VALUE INVESTING CANCELED?

MARCH 31, 2021

DEAR FELLOW PARTNERS & FRIENDS,

Value investors are familiar with the concept of cancel culture, having been canceled years ago. We have this passion for fundamental research; an obsession with reading annual reports and modeling cash flows. We are also long-term-minded. It is this long-term mindset that, we believe, enables the emotional separation necessary to survive successive market cycles. In an on-demand world of instant gratification, this can seem almost quaint. However, I learned early in my career that while bull markets can be fun, most have proven to be cyclical. It is the other side of the market cycle–which has a way of reclaiming much of the gains made in the good times–that led me to the margin of safety investment framework. And it is the reason I have stuck with that framework throughout my career. On balance and over time, it has served our clients well.

If we contrast a value-oriented approach to that of the prevalent momentum strategies, the main difference right now amounts to that between "a bird in the hand" versus "two in the bush." With the reopening of economies seemingly around the corner, it seems obvious that companies exposed to the reopening play should be poised to recover and earnings should grow at fairly high rates for some time. Conversely, it is anyone's guess how many people continue with Zoom, or how many people continue playing with their pet Robinhood stocks after they can socialize again. Should disappointments lead to price drops, my guess is that once stock prices begin to drop below the average day trader's cost basis, their first step will be to freeze their trading activity. Their second step will be to sell on rallies whenever they get close to breakeven. It is this type of behavior that drives the other side of every bull market. Even if I were investment-style agnostic, I believe more exposure to the "bird in the hand" seems smart right now because the rustling in the bush could easily be a bear.

Inflation Debate

Inflation is the latest subject making headlines. In particular, the open question is whether any of the recent signals from the commodity and bond markets suggest an imminent inflation cycle. It seems likely there will be a spike in inflation, but whether it shows up in the heavily massaged government figures will depend on seasonal adjusting and substitution assumptions built into the official releases. The more important question is the persistence of inflation. On one hand, some worry about the long-term inflationary effects of the government's borrowing and spending binge. And I admit that I do worry about how easily the word "trillion" seems to roll off the tongue of every elected official nowadays. Not long ago "trillion" was uncommon to hear. Astronomers use the term to describe unimaginably vast distances between stars and galaxies. Hungary, Germany and Zimbabwe also used that number, but only after they could no longer keep track of the hyperinflation that imploded their economies and left their populations penniless. But I am sure our leaders have read their history books and are smarter than that. Right? Worst case, I guess they could always measure spending in light-years.

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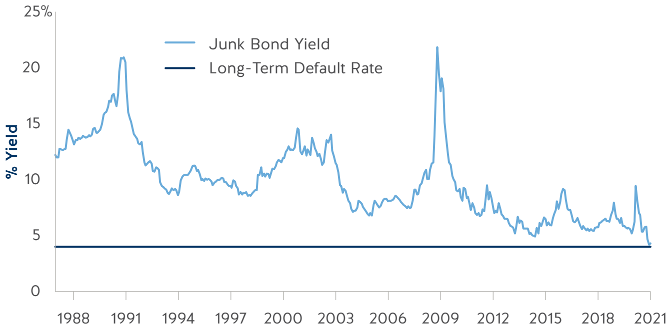
On the other hand, there is a school of thought that believes, from the Japanese experience, that larger debt burdens do not matter for reserve currency countries (US, Japan, UK, Europe). In this case, inflation is driven by population growth and productivity growth, both of which have been trending down in the developed world. The great debt burden suppresses productivity growth and thus, ironically, debt burdens become an inherently deflationary force. In this view, even small interest rate increases are intolerable due to the massive outstanding debts. This mind-blowing theoretical relationship—allowing for unlimited borrowing without inflationary effects—was unfortunately discovered by politicians of both parties, which is why there is so little debate about the wisdom of borrowing so much money. The kids might have found the liquor cabinet in 2008 but watch out because they just found the key.

Regardless, this quest to instill inflation into the system has been the Federal Reserve's prime directive since the early 2000s.

HIGH YIELD BONDS NOW OFFER RETURN FREE RISK



Past performance is no guarantee of future results. Investors cannot invest in an index.

Source: Bloomberg, Centerstone Analysis

NASDAQ-100 BUBBLES?

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Source: Bloomberg

Or more precisely, fear of deflation has been the driver of policy. This was codified by Ben Bernanke in his 2001 speech titled *Deflation: Making Sure "It" Doesn't Happen Here*. It is obvious that the Federal Reserve wants inflation, but the open question is if they can create inflation in a controlled manner. Starting uncontrollable inflation should be easy—just allow the Federal Reserve to lend directly to the public. Of course, that would be the way sign to "the road to serfdom" which so far, we have avoided. No one, including the Federal Reserve, knows how to induce a controlled secular inflation trend, but the current playbook is to eliminate any risk of debt deflation by supporting ever large pockets of the economy. An effect of this masterplan is that the Federal Reserve is now supporting the corporate debt market, much of which is the riskiest sort. According to Moody's, ***half*** of corporate debt is now rated "junk," making it the latest part of the US market that is "too big to fail." For that reason, junk bond yields now hover near their long-term default rate of about 4%. The market is either saying the Federal Reserve will backstop these companies or that it is okay with zero return from the junk bond market.

A corollary to this decline in risk premium for high yield bonds is that the stock market can incorporate a smaller risk premium as well since high yield bonds sit just atop shareholder equity in the capital structure. The market in this scenario would feel justified valuing equity earnings at a higher price-to-earnings ratio than historically because insolvency risk has been greatly reduced, thanks to the Federal Reserve. Ever since the Federal Reserve began its bailout practices (starting with Long-Term Capital Management in 1998 and accelerating with the Global Financial Crisis), our calculated market intrinsic price to earnings ratio has been marching up in tandem. This has mostly been a function of lower interest rates and lower tax rates. However, if the Federal Reserve continues to signal that broader market default risk is effectively zero, our intrinsic price-to-earnings ratio would continue to rise, and materially so. This is the main justification I can see for these (and higher) market multiples. If that logic holds then equities could have a lot of upside, even from historically high multiples. This is the counter to the vertigo-inducing NASDAQ-100 graphic illustrated above.

Over the past year, I have received a lot of top-down questions. While I certainly do think about macro factors and have opinions, there are too many unknowns to conclude anything useful from those opinions. Mostly, I use my opinions for situational awareness. So many risks, so many opportunities, so many questions. I think most of the questions, the details, are like brush strokes on an infinitely huge canvas. Rather than get lost in the abstractness of the unknowable I would rather enjoy stock picking. Let's leave the abstract behind and talk stocks.

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Value-Crystalizing Events

One of the great pleasures for stock pickers is when we come across ideas that few others know about. It is usually because the company has undergone some unnoticed change, it may be small, or maybe it is just out of favor. Better still is when that underappreciated company has, what we believe, a materially mispriced stock. The two Funds, Centerstone Investors Fund (CENTX) and Centerstone International Fund (CINTX) are filled with such companies.

Just last month, Kerry Logistics[1], a Centerstone holding since January 2017, reached an agreement with SF Holding, a Chinese logistics company, to merge logistics operations. Concurrent with the merger, Kerry Logistics agreed to sell all its warehouse properties to Kerry Holdings, its parent company. Kerry Logistics' shareholders will receive a special dividend of HK$7.28 per share from the sale of the warehouse properties and HK$18.8 per share from the merger with SF Holding, for a combined value of HK$26.08 per share. The transaction confirmed our belief that Kerry Logistics' intrinsic value was well above where its shares traded over the last several years. The public's failure to recognize Kerry Logistics' value did not render that value nonexistent; intrinsic value is irrespective of share price. We believe Kerry Logistics' intrinsic value grew significantly during our time as investors, expanding the share price discount over time. In our experience, large gaps between share price and intrinsic value do not exist forever. Eventually, market participants, including other companies and insiders, act to close the gap. While we cannot predict the timing of these value-crystalizing events, we are willing to be patient so long as the company's intrinsic value continues to grow. Kerry Logistics exemplifies the rewards of patient, long-term investing.

Earlier this month, Perrigo[2], a Centerstone holding since September 2018, reached a definitive agreement to sell its generic pharmaceuticals business for total consideration of $1.55 billion. It is now a pure-play consumer healthcare company focusing on its core business. With the sale of its generic pharmaceuticals business, Perrigo has also strengthened its balance sheet and has more flexibility. It plans on making bolt-on acquisitions in the consumer healthcare markets it is in or in adjacent markets, and it may also repurchase shares or pay off debt.

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Both are recent examples of what eventually tends to happen when stock market prices overstay their welcome in undervalued territory. Eventually, knowledgeable buyers emerge. The only real variable is time and of that Centerstone has plenty.

As Centerstone nears its 5th birthday this May, I would like to take this opportunity, on behalf of all of us at Centerstone Investors, to thank you for your confidence and support. While the future remains as uncertain as ever, we remain confident that Centerstone Funds are well-positioned for another five years and beyond. This confidence is grounded in our passion for fundamental research, our long-term mindset, our margin of safety investment framework and our determination to keep learning. We believe from a stock picking perspective, there is no greater position to be in.

Sincerely,

Abhay Deshpande, CFA
CHIEF INVESTMENT OFFICER

1 3.17% position in the Centerstone Investors Fund and 3.55% position in the Centerstone International Fund as of December 31, 2020
2 1.48% position in the Centerstone Investors Fund and 2.53% position in the Centerstone International Fund as of December 31, 2020

Important Risk Information and Disclosure:

The Nasdaq-100 is one of the world's preeminent large-cap growth indexes. It includes 100 of the largest domestic and international non-financial companies listed on the Nasdaq Stock Market based on market capitalization.

High yield bonds (also called junk bonds) are bonds that pay higher interest rates because they have lower credit ratings than investment grade bonds. High yield bonds are more likely to default, so they must pay a higher yield than investment-grade bonds to compensate investors. Issuers of high yield debt tend to be startup companies or capital-intensive firms with high debt ratios. However, some high-yield bonds are fallen angels that lost their good credit ratings.

The default rate is the percentage of all outstanding loans that a lender has written off as unpaid after a prolonged period of missed payments.

The commentary represents the opinion of Centerstone Investors as of March 2021 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. Securities in small and mid-cap companies may be more volatile and less liquid than the securities of companies with larger market capitalizations.

The Centerstone Funds are not invested in Zoom Video Communications.

Price-to-earnings (P/E) Ratio is the ratio for valuing a company that measures its current share price relative to its per-share earnings. P/E ratios are used to determine the relative value of a company's shares in an apples-to-apples comparison.

Centerstone Investors, LLC and Northern Lights Distributors, LLC are not affiliated with Robinhood.

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.