

### Capstone High Quality Small Cap

There are three main building blocks of our investment process; small cap, high quality, and attractive valuation. We like to own companies that are growing faster than the market while trading at a significant discount. When we started our firm, we chose a portfolio of 45 companies that met all of these criteria and have steadily managed our holdings for 22 months. Over that time frame, our turnover has been approximately 40%. We are pleased with the way the portfolio has performed throughout the period. Our annualized since inception return, after all, fees and expenses, is 17.7% compared to the benchmark's annualized return over the same period of 14.3%. Below is a table that corresponds to the characteristics of the portfolio at year-end 2015, year-end 2016, and at quarter end 9/30/2017. The shaded lines show the ratio of the metric in relation to our benchmark the Russell 2000.

	12/31/2015	12/31/2016	9/30/2017
FY1 P/E	12.1	13.7	14.5
Benchmark relative	0.7x	0.7x	0.7x
ROE	19.5	18	19.7
Benchmark relative	3x	3x	3.5x
Earnings Growth*	29.5	39.2	41.3
Benchmark relative	2.43x	3.46x	4.1x
Debt. to Cap.	36.2	30.5	26.8
Benchmark relative	1.03x	0.83x	0.79x
*Historical 3 Year			
Source: Factset			

We have maintained our valuation bias against the benchmark with the PE of our portfolio being just 70% that of the Russell 2000. The ROE of the portfolio is three times that of the benchmark, and the earnings growth of our portfolio is almost four times that of the benchmark. Our portfolio's earnings growth has remained high during the period, and our Net Debt to Market Capitalization ratio has improved. Our disciplined process has enabled us to continue to upgrade our holdings while maintaining an attractive portfolio of stocks. We currently have a portfolio that, when compared to its benchmark, is three times as profitable, has EPS growth four times as high, and is trading at a thirty percent discount. For the quarter we were up 3.77% after fees, underperforming the benchmark return of 5.67%

**Capstone Global Investments High Quality Small Cap Strategy**

As of September 30, 2017 (net of fees)				
	3Q 2017	YTD	1 year	Since Inception*
Capstone HQ Small Cap	3.77%	8.25%	27.79%	17.73%
Russell 2000	5.67%	10.94%	20.73%	14.33%
*Annualized with Inception Date 12/01/2015				

**Portfolio Review**

In the portfolio, we purchased one new position added to 2 existing positions and exited 4 positions during the quarter.

We went through a process to rationalize our positions in the portfolio. Small positions were evaluated to decide if we should exit or commit additional capital to the position. We bought Applied Optoelectronics and added capital to Lazard and Essent. We sold Novanta, it had become expensive, leading us to take profits. We bought Novanta at \$14.97 per share and sold it at \$37.60 per share. Although the company continues to grow, valuation had increased significantly from low mid-teens to the mid-twenties on a forward PE basis. We exited our position in Arthur J. Gallagher which we bought at \$43.93 per share and sold at \$60.60 per share. This stock had become expensive compared to peers in the industry and was at the top end of our market cap range. We sold Mercantile Bank Corporation which we purchased at \$22 per share and sold at \$33 per share. The stock had been trading at 10x PE when we bought it and was valued in excess of 15x when we exited. We exited HCI Group, an insurance company, based on the threat of hurricane Irma. If you look at a map of Florida, HCI had significant exposure on the southern tip and east coast of the state. Fortunately, as the storm swerved, significant claims were avoided. We purchased HCI at \$33 per share and exited at \$28 per share, generating a loss. We no longer viewed the risk versus reward as appealing.

Our new position is in Applied Optoelectronics. It has strong earnings growth, attractive valuation, a net cash position, a mid-20s ROE, and positive estimate revisions. We added capital to Essent, the initial purchase was \$19.70 a share and we added capital at \$39.70 per share. The PE is still only 11x. It has strong earnings growth and continues to look attractive. Lazard pays a 7% dividend, is trading at a PE of less than 12x, has a 30% return on equity, and it has high single digit earnings growth return.



**Third  
Quarter  
2017**

**30-JUN-2017 to 29-SEP-2017**

Ticker		Contribution To Return
<b>5 Highest</b>		<b>2.86</b>
AEIS	Advanced Energy Industries, Inc.	0.79
SPR	Spirit AeroSystems Holdings, Inc.	0.59
RTEC	Rudolph Technologies, Inc.	0.51
HOFT	Hooker Furniture Corporation	0.51
IPHI	Inphi Corporation	0.47
<b>5 Lowest</b>		<b>-3.03</b>
AOBC	American Outdoor Brands Corporation	-1.29
HCI	HCI Group, Inc.	-0.69
APOG	Apogee Enterprises, Inc.	-0.45
LZB	LaZBoy Incorporated	-0.36
AWRE	Aware, Inc.	-0.23

**Quarterly Attribution:**

The portfolio had positive returns but trailed the benchmark. AOBC continued to disappoint and was a sizable drag on performance. We have since exited the position as its earnings outlook continues to deteriorate. There was a rally in low-quality stocks during the quarter, and our strategy by definition did not participate. Within the Russell 2000 stocks with no earnings appreciated on average 8.4% vs. stocks with earnings up on average only 4.9%. The highest quintile of stocks based on beta outperformed the lowest quintile of beta stocks 8.3% to 3.5%. Over more extended periods of time, we would expect these relationships to be precisely the opposite.

**Market Comments**

Over the last 12 months, the S&P 500 has appreciated by 18.6% and the Russell 2000 by 20.7%. Over this one-year period, our portfolio has returned 27.8%, mostly driven by individual stock selection. Stock selection for the period was particularly strong in financials, consumer discretionary, and consumer staples. Stock selection was weak in information technology.

**Closing Comments**

We are off to a good start and have a well-constructed portfolio. We strive to manage an investment portfolio that will maintain your confidence. A significant portion of my wealth is invested alongside yours. Over short periods of time we may fall behind or lag the benchmark, but, over a long-term holding period, our goal is to outpace the market. We look forward to keeping you up to date on our portfolio's progression through 2017.

Sincerely,

Chad Deakins, CFA

**Chief Investment Officer**

**Portfolio Manager**

## Capstone Global Investments Performance Results:

### High Quality Small Cap Equity - December 1, 2015 through September 30, 2017

Year	Gross of Fee Return (%)	Net of Fee Return (%)	Benchmark Return (%)	Number of Portfolios	Composite Dispersion (%)	Total Composite Assets at End of Period	Total Strategy Assets at End of Period	Total Firm AUM	Total Firm AUA
12/1/2015 to 12/31/2015	-4.81	-4.89	-5.02	1	0	<1	<1	<1	<1
2016	32.3	31.02	21.32	3	0.01	2	2	3.5	3.5
YTD 2017	9.06	8.25	10.94	3	0.01	2.2	4.6	5.7	8.1

### GIPS Disclosures:

Capstone Global Investments claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards for the period December 1, 2015 through September 30, 2017. Capstone has not been independently verified for GIPS compliance.

1. Capstone Global Investments is an independent investment adviser registered with the State of Georgia. Capstone was founded in December of 2015 and manages small-cap equity strategies. For composite reporting purposes, the Firm is defined as all equity portfolios managed by Capstone.
2. Beginning December 2015, the composite includes only (SMA) portfolios benchmarked to the Russell 2000 Small Cap Index.
3. The Capstone High Quality Small Cap Equity SMA Composite is composed of portfolios invested in US equities which have a market capitalization greater than \$50 million and less than \$10 billion. The investment goal is to find high quality investment opportunities that are trading at a discount to the market and have a catalyst to help propel their relative valuation up to fair value. A complete description of the composite is available on request.
4. The composite was created in January 2016. A complete list and description of firm composites and performance results are available upon request.
5. All returns are expressed in US dollars. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.
6. The primary benchmark for the Capstone High Quality Small Cap Equity composite is the Russell 2000 Small Cap Index (Net). The Russell 2000 Small Cap Index returns are provided to represent the investment environment existing during the time periods shown. For comparison purposes, the index is fully invested and includes the reinvestment of income. The returns for the index do not include any trading costs, management fees, or other costs. Index returns have been taken from published sources.
7. Gross returns presented above as supplemental information. The SMA fee includes all charges for trading costs, portfolio management, custody, and other administrative fees. Net returns are calculated by subtracting the highest applicable SMA fee (1.00% on an annual basis, or 0.083% monthly) on a monthly basis from the gross composite monthly return. The standard fee schedule in effect is as follows: 1.00% on total assets.
8. The minimum portfolio size for the U.S. High Quality Small Cap Equity composite is seventy-five thousand dollars.
9. Past performance is not indicative of future results and no investment is guaranteed for the return of principal and/or return on investments. All information provided and used in calculations is believed to be correct, but accuracy cannot be guaranteed. Please consult with a financial professional before investing.
10. Composite dispersion is measured as the average of monthly standard deviations for the periods shown.