CENTERSTONE INVESTORS

FROM CRISIS TO CONCENTRATION

JUNE 30, 2020

DEAR FELLOW PARTNERS & FRIENDS,

Prior to the COVID-19 crisis, the world economy, and in particular the industrial segment, was on the mend after a fairly long downcycle. Circumstances seemed to be faring well for non-US economies while their stock markets and currencies, which were generally undervalued, were poised for a rebound. Other pre-existing trends, such as the ongoing shift to online retail and networking were continuing forward, as were the social trends of millennials who have increasingly been in conflict with the norms of older generations. Tensions between rural and urban areas had increasingly been front and center, most obviously highlighted by the election of President Trump in 2016.

That was the backdrop for the set-up to the present. The main influence in the present is the wall of money that has so far been created to mitigate the short-term damage to the global economy. I stopped counting in May at $8 trillion but I believe that is a leading factor of the resurging confidence in global stock markets. As much as global leaders could provide job and payroll support, individual balance sheets for the majority of folks have been strengthened which provides some spending power as things normalize. The good news so far is that the stock market rebound has been fairly broad in participation and the Centerstone Funds were able to recover much of their losses as of this writing. On that front, I am happy with our quick response to the sudden and steep declines in March, especially in the face of a completely new challenge. It was, in hindsight, a good idea to become fully invested when the opportunity arose.

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Pre-Existing Trends Accelerated

Another observation about the present is that it appears that the pre-existing trends that I noted above have all been accelerated because of this crisis. The fiscal policy turnaround in Europe is well beyond what I thought possible in the foreseeable future. In our fourth quarter 2019 commentary titled *Europe In Focus*, we referenced a checklist that included some prospective good news for European stock markets. However, if you read the checklist carefully, I included and checked a box labeled "fiscal policy beginning to turn positive" in Europe. Note the word "beginning." It was prospective but seeing the trends in place I was confident in including this turnaround. As of now, Europe's fiscal policy is no longer beginning to turnaround. It already did. Germany is the decision-maker for such policies and its history with hyperinflation has meant that the country has been reluctant to use its balance sheet to support the Eurozone. But they were presented with a choice between two evils and chose the lesser of the two. Since 2011's Euro crisis this reluctance to "borrow and spend" has meant that while monetary policy has been aggressive, the continent's fiscal policies have been restrictive. In a real sense, one foot has been on the gas and the other on the brakes. The car just would not move anywhere. This development for Europe is one example of a pre-existing trend accelerating due to the COVID-19 crisis. Because of this shift, the idea of a Euro collapse, in my opinion, is off the table for the foreseeable future. That could breathe life and confidence into the area's already undervalued currency and stock markets, which may have a chance to perform well for many years to come.

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Now, focusing on the future. As many of you know, we do not speculate in the stock market and think that forecasting the markets is like forecasting the weather: good weather is predictable, bad weather is not. However, I have found in my experience that trends, once in place, tend to remain in place. This is why I focused this letter on some macro topics that I think do not require us to forecast but instead reinforce our reading of where we are on our journey. Aside from the economic trends already in place, we are also sensitive to the accelerating non-economic dynamics in the world around us. On that note, although Centerstone Investors is an apolitical company, I should note that my own hiring policies have always been simple and follow two basic guidelines for those that fit the job description: is the candidate an exemplary human being, does the candidate have an exemplary work ethic. I remember being given a break by my first boss who ran a small Registered Investment Adviser in Louisville, Kentucky. I was hired as an Analyst, fresh out of college, with no real exposure to the stock markets. What I did have was a burning passion to learn everything I could about investing. I also had a great deal of empathy for our mostly retired clientele and strived to be a guardian for their hard-earned savings. You will see those same ideals in everyone that has ever worked for me and certainly here at Centerstone. Many people in our industry associate these "soft" character traits as incompatible with investment success. I find that to be false. These traits, from my experience, are in fact highly correlated with success in life and in our business.

Concentrating on Quality and Value

Moving from the top-down to the bottom-up, the portfolios of the Centerstone Investors Fund (CENTX) and Centerstone International Fund (CINTX) have evolved since the beginning of the year. For instance, both Funds became more invested during the quarter and more concentrated. There are two main perspectives on concentration. My mentor, Jean-Marie Eveillard, used to derisively regard concentration as a "bull market phenomenon," while the late Marty Whitman would refer derisively to diversification as a "surrogate for knowledge." As usual, I am somewhere in the middle. After a long bull market, I do prefer to have greater diversification and greater reserves due to the implicitly higher risks in extended markets. But that said, after substantial declines I have always found myself narrowing the portfolios and becoming more fully invested as well. A common phenomenon is the indiscriminate selling that occurs during these market phases, which allows me to tilt the portfolios to the securities that exhibit the greatest combination of quality and value. The extent of the concentration typically depends on the extent of the preceding bear market. In the current case, we have been moving into smaller non-US value stocks for some time now and they had a brutal first quarter, enduring a loss of 42% at their worst. The annualized loss at that rate is 91%—you can see how extreme such a loss is in such a short period of time. However, these stocks represented by the MSCI ACWI ex US Small Cap index peaked in January 2018 as illustrated on the following page, therefore, this recent bear market was a little more than two years long. That is one of the longest downturns I can remember for such stocks.

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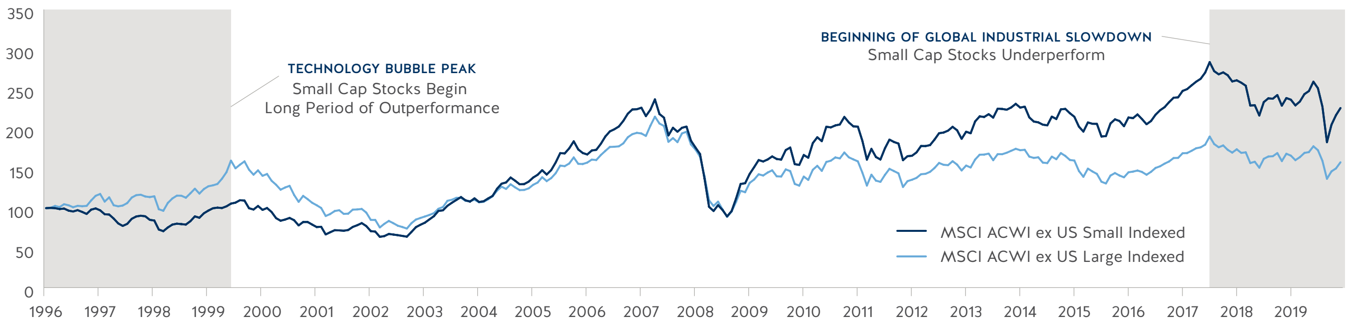
The closest parallel to this environment was over 20 years ago during the run-up to the dot-com bust. Then it was a combination of currency devaluations, excessive Asian sovereign debt levels and internet fever which caused mayhem in smaller global equities. Then, as now, it seemed that nothing could change the trajectory and that large cap stocks had taken up permanent leadership. Eventually, though, intrinsic value did what it has often done and like a magnet, brought prices back to reason over the following many years. History only goes so far as a predictive tool and there is one exception which is the miserable experience of Japanese stocks, in particular, small caps after the 1989 peak. In that case, the TOPIX Small index fell for 12 years, although granted from extreme valuations. For that reason, I am open to being proven wrong but so far, the signs are encouraging for a reversion of leadership back to smaller global equities, as it was at the turn of the century.

An example of the extremely depressed valuations we have seen in non-US small caps is Mekonomen[1], Northern Europe's largest distributor of auto parts and accessories.

WHILE THERE HAVE BEEN PERIODS OF UNDERPERFORMANCE, SMALL NON-US STOCKS HAVE OUTPERFORMED LARGE CAPS OVER THE LONG-TERM



Source: Bloomberg

Note: Values indexed to 100 as of July 1996

Its stock fell 61% in 2020 to its low in April. While it was impacted by restrictions governments put in place to combat the COVID-19 pandemic, its operating results improved significantly in April and May. This is because even though automotive maintenance can be deferred, it typically cannot be deferred for long. In fact, it indicated that there is pent-up demand for its products and services. At its low, the stock was trading for 7x earnings.

ICL Group[2] (formerly known as Israel Chemicals) is one of the world's lowest-cost producers of potash fertilizer. The vast majority of its business is essential and has remained fully operational throughout 2020. Its stock fell 37% to 10x earnings at one point in 2020. ICL's investment appeal is supported by a 6.5% free cash flow yield despite cyclically-depressed potash prices. Asian logistics operators Kerry Logistics[3] is a beneficiary of global trade realignment but its stock fell 30% regardless. At its low point, the stock was trading for nearly half of our estimate of its intrinsic value. It still has a number of opportunities to unlock the value of its real estate portfolio and high growth assets. In the emerging markets Siam City Cement[4], headquartered in Thailand, fell by nearly half in 2020 to its lows. Construction in many countries was deemed essential and governments in Southeast Asia (specifically, Thailand and Vietnam) have announced large infrastructure projects to support economic growth. Even now, Siam City Cement carries a 6% dividend yield.

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There is a common thread in the portfolios in that we consider many of the stocks to be of long duration businesses. This is an important concept in finance that we learn in school—the value of an asset is the present value of the sum of its cash flows generated over its life. A business's intrinsic value is then a function of the durability of its earnings power and the time horizon over which those earnings will be generated. Therefore, the longer the duration of the business, the less impact a single year's earnings will have on intrinsic value. That said, finance theory is not behavioral theory, as we have seen with the stock prices of Mekonomen, ICL Group, Kerry Logistics and Siam City Cement. But that is also what gives us the occasional opportunity to take advantage of what Charles Mackay termed "the madness of crowds" in his book *Extraordinary Popular Delusions and the Madness of Crowds* when he wrote, "Men, it has been well said, think in herds; it will be seen that they go mad in herds, while they only recover their senses slowly, and one by one."

On that note, with the Funds presently positioned in many such attractively valued companies and with a recent historic technical bear market behind us, there is quite a lot of sunlight ahead of us if we are willing to look past the clouds today. That is what we are doing at Centerstone—as always

Economic conditions remain highly uncertain and fund prices may remain low or decline further for an extended period.

1 1.07% position in the Centerstone Investors Fund and 2.20% position in the Centerstone International Fund as of March 31, 2020

2 2.28% position in the Centerstone Investors Fund and 4.50% position in the Centerstone International Fund as of March 31, 2020

3 2.85% position in the Centerstone Investors Fund and 5.02% position in the Centerstone International Fund as of March 31, 2020

4 1.31% position in the Centerstone Investors Fund and 2.51% position in the Centerstone International Fund as of March 31, 2020

> *"On that note, with the Funds presently positioned in many such attractively valued companies and with a recent historic technical bear market behind us, there is quite a lot of sunlight ahead of us if we are willing to look past the clouds today."*

looking ahead. As bleak as it looks now, I am as excited as ever about the future.

Thank you for your continued trust and support. We hope you have a safe and healthy summer.

Sincerely,

Abhay Deshpande, CFA
CHIEF INVESTMENT OFFICER

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Important Risk Information and Disclosure:

The MSCI ACWI ex US Small Cap Index captures small cap representation across 22 of 23 Developed Markets countries (excluding the US) and 26 Emerging Markets countries. With 4,167 constituents, the index covers approximately 14% of the global equity opportunity set outside the US.

The MSCI World ex US Large Cap Index captures large cap representation across 22 of 23 Developed Markets countries excluding the US. With 436 constituents, the index covers approximately 70% of the free float-adjusted market capitalization in each country.

The TOPIX Small index is a capitalization-weighted index designed to measure the performance of the stocks listed on the First Section of the Tokyo Stock Exchange, excluding the TOPIX 500 stocks and non-eligible stocks. The index was developed with a base index value of 1000 as of April 1, 1998.

The commentary represents the opinion of Centerstone Investors as of June 2020 and is subject to change based on market and other conditions. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Any statistics contained here have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed. The views expressed herein may change at any time subsequent to the date of issue hereof. The information provided is not to be construed as a recommendation or an offer to buy or sell or the solicitation of an offer to buy or sell any fund or security.

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.

Past performance is no guarantee of future results.

The value of the Funds portfolio holdings may fluctuate in response to events specific to the companies or markets in which the Funds invests, as well as economic, political, or social events in the United States or abroad. The impact of the coronavirus (COVID-19), and other epidemics and pandemics that may arise in the future, could affect the economies of many nations, individual companies and the market in general in ways that cannot necessarily be foreseen at the present time.

Value investing involves buying stocks that are out of favor and/or undervalued in comparison to their peers or their prospects for growth. 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.

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. There can be no assurance that the Funds' hedging strategy will reduce risk or that hedging transactions will be either available or cost effective. 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.

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.

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.

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. For further information about the Centerstone Funds, please call 877.314.9006. The Centerstone Funds are distributed by Northern Lights Distributors, LLC, Member FINRA/SIPC. Centerstone Investors, LLC is not affiliated with Northern Lights Distributors, LLC.