



DEAR FELLOW PARTNERS & FRIENDS,

The Centerstone Investors Fund (CENTX) and the Centerstone International Fund (CINTX) launched close to five months ago as of the date of this letter. It really is amazing what can happen in just five months – Brexit*, the Zika virus, developments in the Presidential election, topped off by a terrorist attack just around the corner from our office in Manhattan, to name a few. As surprising as those things all were (and are) at the time, I have no doubt that each will fade into the past for most of us. That said, it is a timely reminder that life is full of surprises. Not all surprises are good, which is why I have always found some comfort in Benjamin Graham’s advice to have the flexibility to hold reserves as an alternative to always being fully invested.

Winning by Not Losing

At Centerstone, we scour the globe to unearth securities that may provide our investors equity-like returns with minimal risk of impairment. With the advent of technological threats, common commercial borders and the convergence of accounting standards and currencies, this business is much more competitive than it used to be. There are simply fewer inefficiencies today and the competition is smarter and tougher than in the past. Now, more than ever, the focus has become almost exclusively about “not losing” as in this era, more often than not, the winners are those that make the fewest errors.

Since the dawn of the internet age, investors have watched as many heretofore strong and essential businesses have become shadows of themselves (newspapers) or disappeared completely (Kodak). The threat was limited, however, to those industries which were easily displaced by digitization and the impairments were also fairly limited. However, over the past several years other industries have begun to feel the threat. Digitization has combined with the logistics chain, to threaten even “last mile”

businesses that were immune to technological threats due to the convenience of location to their local markets. Today businesses such as grocery and clothing retailers have begun to feel the heat. We believe this added uncertainty, along with an aging society that can less tolerate potential impairments, is an important driver of flows into high quality companies. Such companies represent safety to many investors in an uncertain world.

We also tend to prefer what we perceive as high quality businesses, but our quality metrics differ by company and by industry. For instance, in certain industries the underlying market structure can help or hurt the overall stability of each business within it. In the liquefied gas market, Air Liquide¹, competes within a fairly concentrated industry where high transportation costs and greenfield capital costs allow for natural monopolies to exist. This has resulted in very stable margins over the years, which can be an important marker of quality.

In other cases, companies such as Emerson Electric² managed to thrive in highly cyclical industries by making themselves indispensable to their clients. Importantly, they maintain a healthy level of ongoing service revenues and co-locate with many of their clients, which potentially lessens the impact of end-market cyclicalities and helps to ensure that their market share does not erode.

In the end, quality is in the eye of the beholder. For us, it is represented by stability of margins, market share, return on capital and free cash conversion, among other important factors. A significant portion of our analysis relates to avoiding errors therefore we spend the majority of our time focusing on the nature of the business model and “what can go wrong,” ultimately trying to win by not losing.

“A significant portion of our analysis relates to avoiding errors therefore we spend the majority of our time focusing on the nature of the business model and ‘what can go wrong,’ ultimately trying to win by not losing.”

1 Air Liquide: 1.82% position in the Centerstone Investors Fund, 3.31% position in the Centerstone International Fund as of September 30, 2016

2 Emerson Electric: 1.13% position in the Centerstone Investors Fund as of September 30, 2016



Small but Big

The investment team and I recently returned from a research trip to Northern Europe and France. In the Nordic region, we have a collection of really great businesses which includes Matas³ and ICA Gruppen⁴, among others. In our view, each of these companies has dominated its industry with leading market share and returns. However, they have been dominant in relatively small countries. Matas is the largest health and beauty retailer in Denmark with approximately 40% market share, but in a country of roughly six million people. The market share advantage gives Matas strong negotiating power with its suppliers, which translates into highly favorable pricing and trade terms.

“Matas and ICA are examples of small, but big, companies and another area of opportunity available to smaller investment managers such as Centerstone.”

ICA is similarly positioned in Sweden, which is a country with a population of 10 million. ICA has 36% market share of the grocery market in Sweden and is approximately twice the size of its next largest competitor. ICA has a strong presence throughout the country and its grocery stores are in 290 out of 295 communities in Sweden. This scale provides it with efficiencies in its distribution and also gives it a procurement advantage. Further, ICA has a large pharmacy business in Sweden and locates many of these stores next to or near its grocery stores. To give a sense of ICA’s market share in Sweden, it’s similar to that of Wal-Mart in the US. Yet, both Matas and ICA remain relatively unknown due to their small market capitalizations. Matas and ICA are examples of small, but big, companies and another area of opportunity available to smaller investment managers such as Centerstone.

“Contrasted with my travels eight years ago, it appears to me, hidden well behind headlines about the Presidential election, interest rates and police brutality, that the actual economy looks okay.”

Eight Year Anniversary of Lehman Brothers

It was eight years ago that Lehman Brothers’ bankruptcy marked the beginning of the end of the vast credit bubble that had built over the previous decades. I know it is more customary to mark an event in increments of five years, but the number eight is significant in its own way. In 2009, authors Carmen Reinhart and Kenneth Rogoff wrote a book called *This Time is Different: Eight Centuries of Financial Folly*. The book documented 800 years of financial crises, from government defaults to banking panics in order to make the point that indeed financial panics are a recurring part of the fabric of human progress. In their study they discovered that economic contractions that were caused by banking crises were among the most intractable of crises, featuring sharp drops in production that required many years to repair. They noted “on average, it takes about eight years” to recover. I only mention this because as I travel across the country I have noticed a change in many local economies that I have visited. Contrasted with my travels eight years ago, it appears to me, hidden well behind headlines about the Presidential election, interest rates and police brutality, that the actual economy looks okay.

Thank you for your support and interest in Centerstone.

Sincerely,

Abhay Deshpande, CFA
CHIEF INVESTMENT OFFICER

3 Matas: 1.49% position in the Centerstone Investors Fund, 2.28% position in the Centerstone International Fund as of September 30, 2016

4 ICA Gruppen: 1.47% position in the Centerstone Investors Fund, 2.73% position in the Centerstone International Fund as of September 30, 2016

* **Brexit** is an abbreviation of “British exit”, which refers to the June 23, 2016 referendum by British voters to exit the European Union.

The Centerstone Funds are new and have a limited history of operation. An investment in the Funds entails risk including possible loss of principal. There can be no assurance that the Funds will achieve their investment objective. In addition, the Advisor is newly formed and has not previously managed a mutual fund.

Domestic economic growth and market conditions, interest rate levels, and political events are among the factors affecting the securities markets in which the Funds invest. Value investing involves buying stocks that are out of favor and/or undervalued in comparison to their peers or their prospects for growth. There is a risk that issuers and counterparties will not make payments on securities and other investments held by the Funds, resulting in losses to the Funds.

Our value strategy may not meet its investment objective and you could lose money by investing in the Centerstone Funds. Value investing involves the risk that such securities may not reach their expected market value, causing the Funds to underperform other equity funds that use different investing styles.

Large-Cap Company Risk is the risk that established companies may be unable to respond quickly to new competitive challenges such as changes in consumer tastes or innovative smaller competitors. Investments in lesser-known, small and medium capitalization companies may be more vulnerable than larger, more established organizations.

In general, a rise in interest rates causes a decline in the value of fixed income securities owned by the Funds. The Funds may invest, directly or indirectly, in “junk bonds.” Such securities are speculative investments that carry greater risks than higher quality debt securities.

Investments in foreign securities could subject the Funds to greater risks including, currency fluctuation, economic conditions, and different governmental and accounting standards. Foreign common stocks and currency strategies will subject the Funds to currency trading risks that include market risk, credit risk and country risk. The Funds use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investing directly in securities and other traditional investments. There can be no assurance that the Fund’s hedging strategy will reduce risk or that hedging transactions will be either available or cost effective.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Centerstone Funds. This and other important information about the Funds are contained in the prospectus, which can be obtained by calling 877.314.9006. The prospectus should be read carefully before investing. The Centerstone Funds are distributed by Northern Lights Distributors, LLC, Member FINRA/SIPC. Centerstone Investors, LLC is not affiliated with Northern Lights Distributors, LLC.