

*Matarin Capital Management, LLC aspires to be a symbol of stewardship within the investment management industry. We are dedicated to delivering above benchmark risk adjusted investment returns 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.*

## Investing in an Environment of Uncertainty

Typically when we hear the phrase “this time is different,” we are highly skeptical. However, over the past few months, the world has truly sailed into uncharted waters. Historical financial datasets going back several decades simply do not include any periods quite like recent months, in which huge segments of the economy are essentially shut down. It remains unclear when, and/or if, things will return to “normal.”

Many investors will respond to this environment of uncertainty by trying to forecast the most likely outcomes. But at Matarin, we see this as a perilous approach. It is difficult, if not impossible, to assess probabilistic outcomes for a series of events that have little or no historical precedent. Today, we have a global pandemic combined with an economic shutdown, both of which may ebb today and re-emerge later. Add to this a deep uncertainty about how consumers or businesses will adjust their spending in these uncharted waters, or how much more stimulus global governments will provide and the extent to which it would truly be stimulative.

Therefore, we believe it makes sense to train our process to see the areas of uncertainty for what they are, and manage around them. Over the past quarter, we have spent a lot of time reviewing, discussing, and evaluating how the virus shock could change the analysis of information that is encompassed in our investment process, and making adjustments as needed. Simply burying our heads in the sand and assuming our models will be unaffected is not an option.

While Q1 financial statements provided a clue as to the coming impact on company financials, we are prepared for large changes in financial data over the next several quarters, and possibly years. While we need to be careful not to overreact to recent events, we also need to ensure that our assessments of company value and business quality fully incorporate the current reality. Some of the significant data changes we have discussed include: a) huge revenue and earnings declines for a large number of companies; b) dividend cuts and eliminations and/or stock dividends in place of cash payouts; c) volatile growth trends (we favor strong and STABLE growers); d) portfolio risk taken by overweighting or underweighting stocks that are highly levered (positive or negative) to the virus. At this point in time, we believe it is more important than usual to focus on forward estimates and less on trailing (pre-virus) data, and we have adjusted factors within our Price and Business concepts accordingly.

To give you a sense of the huge magnitude of change occurring for some companies, the above chart provides a few examples of names traded in client portfolios in Q2. For a highly impacted company like United Airlines (UAL), over the past 6 months, earnings estimates have declined from \$13/share to -\$21/share and revenue estimates have fallen from \$45B to \$18B. Given the incredible uncertainty, the stock has essentially become a leveraged speculation on a virus vaccine and a return to normalcy. Interestingly, many of the businesses most impacted (airlines, cruise lines, restaurants, hotels, etc.) by the virus have become significantly more speculative, and have seen huge increases in share turnover and trading volume. Many of these names have become the preferred lottery tickets for the next wave of day traders and individual speculators. UAL’s shares outstanding have turned over close to 15 times this quarter, or roughly once every 4 days! As you can see in the chart, its median trading volume has increased from 2.0m shares/day to 56.3m shares/day... wow. On the other hand, you can see that Quanta Services (PWR), which is an industrial company that provides specialty infrastructure solutions to the utility, energy, and communication industries, has been less impacted, continues to produce earnings, and has not seen a huge spike in trading activity. In Q2, we sold shares of UAL and purchased shares of PWR in large cap portfolios.

Another example shown above is in the Consumer Discretionary sector where we sold shares in Cheesecake Factory (CAKE) in small cap accounts in Q2 and purchased shares of Big Lots (BIG). Like UAL, CAKE’s business has suffered severe impacts, and its growth prospects look less attractive as does its valuation. On the other hand, BIG has actually seen large improvements in their business over the last few months and rates highly across our Price, Business, and Catalyst concepts.

We never take a “set it, and forget it” approach, we are highly focused on the “future investment merit” of each component of our stock selection model and are constantly monitoring, reassessing, and trying to improve our process.

| Name<br>Ticker<br>Strategy<br>Trade   | Example #1                                |  | Example #2                         |  |
|---------------------------------------|---|--|------------------------------------|--|
|                                       | Quanta Services (PWR)<br>Large Cap Q2 BUY | United Airlines (UAL)<br>Large Cap Q2 SELL | Big Lots (BIG)<br>Small Cap Q2 BUY | Cheesecake Factory (CAKE)<br>Small Cap Q2 SELL |
| Sector                                | Industrials                               | Industrials                                | Consumer Discretionary             | Consumer Discretionary                         |
| Stock Price 6/30/20                   | \$39.23                                   | \$34.61                                    | \$42.00                            | \$22.92  |
| Stock Price 12/31/19                  | \$40.71                                   | \$88.09                                    | \$28.72                            | \$38.86  |
| 3-Mo Volume 6/30/20 (M shs/day)       | 1.4                                       | 56.3                                       | 1.5                                | 3.6  |
| 3-Mo Volume 12/31/19 (M shs/day)      | 1.2                                       | 2.2  | 1.1                                | 0.7  |
| FY2020 EPS Est 6/30/20                | \$3.15                                    | -\$20.81                                   | \$6.41                             | -\$1.57  |
| FY2020 EPS Est 12/31/19               | \$3.83                                    | \$12.82                                    | \$4.04                             | \$2.77   |
| FY2020 Sales Est 6/30/20 (\$B)        | \$11.60                                   | \$18.40                                    | \$5.93                             | \$2.04   |
| FY2020 Sales Est 12/31/19 (\$B)       | \$12.80                                   | \$45.40                                    | \$5.48                             | \$2.94   |
| 2019 vs. 2018 1-Yr Sales Growth       | 8.4%                                      | 4.7%                                       | 1.6%                               | 6.4%   |
| 2020 (est) vs. 2019 1-Yr Sales Growth | -4.4%                                     | -57.4%                                     | 11.4%                              | -17.7%   |

Sources: S&P Compustat, FactSet