-2% Catalyst
2009	25% Price	14% Business	-11% People	-20% Catalyst
2008	10% Business	1% Price	0% People	-9% Catalyst
2007	12% People	9% Catalyst	3% Price	2% Business
2006	8% People	5% Price	-1% Catalyst	-5% Business
2005	11% Price	0% Business	-2% Catalyst	-2% People
2004	8% Business	2% Price	-6% Catalyst	-8% People
2003	7% Price	3% Catalyst	2% People	-6% Business
2002	6% Business	1% Catalyst	1% People	-5% Price
2001	27% Price	9% People	1% Business	1% Catalyst
2000	5% Catalyst	2% Business	-6% Price	-25% People
1999	22% Catalyst	17% Business	-5% People	-7% Price
1998	27% Business	4% Price	3% Catalyst	2% People
1997	9% Business	6% People	4% Catalyst	-5% Price
1996	3% Catalyst	2% Price	2% People	-1% Business
1995	10% People	4% Business	1% Price	-1% Catalyst

Top 150 stocks based on forecasted returns
Sources: S&P, Compustat, FactSet, Northfield

Let's take a closer look at what each of these pieces are and how they perform over time:

Business

We have a multifaceted, longer-term approach to gauging the quality of each company's business. We prefer highly efficient, free cash flow generative businesses, exhibiting strong and consistent organic growth. During 2015, the Business concept performed well, as buying high quality (especially faster growing) businesses and shorting the opposite was a gainful endeavor. The market's recent preference for higher quality businesses began in the middle of 2014. As you can see in the table, the Business concept is the most consistently value additive concept (and our highest weighted), but as with all investing strategies, it experiences periods of weak performance. This was the case in 2003, when credit spreads narrowed dramatically, and many lower quality businesses rallied.

Price

We view company valuation through a variety of lenses. We utilize both backward looking and forward looking metrics, we use factors sourced from a variety of financial statements, and we tailor our comparisons to maximize relevance. Following two years of strong performance for the concept, it did not pay to be a value investor in 2015. This is often the case with value investing, as this concept tends to have longer (and often deeper) spells of strong and weak performance. Even within the family of value indicators, we often see a differentiation of performance patterns through time. For example, in 2015 cheap stocks as defined by more "deep value" metrics like book-to-price did not perform well, as this factor is correlated with leverage and default risk was a concern. However, more "high quality" value metrics like cash flow yield performed better. This is the opposite of what occurred in 2009 coming off the bottom. Both of these observations point again to the benefits of analytical diversity when constructing stock return forecasts.

People

At Matarin, speaking with company managements is not part of our research process. We instead believe that a management team's actions and the numbers tell the story. We prefer management teams that "eat their own cooking" (own stock), avoid excessive share issuance, and have an exhibited ability to add value via wise capital allocation decisions. The People concept tends to perform well during periods of time when prudent capital allocation decisions are being rewarded by rising stock prices, but struggles during periods of speculative excess like 1998 and 1999, when high share-issuing technology, media, and telecom stocks were market leaders. Again, this suggests that investing in companies with shareholder friendly leadership tends to be a winning strategy, but it too can have periods of drawdown.

Catalyst

As stated above, we love higher quality businesses that are well managed and cheaply priced. We rely on the Catalyst concept to help us with trade timing. By using shorter term, more technical and sentiment based factors like price momentum, fundamental trends, and volume changes, we can better time our entry and exit points, and often avoid "value traps." As you can see in the table, this concept is highly volatile. In 2015 for example, while active returns for the Catalyst concept were positive overall, the concept underperformed by 3% in April. Therefore, at Matarin, we have found it beneficial to introduce a number of nuances in when, where, and how we are treating momentum variables, in efforts to achieve a more palatable pattern of returns.

During 2015, the increase in variability of returns for the Catalyst concept, the variability of performance among measures of Price, and the return to leadership as a measure of a good Business all point to one conclusion… we don't know exactly what 2016 will bring for the stock markets, but we should certainly expect the variability to continue. The environment for creating alpha is as challenging as ever, and the benefits of using a balanced approach are rising.

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