CAPSTONE Updates

June 24, 2022

Thank you for your continued trust and confidence. We would like to inform you some trade changes in the CAPSTONE portfolio. We replaced Ally Financial (ALLY), Stem Inc (STEM), Apple (AAPL), and PulteGroup (PHM) with Reinsurance Group of America (RGA), Enphase Energy (ENPH), Crowdstrike Holdings (CRWD), and VICI Properties (VICI).

Weakening consumer demand for loans and higher credit balances are starting to affect loan volume and potential for higher loan loss provisions for most major banks. Additionally, weakening auto financing demand is likely to affect ALLY's financial results due to their large auto loan exposure. Current market and rate environments are shifting our preferences towards insurance companies within the financial sector which resulted in the inclusion of Reinsurance Group of America (RGA). The company reinsures health and life insurances, and results were negatively impacted by COIVD-19 mortalities. However, improving mortality rates as life returns to normal along with rising rates should result in improving investment returns for RGA. We view RGA as a case of upside potential through fundamental normalization as earnings and valuations improve with global mortality trends.

STEM operates intelligent energy storage networks sold as Software as a Service (Saas) but sources its battery hardware from original equipment manufacturers (OEM). Soaring input and supply chain costs have plagued STEM's gross margins and severely shortened the company's cash runway as the company typically absorbs upfront hardware costs in return for long-term Saas contracts with large scale utility generators. Although their long-term potential remains intact, near-term investment risks remain uncomfortably high for our investments team with margin and funding uncertainties. We've replaced STEM with ENPH which produces microinverters and energy monitoring and control systems for the solar PV industry. The replacement seeks to maintain our exposure to renewable energy with a perspective that the tailwind for sustainable renewable energy has accelerated due to shifting consumer behaviors. The company is financially sound while valuation is reasonable for a high-quality growth name.

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Our decision to replace AAPL with CRWD was primarily determined by the high growth hurdle rate we employ towards our growth positions. Although APPL's valuation has declined recently and the company remains a high-quality company for growth investors, we view that the recent decline in other higher growth stocks have invited an opportunity of inclusion in the CAPSTONE portfolio. CRWD continues to execute and grow at a high level with strong offerings and attractive upsell opportunities, managed by a talented management team. Cybersecurity spend on corporate budgets are also likely to expand over the next decade due to greater digitization of our economy and potential for more cyber threats which stands to benefit disruptive cybersecurity companies like CRWD. The company has a positive and growing cash flow yields while showcasing very strong net retention rates.

Family formation remains a long-term secular tailwind for homebuilders like PHM and the housing industry that continues to be short of supply since the housing bubble in 2008. However, tightening financial conditions, greater competition with more building activity, and high raw material prices are factors our investments team are concerned about for homebuilders. Because homebuilders are the stewards for housing supply, we are concerned that homebuilders would be the first to get hurt if the housing market slows dramatically. Considering recent conditions, we favor owners of real estates such as REITs more than builders of real estate. As a result, we replaced PHM with VICI Properties (VICI) which is an experiential REIT whose portfolio comprises of market leading hospitality and entertainment destinations. VICI owns and rents triple net lease properties and has the longest dated lease maturity (average 43.2 years) among its other triple net lease competitors. Additionally, 97% of its leases come with inflation protection via a CPI protection escalator that rises according to the CPI Inflation Index. The REIT has significant growth opportunities within its pipeline with tenants showing resilient cash flows through all economic cycles, including during COVID-19.

If you have any questions about these or any changes in your Liberty One portfolio(s), potential tax implications, or would simply like to learn more, please contact your financial advisor.

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