DOMO
CAPITAL MANAGEMENT

FOR IMMEDIATE RELEASE

DOMO Capital Announces Results through Q4, 2018

Germantown, WI – January 31, 2019

DOMO Capital underperforms market in 2018, but anticipates full recovery by end of first quarter.

Summary

December of 2018 delivered the worst stock market performance since 1931 – all the way back to the Great Depression. This was also the first quarter ever where DOMO failed to outperform the market during a quarterly sell-off of 5% or more. Despite outperforming the market for most of the year, we ended up losing almost 27% for the year, mostly in the fourth quarter. While frustrated with this result, we are far from despair. In fact, as we edit the final version of this letter in late January 2019, we are quite enthusiastic looking forward, based on our detailed knowledge of the companies we hold and the remarkable recovery in their prices already seen in this New Year. While 2018 was difficult, we expect 2019 to be exceptional.

What made this sell-off unique? Should we have done anything differently? As we'll discuss later in more detail, we see most of this short period as a function of market participants behaving irrationally, combined with the arbitrary nature of quarter end as a period for performance measurement. But it is worth examining several elements of this period.

First, there was no single macro event we could protect against.

Second, the sell-off was not based on concrete economic data. In fact, leading economic indicators (such as the ISM Manufacturing/Services Indexes) were not only at historically strong levels, but were accelerating. Consumers are a significant contributor to our economy, and retail sales during the holiday season beat expectations. In general, we believe concerns about the economy have been exaggerated.

Third, a sell-off of this magnitude is typically indiscriminate, and no company-specific catalysts off-set these forces to support our portfolio. Small-cap stocks are typically hit the hardest in a sudden bear market (they were one of the first asset classes to fall more than 20% during the sell-off), which was where we had seen (and continue to see) the most value.

Fourth, we suspect some amount of the downward pressure late last year was attributable to tax loss selling. Several of our new positions in 2018 were already near their 52-week lows when purchased, so they were prime candidates for this sort of selling. We took advantage of the selling pressure by adding to these positions during the quarter, which should eventually lead to greater long-term gains, even though it was painful in the short-term.

These characteristics are very difficult to predict and avoid, particularly for our style of investing. Candidly, even if we had raised cash, we would have reinvested it early in the sell-off due to our confidence in this portfolio.

Most of our 2018 underperformance is attributable to two positions. First, while an investment in the steel industry (prior to the announcement of tariffs) initially resulted in large gains, it cost the portfolio nearly 13 points for the year. We think sellers focused on macro concerns (China, potential Federal Reserve Bank actions, and future US economic growth), missing the financial strength and remarkable valuations of the businesses they sold. In other words, trading in the fourth quarter was driven by emotion, not data. We think steel companies are going to have a breakout 2019, and we expect that our pick within the space will outperform its peers.

Second, over 8 points were lost for the year on an investment we made in the fourth quarter, and for which we anticipate the potential of a 400% gain in the coming years (we discussed it in depth for our clients).

If we strip out these two investments, we would have outperformed the market for the year, and with significantly less volatility. However, we did make those investments, and are glad of it. We expect them to produce enormous returns for the portfolio in the coming years, and while painful, the recent selloff allowed us to continue to add to these positions at significantly discounted prices that will allow us to profit even more.

Here is just one example from the portfolio: This company pays a dividend of over 12%, and trades at around 5 times next year's earnings. The dividend is easily covered by free cash flow (cash remaining after operating expenses and capital expenditures), and there is more cash than debt on the books. We think it is a prime candidate to be acquired by another company. Despite these details, the stock fell about 16% from late November to year-end. If we had anticipated the sell-off, would we have sold it? Absolutely not, because we are never going to sacrifice the possibility of huge long-term gains from a catalyst that could hit at any moment simply to avoid a market selloff - even one that resulted in a 16% loss.

While the details are different, the conclusion for every company we own would be the same. We're not going to try to time the market. To us, the potential loss of long-term gains is much greater than the risk of poor relative short-term performance, even when it occurs at year end. We are proud of our record, and ask that potential investors examine the long term and multiple periods as they analyze DOMO.

That said, historically we've avoided other major quarterly sell-offs, so this one does sting a bit. Sometimes the arbitrary nature of a particular date (quarter-end, for example) makes it difficult to appreciate the value of the holdings within the portfolio; thus, the importance of multiple date ranges and long-term records in considering a manager. Frankly, we won't be surprised when the relative performance of December is erased within the first couple months of 2019. If this volatility had occurred within the same quarter, the price action of December would more likely be viewed as a good thing, as it enabled several purchases at exceptional prices.

About DOMO Capital Management, LLC

DOMO Capital Management, LLC ("DOMO") is a Wisconsin-registered investment advisor, founded in 2007 by Justin Dopierala and headquartered in Germantown, Wisconsin. DOMO is the portfolio manager of the DOMO Concentrated All Cap Value composite – a composite of separately managed accounts utilizing the DOMO Concentrated All Cap Value strategy with an inception date of October 8, 2008. DOMO firmly believes that investing in a concentrated portfolio of securities through a bottom-up methodology, focused on undervalued and out of favor stocks with solid fundamentals, leads to a repeatable process to provide superior, risk-adjusted returns over the long-term.

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