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Mott Capital Management

April 26, 2018

The first quarter of 2018 was volatile, with the stock market soaring to record heights in the month of January, only to plunge in the month of February, followed by a roller coaster ride in March. This February and March felt reminiscent of the first quarter of 2016 when an initial sell-off of 9 percent in the S&P was almost immediately followed by an 11 percent gain, returning to just above the starting level.

There is a difference, however. The volatility of 2016 arose from systemic concerns: fears of a global economic slowdown resulted in nervousness around the adoption of negative interest rate policies by central banks in what seemed to be a last-ditch attempt to spur a recovery. By comparison, the 2018 market outlook seemed to change with the direction of the winds: -- talk of political risk, trade wars, rising interest rates, inflation warnings, and the falling out of favor of technology stocks all had their day at the forefront of investor sentiment. There is a lesson here -- our collective short attention span and willingness to react to hype means that the stock market in 2018 is far more fragile and much quicker to react at the hint of bad news than during the tranquility of the 2017 market. The likely result is that volatility will continue for a while longer, perhaps through the balance of the second quarter and into the summer months.

The good news is that earnings are forecast to be very strong in 2018, with fundamental strength continuing into 2019. Data derived from Dow Jones S&P Indices is forecasting earnings growth of nearly 40% in 2018, and an additional 10% growth in 2019. If achieved, this scenario shows the S&P 500 is trading at only 15.7 times 2019 earnings of $168.64 per share. The strong earnings growth and low earnings multiple should help to support the market, even in the face of transitory volatility.

Thematic Growth 2018 Performance Results Year Through 1Q'18

The portfolio had a strong performance in the first quarter, with stocks like Netflix soaring, and carrying the performance for the Mott Capital Thematic Growth Portfolio. Even in the very early stages of the second quarter, we see more signs of this trend emerge.

For the first quarter, the Thematic Growth composite managed to beat the S&P 500 Total Returns by 2.6 percentage points, net of fees and transactions.

Non-Annualized Performance 1/1/18 – 3/31/18

MCM Thematic Growth Composite*	S&P 500 Total Return Index
1.85%	-0.76%

*Net of Fees and Transaction Cost

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MCM 3 Best & Worst Performers for 1Q'18

Netflix +53.86%	Acadia Pharmaceuticals -25.37%
MasterCard +15.72%	Tesla -14.52%
Raytheon +14.89%	Celgene -14.52%

The Winners

Netflix

Netflix was the clear-cut winner, and the stock picked up where it left off in 2017, surging by nearly 54 percent. As I write (April 26), Netflix has surged even higher, now up over 63 percent on the year. Steep spending to create original content is paying off, helping to drive subscriber growth and pushing up revenue per user. As I have noted since we initiated the position in the third-quarter of 2016, Netflix is leading a significant and evolutionary paradigm shift in the way consumers view and get their TV content. Over the top cable boxes are out -- streaming media on multiple platforms is in. Netflix is the clear-cut leader in this arena, not just in the US, but globally. Netflix's future opportunities are immense, as the company may have just scratched the surface of international growth in a time when a person only needs a mobile phone connection to access Netflix's programming. Truly revolutionary.

I do not normally comment on returns since inception, but in this case, I wanted to let you know that the portfolio's composite per share cost basis for Netflix is $102.55, with shares now trading at approximately $314.50, yielding a composite return of about 206 percent. Netflix stock now represents nearly 11.1 percent of the total portfolio. And, yes, I am aware of the issue of overweighting a single stock, and I am monitoring the situation carefully.

MasterCard

MasterCard is another example of a company that continues to reshape how consumers and businesses interact, and it is likely to continue in its leadership position for many years. Mastercard has been a core holding in the portfolio since its introduction in the third-quarter of 2014, and the performance of the stock has been nothing short of breathtaking. Volume growth for the payment processor continues to rise, and as more businesses like Netflix flourish the more MasterCard will as well. Dominance in traditional face-to-face retail along with e-commerce and business to business transaction management is the gateway to MasterCard's success.

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Raytheon

Raytheon is a position that has performed incredibly well since the introduction to the portfolio in the third-quarter of 2015, a workhorse stock that typically does not get sufficient credit. This quarter it has been well recognized, not the least because of its focus on national defense and cybersecurity products, segments that likely will attract significant governmental support in coming years.

The Losers

Acadia Pharmaceuticals

Acadia continues to disappoint, and if you are wondering why we continue to stick with the stock, it is for many reasons. The company has continually achieved the benchmarks we have been looking for, but the stock has just not been rewarded. Nuplazid, its drug for Parkinson's disease psychosis, continues to grow and is currently in trials for four more indications. The next big milestone for the drug and the company will be the completion of a Phase 2 trial in depression. Based on my research I think the results will be positive, and the stock to this point has not priced-in the potential for a positive outcome. Additionally, the company is forecast to see its revenue more than double in 2018, to nearly $265 million.

In first weeks of April, a report on CNN raised safety concerns regarding Nuplazid, drawing selective data from an FDA incident report website. In my view (and that of other analysts) the negative incident reports on the database show no causal connection to use of the drug. Additionally, ongoing trials since the initial FDA approval of Nuplazid for specified indications also support the drug's safety profile.

Tesla

Tesla's shares fell in the quarter amid rising concerns over Model 3 production and a Moody's debt downgrade. However, the real damage in the quarter came with the stock falling from $307 on March 26, to an intraday day low $244 on April 2, a drop of over 20 percent, driven by a flat-out stupid, bogus commentary, and one that I vehemently disagree with. The commentary, written by a self-admitted short-seller, said Tesla would be bankrupt in 4 months, with no factual support. Unfortunately, the short-seller succeeded in his quest, causing the shares to plunge. In fact, up to now Tesla has had no issue going to the capital market to raise money when needed to fund its operations, and until that changes the risk of bankruptcy seems unfounded. Additionally, Model 3 production finished the first-quarter at a production rate of roughly 2,100 cars per week, an unbelievable success, despite being short of its goal of 2,500.

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The company continues to pick up the pace of production and is targeting 5,000 Model 3's per week by the end of the second-quarter. The shares of Tesla have recovered and are trading at approximately $280 as of the time of this writing.

Celgene

Celgene shares have fallen on tough times after a failed drug trial and investor concerns about the company's dependence on its hematology blockbuster, Revlimid. However, the biotech company is working hard to calm investors' nerves, making two big acquisitions to start the year, and in time I think Celgene shares will recover.

Portfolio Updates

We did not close any positions in the first-quarter and are eagerly awaiting the completion of Qualcomm's acquisition of NXP Semiconductor, to fetch our full $127.50 per share. As of this writing, though, whether or not the deal closes is open to uncertainty. The Chinese regulatory authorities appear to be holding back on anti-trust clearance for the business combination, a step presumably tied to the recent trade tensions between the US and China. That said, NXP's business model has not changed since the stock was first added to the portfolio several quarters ago; should the merger fail the stock may suffer over the short-term but is well positioned to be successful on its own as the market leader in automotive chips and near-field communications.

Meanwhile, we have not replaced General Electric since our sale in the early fourth-quarter, and despite having my eye on few names, I am hesitant to rush into a new position at this time.

2018 Outlook

2018 will undoubtedly continue to test our nerves and stomachs, but the portfolio is built and designed to withstand periods of seeming market disarray, as the best hedge against short-term market volatility continues to be a long-term time horizon.

As always, I will continue to work my hardest to find new long-term thematic investments that are helping to reshape generational and demographic shifts, all in line with our investing discipline.

Regards,

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Year End	Total Assets Firm	Total Assets Composite	Number of Accounts	Composite Performance Net	S&P 500 Total Return	Annualized 3-Year Standard Deviation** Composite	Annualized 3-Year Standard Deviation** Benchmark	Internal Composite Dispersion
2017	2,118	1,716	20	18.77%	21.83%	12.70%	9.92%	0.90%
2016	1,717	1,377	17	-2.10%	11.96%	-	-	0.90%
2015	1,681	1,325	17	1.52%	1.38%	-	-	0.60%
2014†	1,026	628	8	3.82%	7.60%	-	-	N.A.

N.A. - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.
† Performance reflects the non-annualized performance from 8/1/2014 to 12/31/2014.
** For periods with less than 36 months of composite performance, no 3-year ex-post standard deviation measurement is available.

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