

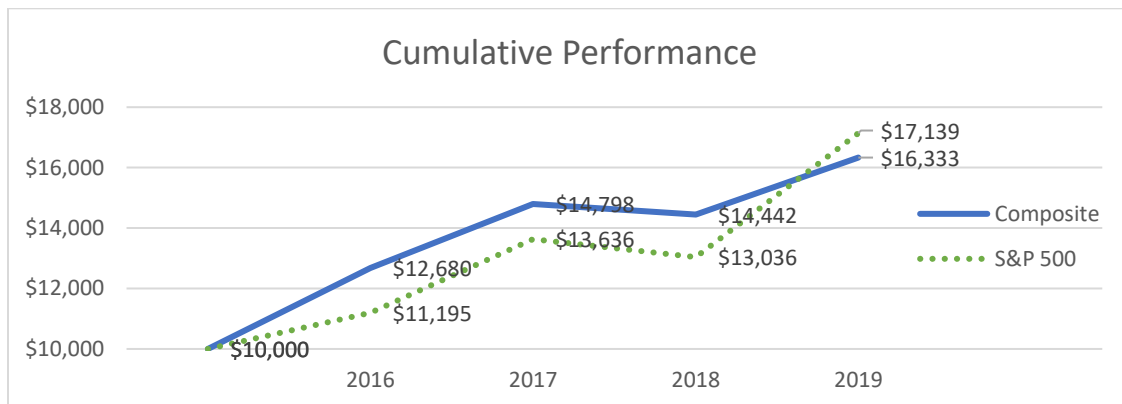
Spring Ocean Capital Newsletter 2019 Q4

Portfolio Performance

Our portfolio performance was:

	S&P 500	Spring Ocean Composite ¹
2016	11.95%	26.8%
2017	21.8%	16.7%
2018	-4.4%	-2.4%
2019 Q1	13.65%	4.70%
2019 Q2	4.30%	2.65%
2019 Q3	1.70%	2.01%
2019 Q4	9.06%	3.15%
2019:	31.48%	13.09%

Assuming \$10,000 was invested at the beginning of 2016, the cumulative performance would be:



The S&P 500 index continued its advance for another 9.1% in the fourth quarter. We were up 3.2% during the same period. For the full year, S&P 500 index advanced 31.5% and we increased 13.1%.

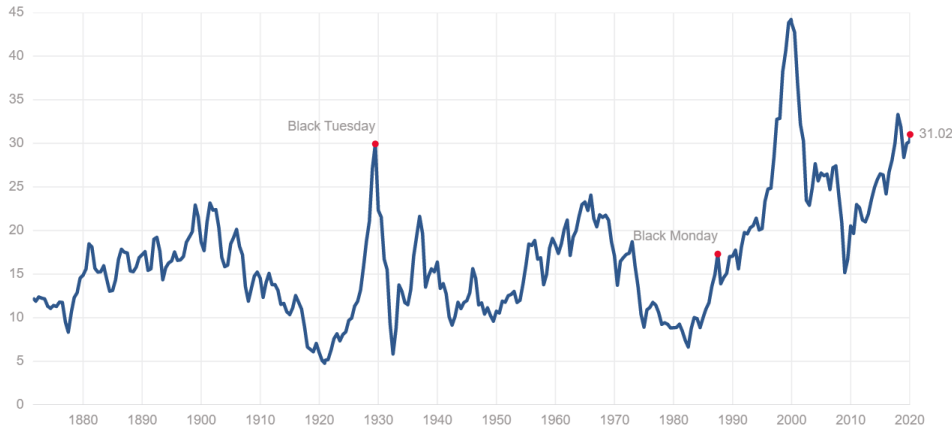
We underperformed the market last year by about 18.4%. The underperformance is mostly because, first, we have a large short position on the index, when the market advanced, we had a heavy loss here. This short position caused about a 5.4% loss. Second, we have almost no technology sector stocks in our portfolio. The technology sector happened to be the best performance sector last year. This also caused about 9% detraction. Third, a couple of our stock selections, such as BEN, GNW and CBL, did not perform as expected.

We certainly should have performed better. However, I notice Warren Buffett, who I have always try to learn from and have a similar investment style with, also had an average year. His Berkshire stock was up about 12% last year. He is famous for avoiding the technology sector, although in recent years he bought a lot of Apple stocks.

After a strong year, the S&P 500 index has increased to a relatively high level in terms of valuation. The P/E ratio stood at 22.3 at the end of the year. Nobel Laureate Robert Shiller used earning based on average

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

inflation-adjusted earnings from the previous 10 years and designed the Shiller-P/E. The Shiller-P/E averages out the economic cycle and adjusts for inflation. It currently stands at 31 (see the following graph). Last time it had such a high value was in 1997. Some research shows that Shiller-P/E had a negative relationship with long-term (5-10 Years) stock returns. Higher Shiller-P/E value usually predicts lower long-term stock returns.

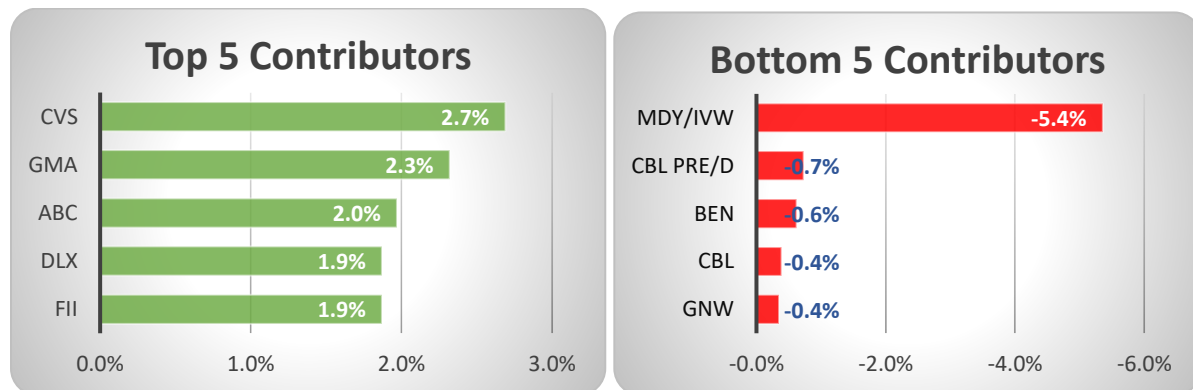


Shiller-P/E value. Source: <https://www.multpl.com/shiller-pe>

We probably are in an environment similar to 1997 in terms of stock market valuation. Going forward, we will stick to our current value investment style. If the market keeps advancing like what happened in the 1998-2000 period, we will most likely underperform the stock market. However, if the market goes the other way, we may also lose some money, but hopefully, we will outperform during the period and build a better investment foundation for the next economic cycle.

Last year, the inverted yield curve sent a strong signal of short-term (1-2 years) recession. With the U.S. China trade phase 1 deal signed, there seems to be no bad news in the near future. Any internal/external shock to the financial system could potentially cause turbulence to the stock market.

Our five top and bottom contributors for 2019 are listed below. The top 5 contributors have a total PnL of 10.7%. The bottom 5 have a total PnL of -7.5%.



Our top 5 profitable positions is essentially same as previous quarter with the exception of CVS:

1. CVS Health (CVS) is one of the largest health insurance companies and retailers in the U.S. We initiated a large position on this stock early this year.

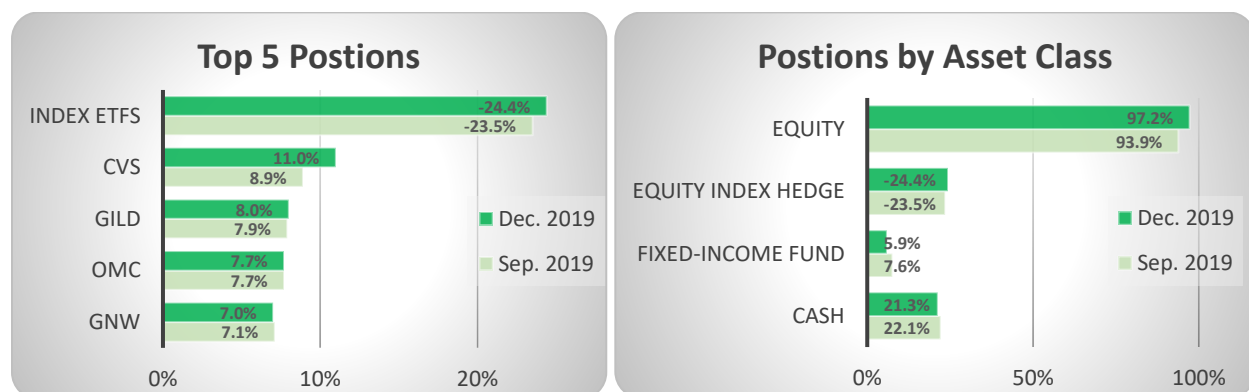
2. Genworth Mortgage Insurance (**GMA**) is an Australia mortgage insurance company. We bought it because of the low price compared to the net asset value and it has a high dividend. It had a large price increase in the third quarter.
3. AmerisourceBergen Corp. (**ABC**) is one of the largest drug wholesale distributors.
4. Deluxe Corp. (**DLX**) is famous for the check printing business.
5. Federated Investors Inc (**FII**) is a mutual fund management company. Its revenue, mostly in asset management fee, is correlated with stock market. With stock market increased this year, the stock price increased as well.

Our bottom 5 contributors are:

1. The index hedging position (**MDY/IVW**). We have large short positions on them and the market rise caused the loss.
2. CBL Properties Preferred Share E and D (**CBL PRE/D**) are the preferred shares of CBL. We converted our equity position (**CBL**) to the preferred share due to safety concerns and also the high dividend of preferred. However, CBL suspended their preferred dividend last quarter and we incurred a large loss here.
3. Franklin Resources Inc (**BEN**) is a traditional mutual fund management company. Their asset under management has experienced loss in 2019 even though the market advanced. Their cost was kept high and 2019 profit was down.
4. CBL Properties (**CBL**) is a REITs company operating shopping malls. We owned a small position here in third quarter and later we sold out these positions and transferred to the preferred share.
5. Genworth Financial (**GNW**) was offered \$5.43/share to be acquired by China Oceanwide. They closed the sale of the Canadian subsidiary. But there are new uncertainties from U.S. side as previous approvals were expired and they need to get re-approval from the state insurance regulators. The stock price has recovered some after the close of Canadian subsidiary sale, recently trading at \$4.30. It still has about 20% upside if the merger goes through.

Major positions

Our top 5 positions and positions by asset class at the end of Dec. 2019 were:



CVS: CVS Health; GILD: Gilead Science Inc.; OMC: Omnicom Group; GNW: Genworth Financial.

Compared to the third quarter of 2019, we trimmed some positions in ABC and ABC is no longer in our top 5 positions. The weight change in CVS is due to price increase. For general asset class positions, we moved some fixed-income position to equity.

Hua Wei, Ph.D., CFA on Jan. 28, 2020 in Orange, Ohio

Portfolio Manager, Founder,
Spring Ocean Capital LLC

<http://www.SpringOceanCapital.com>

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