

Spring Ocean Capital Newsletter 2018 3Q

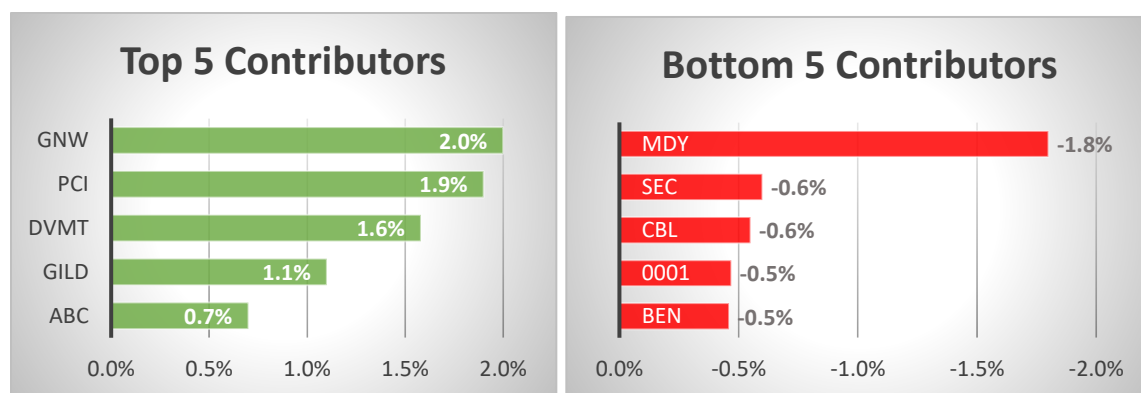
Portfolio Performance

Our portfolio performance was:

	S&P500	Spring Ocean Composite ¹
2016	11.95%	26.8%
2017	21.8%	16.7%
2018 1Q	-0.76%	-1.47%
2018 2Q	3.44%	4.89%
2018 3Q	<u>7.71%</u>	<u>1.17%</u>
2018 Q1-3:	10.56%	4.56%

We underperformed S&P 500 in the third quarter by a large margin. The difference was mostly due to the significant market increase in the third quarter, and also some of the stocks in our portfolio did not perform as expected. We are generally a value based manager. We estimate each individual company's fundamental value based on the future cash flow's net present value, and then we use our proprietary portfolio risk model to calculate a reference weight for each stock in our portfolio. Thus, our valuation model usually filters out high growth, low earning stocks like Amazon, Netflix. As a consequence, in general we underweight the tech sector and growth stocks. S&P 500 Growth Index increased 16.05% year to Sep., versus S&P 500 Value Index's 1.55%, a difference of 14.5%. That is one main reason we underperform the market. We do not expect this difference between growth index and value index can keep growing. In fact, the sharp pull back in October was mostly in the growth stocks. S&P 500 Growth Index lost 9.1% in October, and Value Index lost 5.5% in the same period.

Our five top and bottom contributors for the first three quarters of 2018 are listed below². The top 5 contributors have a total PnL of 7.3%. The bottom 5 have a total PnL of -3.9%.



Genworth Financial (GNW) is an arbitrage position. China Oceanwide offered \$5.43 per share to acquire GNW. After almost 2 years back and forth, GNW finally got approval from CFIUS in June 2018 and is still waiting for a few state insurance agencies approvals. There is still uncertainty with the approvals. Also, the

¹ We used the Interactive Broker's portfolio analytic data output. It included all managed accounts after all expenses and fees. For detailed monthly return data, please see the other report (IB portfolio performance report). Performance data were not audited. Individual account performance may vary.

² We excluded certain arbitrage positions from the top list as their profit and lost cancelled each other out.

recent Anti-China sentiment in US added more risk to the deal. The price went down in the third quarter. However, we still expect the deal has a large chance to be closed by the end of the year.

PIMCO Dynamic Credit Income Fund (PCI) is the largest fixed income position. We do not have trading activity for this position in this quarter.

Dell Technologies (DVMT) is the tracking stock of VMware. Dell proposed buying the tracking stock DVMT for \$109 a share in cash and stock. However, the stock portion is unlisted Dell equity share, which is hard to value. The market certainly discounted the claimed price and DVMT was traded around \$95. Michael Dell has a history (privatizing DELL in 2013, acquiring EMC in 2015) of taking advantage of minority shareholders. We closed this position and locked in the profit.

Gilead Sciences (GILD): We have a large weight and the price fluctuation caused the profit.

AmerisourceBergen Corp (ABC) saw lots of up and down this year. In the first quarter, its stock price was negatively impacted by news that Amazon was planning to enter the pharmacy distribution business. Then, in the third quarter, the rumor that Walgreen was considering a merger with ABC bid up the price. However, we are more focused on the fundamental number, which is solid. The company is valued reasonably.

Our biggest loss for the first three quarters is our **Index hedging position** as the market has turned upward sharply in the third quarter.

Senvest Capital (SEC) is a Canadian asset management company. The company mainly manages its own money and some outside money. Its stock price has a huge discount (about 40%) compared to its net asset value. The stock is thinly traded; in average it only trades a couple hundred shares a day. The stock price decreased another 5% in the third quarter. We have confidence in the company. It is profitable and has sound management. Its asset is almost all liquid security.

CBL Properties (CBL) is a REITs company operating shopping malls. After the third quarter, they cut the dividend, and the stock price decreased a lot. We trimmed some weights in June when price was high. However, we still suffered great loss in the third quarter and later. We revisit this stock recently and did a property by property analysis. Our analysis suggests even after the deteriorate fundamentals, our estimated valuation still offered some upside potential. We will hold this position at its current price.

CK Hutchison Holdings Ltd. (0001) was a recent new position built early this year. The loss in this position is probably due to the general Hong Kong bear market, which is probably caused by the China-US trade tension.

Franklin Resources INC (BEN) is one of the largest mutual fund manager in U.S. We initiated this position in the second quarter. BEN has had some industrial headwinds due to the competition from passive investment. But it has a very low valuation at a P/E of 6 excluding cash and very strong balance sheets.

In summary, we underperformed the S&P 500 in the first three quarters of 2018. As we mentioned many times in previous newsletters, we have taken a defensive position to prepare for a possible pull back of the market. The general market growth in the first three quarters obviously hurt our performances. Subsequently in October, the market pulled backed sharply; our defensive position holds well during this period. We will describe that in detail in our year end newsletter.

Major positions

Our major 5 positions at the end of the third quarter 2018 were:

	Jun. 2018	Sep. 2018
Index ETFs	-24.3%	-24.9%
ABC (AmerisourceBergen Corp.)	11.3%	13.0%
GILD (Gilead Sciences)	9.6%	10.0%
OMC (Omnicom Group)	2.1%	8.0%
BEN (Franklin Resources INC)	5.5%	8.0%

Compared to the second quarter 2018, we sold our position in DVMT, substantially increased our position in OMC and BEN, and slightly increased our position in ABC. OMC is new position we started in the second quarter. It is one of the major advertising agency in the world.

Our positions by asset class at the end of third quarter 2018 were:

	Jun. 2018	Sep. 2018
Equity	87.4%	89.0%
Equity Index Hedge	-24.3%	-24.9%
Fixed-income fund	9.7%	9.3%
Arbitrage	-2.2% (17.1%, -19.3%)	-2.0% (15.9%, -18%)*
Cash/cash equivalent	29.5%	28.6%

*The arbitrage position consist of 15.9% long and -18% short positions, net of -2.0%.

There is slight decrease in Cash and slight increase in equity.

Hua Wei, Ph.D., CFA on Nov. 15, 2018 in Orange, Ohio

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