

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. See general disclaimer last page.

Protecting Your Blind Side

What Has Changed?

At Matarin, we strive to deliver returns that are independent of political outcomes. Since the U.S. election, political risk has presented itself in outsized gains and losses for a number of broad market risk factors. Some of the effects have been dramatic, but because of Matarin's risk management process, we have avoided a lot of the drama, and continued to deliver on our promise to clients of focusing on risk-adjusted returns.

What Moved?	What's the Political Outcome the Market Expects for Risk Factors?	Post-Election
	<i>Top 20% vs. Bottom 20% of Stocks by Risk Exposure (% Return Diff.)</i>	
Leverage Ratio	Companies with more leverage could benefit from tax credits for debt-financed projects and narrower credit spreads	11.7
"Blind Factor 3"	A statistical risk defined by Northfield Information Services (see below)	4.5
Interest Rate Sensitivity	Bond proxies could suffer with rising interest rates	-8.0
Market Cap	Smaller companies could benefit from lower corporate tax rates and stronger dollar, as they earn more revenues domestically	-9.4
Credit Ratings (A vs. C rated)	Companies with lower credit ratings could benefit from less risk-aversion among investors	-20.5

The table above shows the difference in returns of the top 20% of stocks within each risk factor minus the bottom 20%. You can see, for example, that the most leveraged stocks outperformed the least leveraged by almost 12% from November 9th to year end.

Managing the Unknown Unknowns

Matarin portfolios have remained neutral to election (and other) risks by maintaining roughly equal amounts of over- and underweight exposure to risk factors such as industry and interest rate risk. We seek to control specific meaningful risks which we believe are not core elements of our skill, or 'edge.' However, there are some risks that may be more fleeting, surprising, or even beyond intuitive comprehension which, if left unmanaged, could be harmful to returns. How can we manage what we can't define?

In the table to the right you see a risk factor called Blind Factor 3. Matarin has customized a Northfield Risk Model to aid in constructing our clients' portfolios, and in that model the 'Blind Factors' are purely statistical measures that identify risks in the market which have not been previously defined by Northfield or Matarin, but which are still mathematically evident. The Blind Factors represent and control the 'unknown unknowns' when we build portfolios. The nature of the risks reflected in each of the Blind Factors changes through time as the environment changes. Sometimes, but not always, a clear pattern can be seen among the stocks that have most and least exposure to a Blind Factor.

For example, in the table on the right you see the six stocks with the most positive and negative exposure to Blind Factor 3. Sorting in this way makes it clear that during the prior five year period over which risk estimates are calculated, there was significant comovement among gold and silver stocks that had not been fully described elsewhere in the risk model. From the time of the election to year end, gold and silver stocks showed polar opposite performance from other metals and mining industry stocks including aluminum (+10%), steel (+27%), and copper (+9%) which rose strongly, while gold stocks (-12%) and silver stocks (-18%) fell sharply. While Blind Factor 3 picked up this risk ahead of time, Matarin previously had gone a step further and created gold and silver custom risk factors before this post-election event. In retrospect, it is clear that just being industry neutral is not enough to control risk in some periods. Post-election 2016 is a 'shining' example of Matarin and Northfield Blind Factors protecting the clients' blind side!

Company Name	Blind Factor 3 Exposure	Industry	Post-Election % Price Chg
<i>3 Lowest of Northfield Blind Factor 3</i>			
NovaGold Resources	-11.3	Metals & Mining	-6.4
Eldorado Gold	-11.0	Metals & Mining	2.5
Silver Standard Resources	-10.7	Metals & Mining	-19.1
<i>3 Highest of Northfield Blind Factor 3</i>			
Marathon Oil	7.1	Oil Gas & Cons. Fuels	21.5
Joy Global	7.3	Machinery	0.1
United States Steel	8.2	Metals & Mining	57.5

What to Expect from Matarin in 2017?

At Matarin, we find it too risky to bet our clients' money on inscrutable outcomes. We humbly admit that we can't foresee what is on the political horizon. While the markets have been high on post-election wagering, our approach has remained steady. Fourth quarter results at the firm were good, but it was not because of political risk taking. It is because the market strongly rewarded the firm's long-term approach to picking stocks, which focuses on more 'pure,' bottoms-up, risk-aware stock selection. In fact, even as the market environment transformed on November 9th, the rewards to [Matarin's Four Broad Concepts](#) remained relatively consistent.

We believe that the return factors that have driven our portfolios' performance both before and after the election continue to have strong future investment merit, and we will continue to focus on these sources of alpha in 2017.

Data Source: FactSet, Northfield