Q1 2020 Newsletter

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.

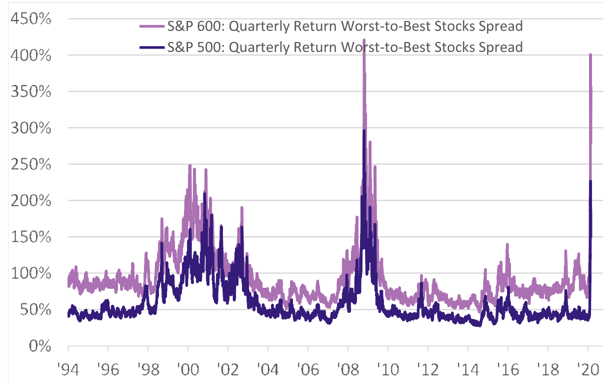
Opportunity Knocks, Skill Matters

At Matarin, we believe that Dispersion and Skill are two core drivers of opportunity for active investment. In the current moment both of these areas are showing promise.

Dispersion

When it comes to beating the market, it matters a great deal how much dispersion there is among potential investments. If there is a wide dispersion in returns, we can outperform by picking the best performers and shunning the worst. And in fact, during Q1'20 dispersion is hitting highs not seen since the 2008 financial crisis. This graph depicts the returns that the poorest performing stocks would have to generate to reach the returns of the best performing stocks. As you can see, that spread has dramatically spiked, such that this difference is now 150% within the S&P 500®, a large cap index, and has surpassed a whopping 400% in the S&P 600 SmallCap® index. This means that the potential reward for selecting the right stocks is wide in all market cap ranges, and that it's considerably greater among the smaller stocks than larger ones.

S&P 500® and S&P 600® Return Dispersion



Data as of 3.31.20. Sources: S&P Dow Jones Indices, FactSet

Skill

However, when it comes to value-additive active management, having a wide range of return differences among stocks is not enough — you also have to pick the outperformers. So, it's worth sharing some of our thoughts on stock picking in the current environment .

It's been interesting to see growth and momentum stocks recently adding to their prior years of outperformance, even though the environment has changed so dramatically. In Q1, the Russell 1000 Growth® outperformed the Russell 1000 Value® by 12.6%, and by 7.3% in March alone! It's curious to observe that investors continue to hunt for growth, even as the market crashes and the economy appears to be entering a painful recession. While some of this performance is attributable to sector weighting differences, the fact remains that price momentum and growth have continued to dominate other factors like valuation and cash flow generation. This reinforces our belief that market participants' trust in "growth as the new safety" is deeply embedded and will eventually be overdone. In this emotional market environment, it will be important for investors to express their skill with cool heads and to rigorously re-evaluate situations as new information arrives. This is why we remain confident in Matarin's unemotional, systematic approach, in an environment teeming with uncertainty and fear. Here is where we expect our skill to be most rewarded in the coming period:

a) We expect **value investing** (our Price concept) to turn around. For some valuation indicators, spreads between the cheapest and most expensive stocks are at levels near or exceeding the tech bubble and the financial crisis after a long period of value underperformance. In these two prior periods when spreads were similarly wide, value-based strategies went on to perform very well. While it's not clear what the catalyst will be to turn it around, it will be interesting to see how the more expensively valued, higher expectation names perform in the upcoming earnings announcement season that's likely to be rife with disappointments. While some investors have given up on value investing, we are sticking with our discipline, modestly increasing our exposure to value stocks, and doing our best to "get comfortable with being uncomfortable."

b) We are strong believers that fundamentally **higher-quality businesses** (our Business concept) are better equipped to weather the current storm and thrive on the other side. When assessing businesses, we take a long-term perspective to get a sense of how a company performs across environments. More than ever, we think highly free cash flow generative, efficient, predictable, and growing businesses are less likely to be permanently impaired, and more likely to lead us out.

c) Matarin usually manages its portfolios to be size neutral, relative to benchmark. This is distinctive from many other active managers who may take size bets for various reasons. For example, small-cap managers may tend to drift into buying mid-cap stocks, on average, especially if they are not managing capacity tightly. Russell 1000® large-cap stocks have outperformed the Russell 2000® small cap by 6.5% annualized over the past 5 years, benefitting some managers who take size risk. However, Matarin uses a proprietary forecasting model to signal environments with significant size-risk opportunity. At the end of March, this model gave a strong **signal for small stocks to outperform** large going forward. This forecast should benefit the size-neutral stance in Matarin's Small Cap strategy, and in our accounts that hold larger-cap stocks (Large Cap Core and Low Volatility), we are implementing a rare signal to tilt those portfolios slightly smaller in size relative to their benchmarks.

d) We will continue to stick to our knitting and do what we we've always said we would do. At the same time, we are constantly striving to improve our process. We have recently added two new, diversifying factors (**Business Predictability** and **Innovation Investors**) that have both added value since their addition, and should serve us well in the upcoming environment.

As bleak as the markets have looked so far this year, there is hope that these very challenges will bring opportunities for investors. We believe that the same can be true for our society as a whole, as we continue to find bright lights of inspiration in this difficult time of loss.

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