First Quarter 2018 Newsletter

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Spotlight:

2018: The Year of the Dog, And Volatility

Béatrice Philippe
President
FOUR*POINTS* Asset Management

The optimism that prevailed in equity markets in 2017 (the S&P 500 and the MSCI Europe were up 21.8% and 26.2%, respectively) continued in January with the S&P 500 gaining 5.7% and the MSCI Europe up 5.4%. However, this fervor proved too much, too fast! Volatility, which had been extremely low throughout 2017, came back with a vengeance in February and March, causing significant market corrections. Ultimately, the S&P 500 and the MSCI Europe ended the quarter down 0.8% and 1.9%, respectively.

Despite increased tensions over trade policy and recent softness in business surveys, the near-term outlook for the global economy is still positive. The U.S. will benefit from fiscal stimulus this year, while the Eurozone is expected to continue to grow at a reasonably strong pace. Meanwhile, the European political landscape, which was mired by populist uncertainty last year, is moving in a more constructive direction in 2018.

One silver lining to February/March's correction was that equity valuations around the world have become more attractive. Of course, headwinds abound: though we do not believe that there will ultimately be a trade war, President Trump has been antagonizing U.S. trading partners with the threat of tariffs, the U.S. is preparing for denuclearization talks with North Korea, Mueller's investigation into Russian election meddling continues, tensions in Syria and in the ever-explosive Middle East continue to mount, and Italy's March general election ended in a hung parliament, just to name a few! In spite of it all, there is less complacency in the markets and underlying fundamentals are strong, so we remain positive.

In the meantime, we hope you have a lovely spring! We've been eagerly awaiting its arrival in the North East!

Thank you for your continued support,

Béatrice

Philippe
Euro Global Leaders

The MSCI Europe Index, which rose 5.4% in January, started the year on a very strong note, driven by continued economic momentum and earnings growth acceleration thanks to U.S. fiscal reform. Unfortunately, fears over inflation and the potential impact to the pace of interest rate hikes by the Federal Reserve, which could pose a threat to U.S. economic stability, more than pared this early gain. Moreover, these fears spread to Europe, where sovereign yields rose sharply, especially the German bund, which reached 0.77% in mid-February, its highest level since September 2015. In addition, the euro appreciated from $1.20 at the start of the year to $1.25 in February.

Over the quarter, sectors with the greatest sensitivity to interest rates saw the biggest declines (telecom -5.9%, consumer staples -5.2%, and health care -4.3%). Thankfully, inflation and interest rate expectations quickly reverted in the last few weeks of the quarter. However, weaker-than-expected PMI and confidence indicators across the region prevented the market from rebounding.

The Philippe Euro Global Leaders, LLC ended the quarter down 2.1% compared with a decline on 1.9% for the index. The fund's consumer staples and consumer discretionary holdings, which suffered from the market rotation in general, were also negatively impacted by stock-specific factors. In particular, **<u>Sodexo</u>** dropped 23% after reducing its profit forecast for the current fiscal year. Attributable primarily to underperformance in the U.S. health care and education markets, the company reduced its organic revenue growth guidance to 1%-1.5% from 2%-4% prior, while its operating margin target was cut to 5.7% of sales from 6.5% as some large contracts fell behind schedule at higher start-up costs than expected.

This was particularly disappointing because the company typically benefits from very high sales visibility. The news prompted the sell-side to reduce earnings expectations for this year and the next by 10%-15%. The stock's rapid de-rating suggests that investors have lost faith in **<u>Sodexo</u>**'s ability to reinvigorate sales growth.

However, reality is not necessarily so dark. **<u>Sodexo</u>**'s problems are isolated to the U.S. health care and education markets, where the company is ceding share to Compass, which stands in stark contrast to its robust enterprise and government businesses. Moreover, a rebound in activity in Europe and emerging markets contributed to a 4.4% increase in sales outside of North America in the first half of the fiscal year. In addition, the company's new CEO is reinvesting productivity savings to spur growth, and there are further cost reductions likely to be made. Lastly, with its very healthy balance sheet, we suspect **<u>Sodexo</u>** could find accretive acquisitions in sectors where valuations have fallen in recent months, or it could buy back its own shares at a bargain.

During the quarter, we took advantage of January's rally to trim (**<u>Wirecard</u>**, **<u>Norma</u>**, **<u>GTT</u>**, **<u>CTS Eventim</u>**, and **<u>Diageo</u>**) or exit (**Intertek** and **Tullow Oil**) positions that we felt had little or no remaining upside potential. Conversely, we used the sharp corrections in February and March to reinforce

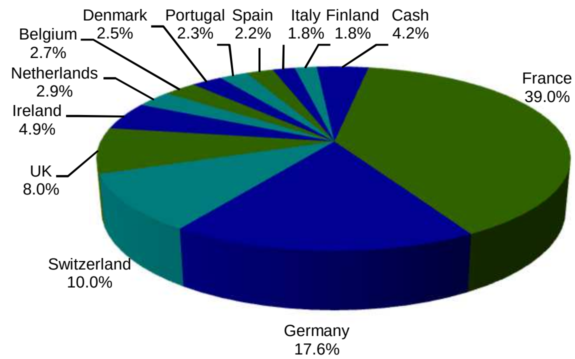
Continued on page 4

Stocks held in the portfolio are bold and underlined. All stock and index performance is in USD.

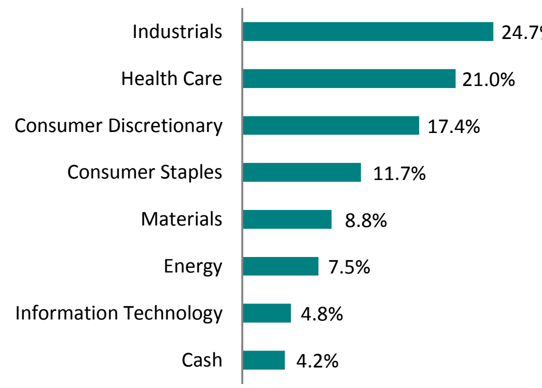
Market Cap Allocation as of 3/31/18

Mega Cap (Greater than $50 billion)	26.0%
Large Cap ($7.5 billion - $50 billion)	41.1%
Mid Cap ($750 million - $7.5 billion)	28.7%
Small Cap (Less than $750 million)	4.2%

Geographic Breakdown as of 3/31/18



Sector Breakdown as of 3/31/18



Top Ten Holdings as of 3/31/18

Française de l'Energie	4.1%
Thales	3.4%
Airbus	3.0%
Schneider Electric	2.9%
Philips	2.9%
Danone	2.8%
Michelin	2.7%
Anheuser-Busch InBev	2.7%
Fresenius SE	2.6%
ISS	2.5%
Total:	**29.4%**

Performance as of 3/31/18 in USD

	<u>Philippe Gross Return</u>	<u>MSCI Europe</u>
Quarter	(2.1%)	(1.9%)
1 Year	17.8%	15.1%
Since Inception	21.4%	18.7%

Inception date: January 3, 2017

Sources: Northern Trust, Zephyr Style Advisor

FOURPOINTS

Philippe
U.S. Equities

U.S. market strength in January, driven by synchronized global growth and fiscal policy, was more than offset by volatility in February and March due to rising trade tensions and fears over higher interest rates[1] and inflation. The S&P 500 ended the first quarter of 2018 down 0.8%, its first negative quarter since the third quarter of 2015. Following revelations of **Facebook**'s data-harvesting activities and **Tesla**'s production and safety difficulties, negative sentiment weighed on the information technology sector, particularly FAANG (**Facebook**, **Apple**, **Amazon**, **Netflix**, and **Alphabet**'s Google) stocks. Despite this correction, tech has posted the strongest year-to-date performance of any sector, up 3.2% in the first quarter. Consumer discretionary (+2.8%) was the only other sector that ended the quarter in positive territory. The telecom (-8.7%), consumer staples (-7.8%), and energy (-6.6%) sectors are the greatest laggards year-to-date.

The fund was down 0.5% in the first quarter 2018. Outperformance relative to the index was driven by the portfolio's health care holdings (**Thermo Fisher Scientific**, **LivaNova**, and **Gilead**) and our limited exposure to consumer staples, which underperformed during the quarter. Weakness in our consumer discretionary holdings, particularly **Carter's**, **Home Depot**, and **Walt Disney**, was partially offset by strong outperformance by **Tapestry**, formerly **Coach**. This weakness, some of which is attributable to seasonality, does not change our longer-term investment theses for these industry leading companies.

During the quarter, we took profits on various holdings (**PTC** and **Xylem**, which had reached our target prices, and **Procter & Gamble** to diversify into more dynamic investment opportunities) to introduce new positions in the technology (**Mercury Systems**, **Salesforce**, **EPAM Systems**, and **Novanta**) and financial (**S&P Global**) sectors.

Mercury Systems is a commercial provider of secure processing subsystems designed and made in the United States for critical defense and intelligence programs. The company delivers affordable solutions, service, and support to more than 300 programs and to over 25 defense prime contractors, thereby helping to reduce costs, minimize technical risk, and stay on schedule and on budget. We believe the company is well-positioned within the multibillion dollar subsystem market to capture continued growth in fiscal 2018 and beyond.

Salesforce.com is a pure-play software-as-a-service (SaaS) company offering customer relationship management (CRM) solutions for sales, customer service, marketing, and analytics applications. In addition to its application marketplace, the firm also offers a full-featured platform-as-a-service. SaaS is among one the fastest and most effective methods for enterprises to cut IT infrastructure costs. Management guided for its revenue and total addressable

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[1] In March, the Federal Open Market Committee raised its target range for the federal funds rate to 1.5%-1.75%, which was the sixth hike since December 2015 and the first hike for new Chairman Jerome Powell.

Stocks held in the portfolio are bold and underlined. All stock and index performance is in USD.

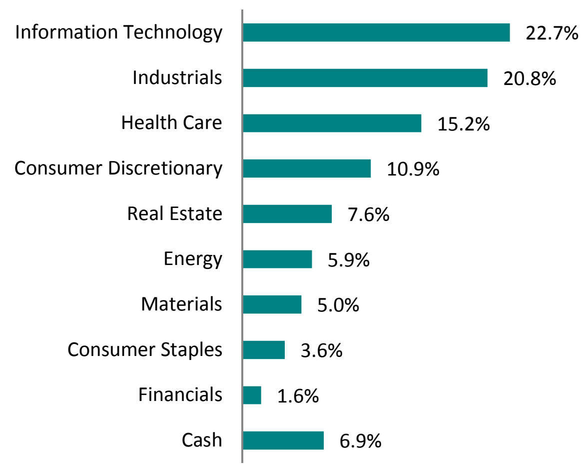
Market Cap Allocation as of 3/31/18

Mega Cap (Greater than $50 billion)	40.2%
Large Cap ($7.5 billion - $50 billion)	37.4%
Mid Cap ($750 million - $7.5 billion)	22.4%
Small Cap (Less than $750 million)	0.8%

Top Ten Holdings as of 3/31/18

Alphabet	3.4%
Westinghouse Air Brake Technologies	3.2%
Howard Hughes	3.2%
Genpact	3.1%
United Technologies	3.1%
IBM	3.0%
Stanley Black & Decker	2.9%
Home Depot	2.9%
Zoetis	2.8%
FedEx	2.8%
Total:	**30.5%**

Sector Breakdown as of 3/31/18



Performance* as of 3/31/18 in USD

	Philippe Gross Return	S&P 500	Russell 1000
Quarter	(0.5%)	(0.8%)	(0.7%)
1 Year	8.5%	14.0%	14.0%
3 Years	4.5%	10.8%	10.4%
5 Years	7.6%	13.3%	13.2%
Since Inception	5.3%	6.1%	6.3%

**Performance greater than 1 year is annualized.*
Inception date: January 29, 1999

Sources: Northern Trust, Zephyr Style Advisor

Philippe Euro Global Leaders (*Continued from page 2*)

several health care, consumer discretionary, and industrial holdings, as well as to initiate several new positions, including **Capgemini** (technology), **ConvaTec** (health care), and **Huhtamaki** (materials).

French-based **Capgemini** is one of the top ten global IT service providers with nearly 200,000 employees worldwide. The company is benefitting greatly from the digital transformation initiatives (big data, e-commerce, digital marketing) it is helping its customers implement, with plenty of underpenetrated growth areas (data capture and analysis of industrial processes, automation, the Internet of Things, digital manufacturing, cybersecurity). In fact, **Capgemini**'s digital and cloud segment, which already accounts for 38% of total revenues, grew 25% over the first nine months of 2017.

Nevertheless, for nearly three years, growth was masked by temporarily unfavorable conditions. Two factors, in particular, negatively impacted revenue growth by approximately 2 percentage points per year: 1) the reduction in the scope of a large contract with the British government, which weighed on outsourcing segment revenues, and 2) cutbacks by North American oil-producing customers following the sharp decline in oil prices at the end of 2014. Thankfully, these headwinds are dissipating. The impact from the U.K. contract loss is expected to be minimal in the first half of 2018, and it will annualize fully in the back half of the year. Moreover, following a return to 12% growth in the U.S. in the fourth quarter of 2017, the energy sector should no longer be a drag in 2018.

As a result, we believe **Capgemini** can grow by nearly 5% in 2018. While investments behind the company's digital service offering limits short-term margin upside, over the medium-term we believe the company's profitability will benefit from increased offshoring of IT services to India-based teams, as well as in-house initiatives to increase competitiveness.

The strength of **Capgemini**'s balance sheet (0.6x net debt-to-EBITDA as of the end of 2017) also leaves room to supplement organic growth with acquisitions. However, we believe the more likely scenario is for the company to increase returns to shareholders considering dividends currently represent only 30% of profits.

Relative to its earnings growth potential, we believe **Capgemini** trades at a very reasonable valuation (13x 2018E EV/EBIT, 17x 2018E FCF). In our opinion, the stock should perform well as the market better understands the company's sales growth potential and upside to management's capital allocation strategy.

After it published reassuring results, we also initiated a position in U.K.-based **ConvaTec**, a leading player in the ostomy, wound, and continence care markets, each of which are growing 4%-5% per year. The company publicly listed at the end of 2016 with the aim of closing the profitability gap with competitor and ostomy market leader **Coloplast** by restructuring its production footprint. However, this ambitious undertaking proved to be more difficult than expected, causing significant production and delivery delays in the U.S. In 2017, sales decelerated sharply and operating margin contracted by more than 200 basis points.

However, the problems from 2017 now seem under control. On the fiscal year-end conference call, management confirmed that the reorganization of its production facilities was almost complete. While investments behind the restructuring and launch of new products are expected to continue to weigh on margins in the first half of 2018, management maintained longer-term guidance to grow sales in line with, if not in excess of, its underlying markets and to increase margins.

Since its June 2017 high, **ConvaTec**'s share price has collapsed by nearly 40%. With approximately 25% upside potential in our model, we believe the stock, which is trading at a 20% discount to peers, offers a very attractive risk-reward profile.

In addition, we introduced Finnish food packaging specialist **Huhtamaki** to the portfolio during the quarter. The company, whose major customers include **McDonald's**, Burger King, Subway, and Costa, enjoys high visibility as a supplier of basic consumption-related products. For example, **Huhtamaki** provides the aforementioned fast food chains 18 billion paper cups annually, enough fiber-based packaging for more than 52 billion eggs each year, as well as flexible packaging solutions for customers like **Unilever**, **Nestlé**, and Mars.

Transitory impacts from reforms carried out in India and capacity constraints in the U.S., which account for 10% and one-third of **Huhtamaki**'s sales, respectively, caused organic revenue growth to slow to 1% in the second quarter of 2017. However, normalization in the Indian market since the end of the third quarter and the launch of a large Arizona plant at the end of 2017 contributed to the recovery in organic growth to 6% in the fourth quarter of last year. In 2018, we believe **Huhtamaki** will return to organic growth of at least 5%, in line with its medium-term target.

While the company has suffered commodity cost inflation in recent quarters, it has been able to leverage its pricing power to preserve operating margins around 9%. Margins are expected to increase closer to management's 10% target this year.

Finally, we're hopeful the company will increase acquisition activity in 2018 after a calm 2017. Management, which has an excellent track record identifying and integrating accretive transactions, has planned for acquisitions to contribute 5% to total revenue growth over the medium-term. In seven years, **Huhtamaki** paid 0.8 times sales for 13 acquisitions that now represent 20% of its total sales.

After suffering a major de-rating in 2017, the stock is trading at a 10% discount to European industrials compared to a 20% premium in 2016. At these levels, we model more than 15% upside for **Huhtamaki**.

Philippe U.S. Equities (*Continued from page 3*)

market to grow over the next five years at compound annual growth rates of 21% (organic) and 11%, respectively, while continuing to deliver roughly 100 to 300 basis points of margin expansion each year. We believe **Saleforce**'s strategic partnership with Google Cloud demonstrates and supports its determination to expand internationally (only 28% of total revenue is generated outside of the Americas today) with a best-in-class service offering (Salesforce CRM, G Suite, and Google Analytics) for its customers. **Salesforce** remains poised to capture additional market share as cloud migration/CRM application spending continues.

EPAM Systems, which is growing organically at a robust 20%+, provides software product development and digital platform engineering services to clients around the world. We believe its expertise developing products and its focus on talent acquisition are competitive advantages in the digital services space.

Novanta manufacturers tailored photonic and motion control components for high precision, high performance medical and industrial applications. The company's diversified portfolio of niche industrial (49% of total revenues) and medical (51%) products and solutions, including 3-D printing, advanced laser material processing, warehouse automation, DNA sequencing, and minimally invasive and robotic surgery, serve a $3.5 billion market that is growing at a compound annual rate of 5%-7%. Thanks to high industry barriers to entry, the company expects to grow mid- to high-single digits organically over the long-term, driven by new product development and innovation, supplemented by accretive acquisitions. In fiscal 2018, **Novanta** is targeting a 20% EBITDA margin.

Finally, we initiated a position in **S&P Global**, the world's leading credit rating agency with approximately 50% market share. With the top three players controlling more than 95% of the global ratings market, barriers to entry are high and competition is limited. In spite of rising interest rates in the U.S. (60% of revenues by geography), we expect debt issuance and refinancing activity to remain strong given persistently low interest rates relative to historical levels. Moreover, we believe revenue and costs synergies related to the integration of recently acquired SNL Financial (market data) will allow **S&P** to significantly expand margins for its data and analytics business (40% of revenues by segment, 30% of profits), which are well below the company average. Finally, we believe **S&P**'s indices business will continue to benefit from the growing trend towards passive investing (exchange traded funds, index funds), for which it receives asset-linked fees for products based on its indices (e.g. SPDR S&P 500 ETF, options, CBOE's VIX index).

Generally, we remain constructive on the U.S. market, which is underpinned by solid corporate fundamentals and positive macroeconomic data, including strong business and consumer confidence. Looking forward, the biggest risk to market stability lays in rising trade tensions. In our opinion, the risk of a trade war is limited, as both the U.S. and China have indicated that they remain open to negotiations. However, a stall in trade negotiations could upset the global synchronized expansion that kept investor sentiment aloft in 2017 and could cause increased volatility, especially in equities where fund flows have been improving lately. This may provide an opportunity to invest or reinvest in strong companies with limited sensitivity to global trade uncertainties that we believe stand to benefit from a generally favorable macro backdrop marked by supportive financial conditions, fiscal stimulus, and a weaker dollar.

LLC Descriptions

The **Philippe Fund Euro Global Leaders, LLC** is a commingled fund suitable for U.S.-based, high net worth individuals and endowment/foundation clients. The minimum investment in the LLC is $250,000. The minimum time frame recommended for investment in the LLC is two years. The LLC is officially valued at the end of each month. Further information is available in our Confidential Memorandum, which can be obtained from **FOUR***POINTS* Asset Management, Inc. The benchmark is the MSCI Europe Index. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. A fee schedule is available upon request and is described in Part 2 of the firm's Form ADV. The fund is available to qualified investors only. Accounts are included from the first full month under management. Leverage is not used. Past performance is not indicative of future results. The fund's assets under management as of March 31, 2018 were $29.6 million.

The **Philippe Fund U.S. Equities, LLC** is a commingled fund suitable for U.S.-based, high net worth individuals and endowment/foundation clients. The minimum investment in the LLC is $250,000. The minimum time frame recommended for investment in the LLC is two years. The LLC is officially valued at the end of each month. Further information on the LLC is available in our Confidential Memorandum, which can be obtained from **FOUR***POINTS* Asset Management, Inc. The benchmark is the S&P 500 Index. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. A fee schedule is available upon request and is described in Part 2 of the firm's Form ADV. The fund is available to qualified investors only. Accounts are included from the first full month under management. Leverage is not used. Past performance is not indicative of future results. The fund's assets under management as of March 31, 2018 were $25.7 million.

Performance Disclosures

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All returns shown in this publication assume the reinvestment of dividends.

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A complete list and description of FOUR*POINTS* Asset Management, Inc.'s LLCs is available upon request.

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