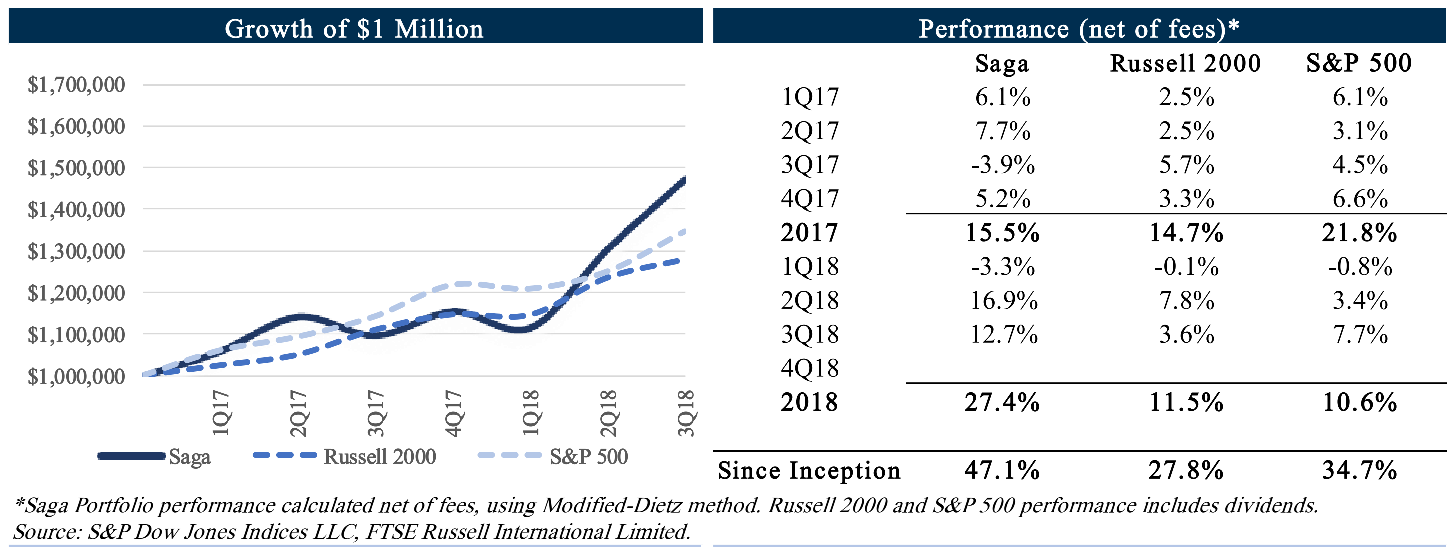
QUARTERLY REPORT

THIRD QUARTER 2018

3Q18 Results

During the third quarter of 2018, the Saga Portfolio ("the Portfolio") increased 12.7% net of fees. This compares to the overall increase, including dividends, for the Russell 2000 and S&P 500 Index of 3.6% and 7.7%, respectively. Since inception on January 1, 2017, the Saga Portfolio returned 47.1% net of fees, compared to the Russell 2000 Index and the S&P 500 of 27.8% and 34.7%, respectively.



Performance (net of fees)*

	Saga	Russell 2000	S&P 500
1Q17	6.1%	2.5%	6.1%
2Q17	7.7%	2.5%	3.1%
3Q17	-3.9%	5.7%	4.5%
4Q17	5.2%	3.3%	6.6%
2017	**15.5%**	**14.7%**	**21.8%**
1Q18	-3.3%	-0.1%	-0.8%
2Q18	16.9%	7.8%	3.4%
3Q18	12.7%	3.6%	7.7%
4Q18			
2018	**27.4%**	**11.5%**	**10.6%**
Since Inception	**47.1%**	**27.8%**	**34.7%**

**Saga Portfolio performance calculated net of fees, using Modified-Dietz method. Russell 2000 and S&P 500 performance includes dividends.*
Source: S&P Dow Jones Indices LLC, FTSE Russell International Limited.

Strategy update – expanding the investment universe

When we launched the Portfolio at the beginning of 2017, we made the decision to focus our efforts on investing in small and mid-cap (SMID cap) companies calling our portfolio the Saga SMID Cap. We did this for two main reasons; 1. the Portfolio was likely to be invested in small and mid-cap companies because that is where we found and expected to continue to find the highest returning investment opportunities, and 2. it was easier to bucket a particular investment strategy into a certain category.

We expected the majority of our investments that would make up the Portfolio would likely be in the less efficient corners of the market, we did not believe limiting ourselves to small and mid-cap companies would be overly restrictive, but that is just not the case when it comes to the market. The fact of the matter is that restricting the investment universe to certain companies limits the number of opportunities available and therefore hurts the Portfolio's potential returns. By avoiding attractive opportunities simply because their valuation was a certain size have and would continue to hurt long-term results than would be otherwise if we were free to allocate money to the best opportunities available regardless of market cap.

After a lot of reflection on what was best for our current investors, combined with the goal of compounding capital at the highest possible rate over the long-term, we made the decision to remove the small and mid-cap investment restriction. Going forward, the Saga Portfolio will not be confined to a specific part of the public market and will pursue the best opportunities available at any given time, regardless of market capitalization, geography, or industry.

Benchmarks

Now that the Portfolio is not restricted to small and mid-cap companies, the next reasonable question is what benchmark should be used to compare performance. No index truly provides a good proxy for the Portfolio given its relative concentration, but we still believe both the S&P 500 and Russell 2000 indices provide reasonable benchmarks over the long run. We like the S&P 500 as general proxy for the market because it is a widely referenced and easily investible index for the passive investor representing ~80% of U.S. publicly traded companies.

A large portion of the Portfolio will likely continue to be allocated to smaller cap companies because that space will continue to be a good hunting ground to find high quality, undiscovered or misunderstood "compounder" companies. Given the greater allocation to small and mid-cap companies, it is reasonable to expect short-term performance to be more correlated to the Russell 2000 index.

Below is a chart of Portfolio's market cap allocation compared to the Russell 2000 and S&P 500 at the end of September. In terms of benchmarks, we will continue to provide relative performance for both indices and obviously each investor is free to compare the Portfolio with whichever index they prefer.

	Market Cap	Saga	Russell 2000	S&P 500
Small-Cap	$200M - $2B	24%	45%	0%
Mid-Cap	$2B - $10B	75%	55%	2%
Large-Cap	$10B+	0%	0%	98%
	Cash	1%	0%	0%
	Total	100%	100%	100%

Source: Factset Research Systems, LLC

Interpretation of results and long-term thinking

These letters are the best way for us to communicate our thoughts about investing and portfolio management. We err on the side of greater transparency by providing regular updates and reiterating our philosophy to help investors better understand how we think and manage their capital.

Following some recent market volatility where both the Russell 2000 and S&P 500 declined a respective 16% and 10% from their September peaks to recent lows, it makes this a good time to bring up an excerpt from John Keynes' 1936 *The General Theory* discussing public equity investing:

> *"For most of these persons (investment professionals) are, in fact, largely concerned, not with making superior long-term forecasts of the probable yield of an investment over its whole life, but with foreseeing changes in the conventional basis of valuation a short time ahead of the general public. They are concerned, not with what an investment is really worth to a man who buys it 'for keeps', but with what the market will value it at, under the influence of mass psychology, three months or a year hence."*

Over 80 years later and this quote still applies today in how most public market investing is based on trying to predict how a stock will trade based on expectations of what other people's expectations will likely be at that time. It's more of a speculative activity, which Keynes defined as forecasting the psychology of the market vs. an investing or enterprising activity, defined as forecasting the prospective yield (i.e. cash flow) of assets over their whole life. The stock market is full of people "*interested in discovering what average opinion believes average opinion to be*."

Keynes goes further, suggesting a way to decrease speculation by making "*the purchase of an investment permanent and indissoluble, like marriage, except by reason of death or other grave cause, might be a useful remedy for our contemporary evils. For this would force the investor to direct his mind to the long-term prospects and to those only*." If you imagined the stocks in your investment account are wholly owned businesses that you can't sell for at least 10 years, daily quotations would no longer matter. The fact there is always a quoted price and the ability to sell shares back every day can cause normal, although potentially disadvantageous, human reactions when prices fluctuate.

Ben Graham created a parable, later popularized by Warren Buffett, to help investors think about how the market works. He personified the market as a manic-depressive business partner named Mr. Market. Everyday Mr. Market shows up at your door and quotes a price at which he will either buy your interest in the business or sell you his. Even if the private business you both own together is fundamentally stable, Mr. Market may feel euphoric one day, only seeing upside in the business and therefore quote a very high price. At other times he may feel depressed and see nothing but trouble ahead and quote a very low price. Without a doubt, Mr. Market will show up each day and provide a quote based on whatever mood he may be in.

However, investors do not have to listen to him because he will always be back again with a new quote. Therefore, the more manic-depressive he behaves, the more you can take advantage of him. Although his emotions can influence you if you are unsure whether you understand the

business. That is why the key to successful investing, whether in public or private markets, comes from making good business decisions and not being influenced by the manic swings in the market. The Mr. Market metaphor is a helpful tool to navigate the inevitable ups and downs of the market.

Rather than have the daily price quotations tell us how the companies are performing, we look to the company's operating results, although even annual fundamentals can have irregularities. Very few success stories move in a perfectly straight line or smooth path. Over time, if we are successful at buying great companies run by honest managers when they are attractively priced, the stock will provide the returns we look for.

Risk and Concentration

Conventional portfolio theory defines risk as volatility, therefore conventional money managers aim to lower risk by lowering volatility through increased diversification. Alternatively, we define risk as the possibility of permanent capital loss, or in other words *uncertainty*. Investing is a matter of forecasting an asset's future cash flows which is anything but certain.

We have found that if a company meets our four simple filters; 1. a business we understand, 2. has a growing competitive advantage, 3. has high caliber management aligned with shareholders, and 4. selling for an attractive price, the degree of uncertainty, or risk of permanent capital loss over the long term, greatly diminishes. While these filters are not as precise or quantifiable as risk measured by betas or standard deviations, we believe they are more relevant despite their imprecision and more likely to lead to attractive investments.

Few companies meet filters 1, 2, and 3, but if they do it is rare the market has not already realized its strong prospects and placed a valuation on the company that lowers the potential for future excess returns. We approach the market as efficiently priced most of the time, believing Mr. Market knows more about a company's prospects until we conclude we have some upper hand or variant perception. It is very difficult for a company to meet all four filters, therefore an investment strategy based on placing many bets with high frequency will likely find it difficult to beat the market in a meaningful or sustainable way. It seems fairly obvious to us that putting more money into your 20th best idea than in one of your highest conviction ideas will more likely hurt rather than help overall returns.

While investing in a concentrated way is no guarantee of success, a high level of diversification and turnover will likely provide average results at best. There is a much better chance of *decreasing* risk in a concentrated portfolio than in a diversified one if it means it increases the intensity with which we think about a business and its prospects before buying into it. A smaller number of investments and infrequent trading allows us to spend a significant amount of time studying a company before investing, or more importantly, not investing. In other words, we

prefer to do a lot of thinking and not a lot of acting while most of Wall Street prefers to do a lot of acting and not a lot of thinking.

Just because we have high conviction about a company's prospects and expected returns does not mean we have any idea what the share price will do over the next year. With greater concentration, we accept that near-term returns will be lumpier. Large drops in share prices are like earthquakes, they are unpredictable and bound to occur every now and then. After a selloff, one must determine whether the decline was due to a more accurate reflection of the company's lower intrinsic value, in which case it might make sense to reallocate capital accordingly, or due to the random manic swings of the market, in which case it might make sense to increase a portfolio's allocation to the more attractively priced opportunity. Only having a solid grasp as to the company's real value will help one take advantage of Mr. Market instead of the other way around.

Portfolio Update

We want to discuss any relevant updates to the Portfolio's positions so you know what you own and why you own it. Since we are now able to invest in any company regardless of market capitalization, we started to build a position in a well-known large cap company which we plan to discuss further in the next letter.

Writing out an investment thesis is a productive part of the investment process that helps us organize our thoughts and analysis. Publicly stating positions could lead one to dig their heals into the ground despite finding out the original thesis may have had some cracks. While we explain the reasoning for why we may own a company and enter each investment with an expected holding period of *forever*, we reserve the right to change our minds if the facts change.

The Trade Desk (TTD):

We wrote about our investment thesis in The Trade Desk last quarter. It is a software platform company that enables customers to purchase and manage their digital ad campaigns. The Trade Desk is a great example of a platform business model that adds value by growing the network of connected buyers and sellers, increasing transparency, and enabling more accurate price discovery for buyers who want to make data driven decisions. This is a company that benefits from a self-reinforcing virtuous cycle which becomes more valuable the larger its network becomes. With The Trade Desk's high barriers to entry, scalable business model that requires nominal capital to grow, and large total addressable market, we expect the Company to be worth a multiple of its current valuation.

Platform Specialty Products (PAH):

Element Solutions provides specialty chemicals that focus on surface treatment and electronic assembly. The business is part of integral processes generally tailored to meet customer specific requirements. Its products typically represent a small proportion of total end material costs but play an essential role, providing sticky customer relations and higher margins.

The Company announced 3Q18 results where sales and adjusted EBITDA for the Performance Solutions segment grew low single digits reflecting some softness in Asian markets. The $4.2 billion sale of the Arysta segment to UPL is expected to close on 12/31/18, at which time Platform Specialty Products will be renamed Element Solutions.

Including $25 million of estimated cost savings from the reorganization, 2019 proforma EBITDA is expected to be $450M-$470M. Proceeds from the sale will go towards paying down debt resulting in a net debt of $1 billion. Valuation looks attractive with shares trading at 9x-10x proforma EV/EBITDA. Free cash flow is expected to be in the range of $275M-$300M, or only 11x-12x the current market value. There is a $750M share buyback program in place which management indicated would be one of the best uses of capital at current share prices as long as leverage remains less than 3.5x adjusted EBITDA.

Linamar Corporation (LIMAF):

Linamar is an auto-OEM headquartered near Toronto, Canada that we started to follow in 2017. While auto manufacturers such as GM and Ford have provided lackluster returns to equity holders throughout their history, numerous auto-OEMs such as Linamar have performed much better.

Linamar benefits from its customers typically having higher switching costs, resulting from a 5-10 year production life cycles tied to contractual agreements, integrated processes, and long-term relationships. Several auto components are critical to the final product which creates a quality risk of switching to a new supplier. Linamar also operates on a global playing field providing some scale advantages.

Shares of companies touching the auto sector have reflected fears of peak cycle auto sales and uncertainty surrounding tariffs. While a preliminary NAFTA deal, renamed the United States-Mexico-Canada Agreement (USMCA), helps provide more clarity, tariffs or declining auto unit product are real risks and could potentially impact fundamentals.

Investing in a cyclical company at a potential peak could mean near-term fundamentals will deteriorate if auto unit production falls materially. Despite operating in a cyclical industry, Linamar has grown revenue and operating income at double digit rates over the last full auto-

cycle benefitting from secular industry tailwinds from outsourcing of propulsion systems, growing market share, and making strategic acquisitions.

Further, Linamar's auto industry exposure has declined following the $933M acquisition of Macdon Industries in February 2018. The industrial segment which manufactures harvesting equipment and aerial work platforms made up nearly 50% of operating income in the last quarter. Most recently, 1H18 sales and operating income grew by 18% and 19%, respectively.

The amount of fear and downside baked into share prices looks extreme in our opinion. Linamar is selling for an expected 2018 P/E and EV/EBIT of 6x and 6.5x, respectively. Even if auto demand falls and unit volumes tumble, we expect Linamar to grow at a steady rate over the next full cycle. We do not care if over the next four years, a company earns a lumpy $100, $0, $0, $100 or steady $50, $50, $50, $50, as long as we believe the current valuation provides an attractive return on expected cash flows.

Under Armour (UA):

Kevin Plank started the company in 1996 from his grandma's basement and has grown the brand over the last 22 years. The Company has focused on creating a brand based on providing high quality performance apparel to athletes, growing with the sports apparel market and gaining share from Nike and Adidas. Since going public in 2006 through the end of 2016, sales grew greater than 20% a year. Starting in late 2016, sales and profitability slowed as North American sports apparel industry faced headwinds combined with several company specific setbacks.

Under Armour's fundamentals have deteriorated, however we think the decline in share price has more than compensated for any decrease in expected earning power in our opinion. The company is in the middle of a restructuring plan which includes lease and contract terminations and inventory/asset-related charges which are expected to total $190-$210 million during 2018.

The company reported 3Q18 results which reflect ongoing operational improvements focused on several supply chain initiatives. North American revenue trends started to show signs of improvement and international sales remain strong. Margin expansion is a positive sign there was better product mix and less promotional activity.

We expect the company will continue to be one of the largest sports brands in the world that is going through growing pains which provided an attractive buying opportunity. We expect that the company will resume growth and increase profitability once industry conditions improve. Even if Under Armour sales remain flat but operating margins are able to reach historic levels, they are trading at an attractive valuation.

Conclusion

A strong investor base is a true competitive advantage in the investment management business. The success of the Portfolio requires investors that are stable, long-term, and realistic in their expectations. So far, we could not be happier in this regard. We hope you found this update helpful in understanding your portfolio. If you have any questions or comments please reach out, we are always happy to hear from you!

Sincerely,

Joe Frankenfield

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