EXTREMES IN THE EXTREME

MARCH 31, 2020

DEAR FELLOW PARTNERS & FRIENDS,

Beyond the markets, I wish everyone safety and good health. As a son of elderly parents and father of four, I feel what everyone is feeling in the midst of the Coronavirus (COVID-19) outbreak. I also feel especially grateful that I have a home to go to and food on the table. Unfortunately, that is not the case for many people caught unaware around the world and especially in New York City. Even before this crisis, half of the city lived paycheck-to-paycheck. One startling statistic is that this cohort is just one paycheck away from losing the roof over their heads. As a result, many everyday folks are struggling for the basics, and without help, this could turn into a humanitarian crisis of unimaginable proportions. We are doing what we can to help.

From a performance standpoint, this year has gotten off to a rough start, to put it mildly. At the beginning of the year, I was optimistic that the right set of conditions was finally in place to begin the healing process for international value stocks. European governments seemed poised to adopt more accommodative fiscal policies, Brexit had reached a resolution and US-China trade tensions were beginning to ease. The economic cycle also remained fundamentally healthy and thus even after the initial COVID-19 outbreak in China, a quick recovery appeared to be the most likely outcome. But no economic cycle is healthy enough to overcome the global cessation of all business activity that has been adopted to mitigate the spread of COVID-19. Stocks fell dramatically in the first quarter with few places to hide. Value stocks did not provide any cushion and even our positioning away from index concentration risk—as I discussed in our fourth quarter commentary titled *Europe In Focus*—did little to shield the Funds. At the same time, the combination of leveraged sellers, ETFs and volatility-driven quantitative models proved incredibly difficult to diversify against. Even insulated businesses saw intraday stock price gyrations of up to 50%. These wild swings do not seem fundamentally driven, or even rational.

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Wait and See

In the meantime, I saw valuations fall to levels that I did not even see in the 2008/2009 Global Financial Crisis. We now have a number of “crossover stocks” in the portfolio, as was also the case during the Asian Financial Crisis in the late 1990s. The “crossover” occurs when the price to earnings ratio of a stock falls below its dividend yield. Provided that the dividend is secure, this has signaled fire sale prices in the past. There are some areas of caution, however, including many oil-related companies which have suffered steep drops in intrinsic value and whose dividends are at great risk. We did make an exception and purchased one company whose dividend is likely secure, but many other highly leveraged exploration companies will likely come to a bad end.

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The oil shock that surfaced over the weekend of March 7th came at possibly the worst time given the emerging virus fears. As oil fell 30% on the following Monday, Treasury bond yields fell to 50 basis points (one half of one percent) and the S&P 500 fell almost 10% as markets began to price in the deflationary potential of such a drastic decline in oil. That shock on top of the virus-related news only added to the chaos and intertwined to magnify the pre-existing concerns to an outright panic. As of this writing, the Federal Government has embarked on a very aggressive fiscal expansion, the longer-term effect of which could be rather inflationary. Even the Germans have gotten into the act. From the checklist that I presented in our fourth quarter commentary titled *Europe In Focus*, ironically enough, all the pieces are now in place for a meaningful long-term inflationary expansion of global economic activity after this recession comes to an end. In fact, the oil price decline is the equivalent of an additional large tax cut for everyone around the world. This is the message from gold as well. We just have to wait and see because the global monetary and fiscal response is unprecedented and I am not totally sure how the road will unfold. I am only confident that it should be good for nominal stock returns in selective industries. From current price levels, the return potential is an order of magnitude higher than just a few months ago.

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Three Distinct Investment Themes

We believe our portfolios are designed to withstand severe economic shocks. The leading edge of the portfolios is mostly comprised of long duration franchises with above-average earnings and dividend predictability. This includes companies like the industrial gas supplier Air Liquide[1] and the tank storage operator Vopak[2], which both have a substantial portion of their earnings from long-term, take-or-pay contracts. Even in a protracted downturn with self-imposed isolation, we do not expect these businesses to see a significant earnings impact. In fact, a meaningful portion of Vopak's business is likely to see increased earnings as a result of the contango situation in crude oil markets, which arises when the futures price of oil is higher than the spot price. This typically increases demand for tank storage, as traders buy oil in the spot market, store it and enter a futures contract to sell it at a higher price.

The large middle ground of the portfolios is mostly comprised of long duration franchises with secure intrinsic values but uncertain near-term earnings prospects. This includes companies like Wärtsilä[3], a Finnish company that has dominant global market share in ship engines and power plants. While the company is likely to see a significant decline in earnings in the near-term, particularly in its original equipment business, Wärtsilä's medium and long-term earnings power should be largely unaffected.

Finally, we retain a tail of extremely cheap stocks with more uncertainty regarding the timing of their recovery. The common theme is that, with few exceptions, our businesses are well-capitalized and their market positions are either secure or even being enhanced by the sudden change in the competitive environment. This includes companies like Israel Chemicals[4] which is the lowest cost supplier of potash to China and India and the lowest cost producer of bromine compounds globally. A low-cost position in its two largest businesses ensures the company is cash generative even during difficult periods. Additionally, both of these businesses are "essential" and should continue to operate despite social distancing. With over $1 billion in liquidity available and no long-term debt due in 2020, liquidity and survivability does not appear to be an issue for Israel Chemicals.

Granted, prices may drop even lower in the extreme, but the portfolios are now the most undervalued they have been in recent memory and in general these valuations accompany the bleakest conditions. Although every crisis is different, there eventually is a recovery and things seldom get as bad as prices would imply. This too shall pass.

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1 1.94% position in the Centerstone Investors Fund and 3.18% position in the Centerstone International Fund as of December 31, 2019
2 1.99% position in the Centerstone Investors Fund and 3.01% position in the Centerstone International Fund as of December 31, 2019
3 2.15% position in the Centerstone Investors Fund and 3.21% position in the Centerstone International Fund as of December 31, 2019
4 0.64% position in the Centerstone Investors Fund and 0.98% position in the Centerstone International Fund as of December 31, 2019

With that said, I do feel the need to apologize for the Funds' recent performance. While virtually no one predicted the full impact of the virus, I should have appreciated markets' tendency to overshoot and in turn put our reserves to work more slowly. We are now fully invested and excited about the future prospects for a portfolio trading at historically depressed valuations. But the ride down could have been less bumpy. In the meantime, please know that I am personally feeling every bit of the displeasure that other shareholders are feeling, as I have the bulk of my liquid net worth invested across the two Funds.

"We are now fully invested and excited about the future prospects for a portfolio trading at historically depressed valuations."

We will continue to work tirelessly to reward your trust.

We wish you much health.

Sincerely,

Abhay Deshpande, CFA
CHIEF INVESTMENT OFFICER

Important Risk Information and Disclosure:

The S&P 500 Index is a widely recognized unmanaged index including a representative sample of 500 leading companies in leading sectors of the US economy and is not available for purchase. Although the S&P's 500 Index focuses on the large-cap segment of the market, with approximately 80% coverage of US equities, it is also considered a proxy for the total market.

The commentary represents the opinion of Centerstone Investors as of March 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, 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.

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

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.