



November 8, 2019

Dear Appleseed Shareholder,

*"Things fall apart; the centre cannot hold;  
Mere anarchy is loosed upon the world,  
The blood-dimmed tide is loosed, and everywhere  
The ceremony of innocence is drowned;  
The best lack all conviction, while the worst  
Are full of passionate intensity."*

*"The Second Coming," W.B. Yeats*

Slowly but surely, the world has been moving from compromise and coordination to name-calling and tribalism. We read news of impeachment inquiries, trade wars, mass demonstrations, accusations of treason, worsening geopolitical tensions, conspiracy theories, fake news, and Twitter curses, sometimes all in the same day. The current period will likely be studied closely by historians trying to make sense of the many seemingly irreconcilable conflicts that have surfaced.

Rising areas of contention include but are not limited to the United States vs. China, the rich vs. the poor, the old vs. the young, capitalists vs. socialists, Democrats vs. Republicans, and globalists vs. nationalists. Many of these conflicts seem irreconcilable, which means that a risk exists that some conflicts could be fought until won or lost rather than negotiated through compromise. The ongoing news about these conflicts creates uncertainty and stress for all concerned citizens.

As investors, we do not yet know how these conflicts will get resolved. Just as it would have been impossible to predict the drone attack that took place in September against Saudi Arabia, crippling approximately 50% of its oil processing capacity, it would be folly for us to make concrete predictions about political outcomes. Nevertheless, we have no choice but to express an opinion about probable outcomes through the investment decisions we make on behalf of Appleseed shareholders.

In this regard, we thought it would be useful to focus on a few areas of particular friction and discuss their likely economic and financial implications.

### **Global Geopolitical Uncertainty**

Two phenomena have driven the increased friction between the United States and China. First, as China's economic and military strength has grown, China is increasingly able to challenge the global hegemony of the United States from economic, military, cultural, and monetary standpoints. Second, ever since China joined the World Trade Organization in 2002, U.S. manufacturing job losses accelerated as U.S. companies built new production capacity in China while closing down domestic manufacturing facilities, which has exacerbated rising



economic inequality within the United States.

While President Trump and Chairman Xi negotiate the terms of the U.S./China bilateral relationship, the uncertainty is unsettling for financial markets. President Trump often tries to buoy the stock market with hopeful tweets about trade discussions, except for when he scares the stock market with defiant tweets that stoke geopolitical tensions. As time passes, it grows more likely that the United States and China could enter a new cold war. In a worst-case scenario, we would expect to see a bifurcation of supply chains, payment systems, technology infrastructure, financial markets, and even the Internet. In a best-case scenario, we would expect a bilateral agreement between the United States and China that allows for limited trade and places additional restrictions on currency manipulation.

With regard to the Middle East, the United States is trying to withdraw from its role as a regional peacekeeper. As we write this letter, President Trump has announced his intent to withdraw from Syria. The drone attack on Saudi Arabia's processing facilities probably took advantage of the Trump administration's communicated lack of appetite for engaging in new regional conflicts in the Middle East. With less interest and ability to project power in the region, the lack of a presence by the United States will allow other countries like Russia, China, and Iran to fill the void.

The international monetary system, too, is in the middle of a transition as a unipolar monetary system centered around the U.S. dollar becomes increasingly multipolar. Since the Financial Crisis, perhaps in anticipation of current geopolitical shifts, foreign central banks have been turning away from the U.S. dollar as a hard currency reserve and turning towards gold. The United States has attempted to combat these efforts through economic sanctions, but sanctions are causing many countries to become even more eager to reduce their reliance on a U.S. dollar-centric monetary system. With the United States withdrawing or reducing its military presence in the Middle East, the role of the U.S. dollar as the currency of choice in global trade should inevitably diminish.

As the world shifts from a unipolar one with the United States as the world's policeman and reserve currency issuer to a multipolar one, it should inevitably mean higher trade barriers, less globalization, less foreign hoarding of U.S. dollars, more support for gold as an international reserve, and fewer military commitments overseas for the United States.

### **Domestic Political Uncertainty**

Over the past 30 years, with increased globalization, low inflation, and declining interest rates, U.S. investors have benefited greatly from increasing corporate profit margins and strong financial returns. At the same time, while wage gains have been robust for the upper 10% of the income distribution and especially for the upper 1% and above, wages for the bottom 90% of the income distribution have remained stagnant. As a result, income and wealth inequality has reached extreme levels not seen since the early 1930s, resulting in social discontent, class conflict, and the rise of populist politicians like Donald Trump on the Republican side and Bernie Sanders, Elizabeth Warren, and Andrew Yang on the Democrat side.

When considering the theme of economic inequality, we are reminded of historian Will Durant's warning that an "unstable equilibrium generates a critical situation, which history has diversely met by legislation redistributing wealth or by revolution distributing poverty." Current prescriptions that propose to address economic inequality

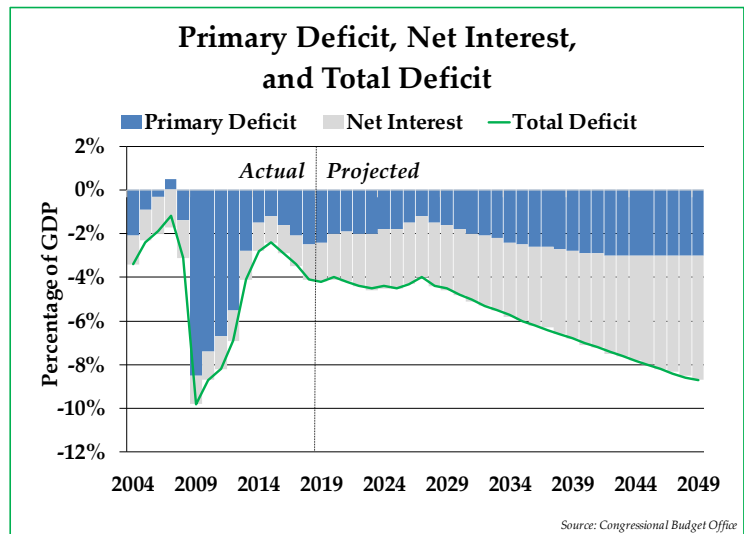


vary. Some propose devaluing the dollar (e.g., Warren, Trump), thereby reducing the real value of debt obligations. Others propose wiping away debts, such as college loans (e.g., Warren, Sanders). Meanwhile, several want to use tax and fiscal policy to redistribute wealth explicitly (e.g., Yang, Sanders, Warren).

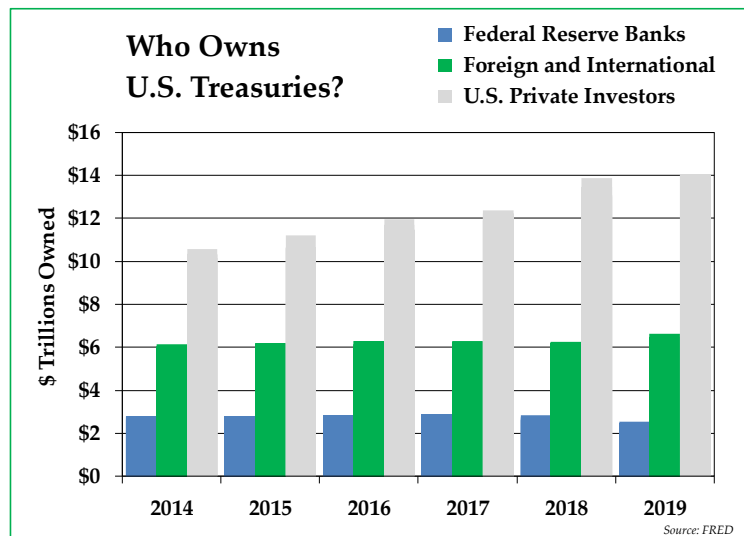
Regardless of the outcome of the 2020 election, whoever becomes president will likely face a starkly divided nation, enjoying wild popularity among one-half of the electorate while being despised by the other half.

For investors, however, it may be the similarities between President Trump's plans and various Democrat plans that are worth noting. President Trump has made it abundantly clear that he has no intention to lower the Federal deficit. If anything, he would be eager to sign a bill that increases spending to invest in infrastructure or further reduce tax rates. While Democratic candidates are calling for increased taxes, the taxes planned would hardly pay for proposed new spending. The top presidential candidates seem to all agree that keeping the Federal deficit under control is no longer a policy priority.

During the three consecutive years between 2016 and 2018, the budget deficit has expanded without a recession for the first time in U.S. history and is currently running at approximately 4% of GDP (see right chart). Based on current Congressional Budget Office projections, it is difficult to see anything that would get in the way of growing deficits during the next several decades, even without any policy changes. The policy proposals of President Trump and most Democratic presidential candidates would worsen an already poor budget outlook.



An increasing deficit is concerning enough, but the situation is made worse by the fact that the U.S. Treasury is starting to have increasing difficulties in financing these deficits. Since 2014, U.S. private investors, especially U.S. primary dealers such as JPMorgan Chase, have absorbed most of the additional supply of U.S. Treasuries (see bottom right chart). However, these primary dealers have little room to expand their balance sheet further to buy U.S. Treasuries, which is why the Federal Reserve will have to become an increasingly significant source of government funding.

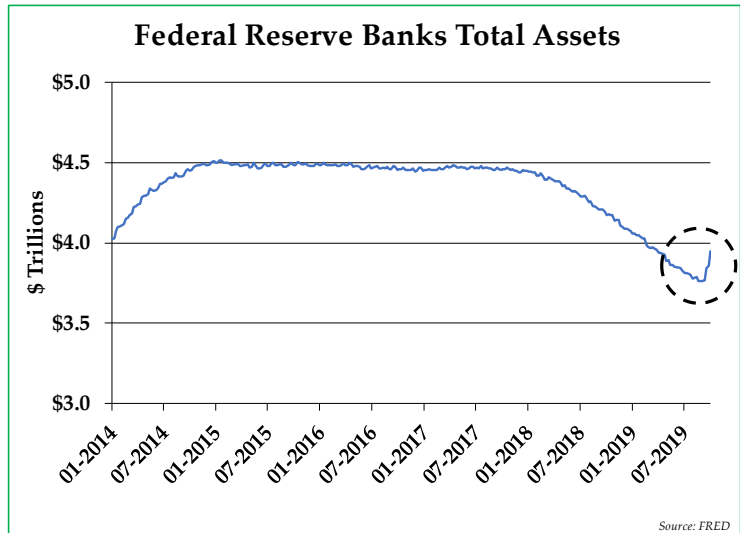


Indeed, in recent weeks, the Federal Reserve has



begun to increase the size of its balance sheet again by purchasing U.S. Treasury bills to ensure that the Federal government remains funded (see right chart). While denying any kinship to the quantitative easing measures that took place earlier this decade, the Federal Reserve has resumed these purchases while the only visible difference is that its purchases are restricted to short-term Treasuries.

We expect that the Federal Reserve will continue to “inject liquidity” and buy U.S. Treasury bonds as necessary with that liquidity, with no end in sight. Our confidence level is supported by the large supply of Treasury bonds that already has become too large for private investors to absorb and should only increase in the future.



### Investment Implications

The ongoing, centrifugal transition towards a multipolar geopolitical environment and a more populist but divided political environment should have important long-term repercussions on the economy and financial markets. For the United States, a less globalized economy and increasing fiscal deficits monetized by the Federal Reserve are likely to result in higher wages, lower corporate profit margins due to increased labor costs, accelerating cost-push inflation, reduced capital inflows, a lower exchange rate for the U.S. dollar, and a renewed policy focus on domestic manufacturing production.

Inflation’s acceleration has already begun, albeit quietly, due to a combination of increased tariffs, reduced immigration, and minimum wage increases, despite the dollar remaining strong up until this point. The consumer price index (CPI) currently stands at a ten-year high. Further acceleration of inflation, while harmful to consumers and especially so to retirees, would make it easier for the U.S. government to reduce the real debt burdens of the Federal government, U.S. corporations, and U.S. households alike.

With a weakening dollar, we would expect foreign stock markets, commodities, and gold to outperform. We have been increasingly positioned towards such investments, with a large allocation to gold, a significant commitment to companies that benefit from higher agricultural commodity prices, and an allocation to foreign equities that is greater than it has ever been for Appleseed. We expect these positions to perform if the dollar eventually weakens.

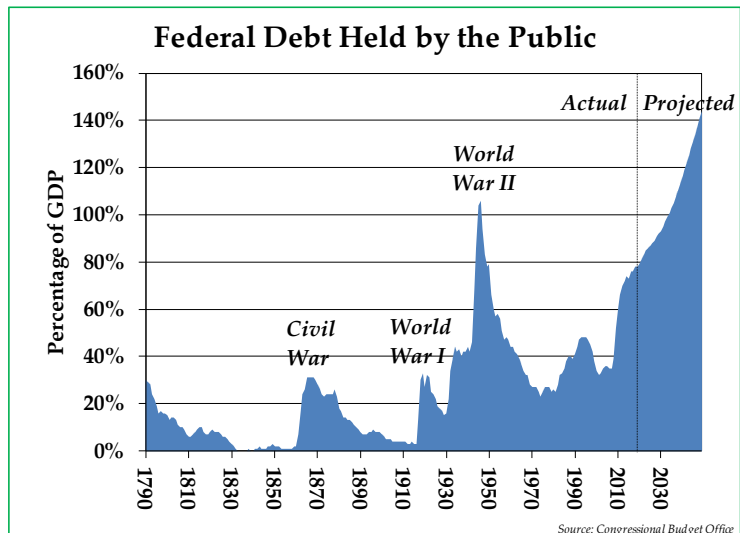
While we have gradually increased our allocation to foreign equities during recent years, we have also increased our allocation to emerging market equities. Appleseed Fund has a significant exposure to companies which operate in South Korea (**SK Telecom, Hyundai Home Shopping**), in China (**China Mobile, Sina, Weibo**), in Hong Kong (**Cosco Pacific, ASM**), and in South America (**Despegar, Embraer**). These investments are bottom-up investments in companies that are remarkably undervalued, in our estimation. The common objection with owning emerging market stocks is that emerging market stocks experience increased short-term volatility and,



depending on the industry sector, concerns about environmental, social, and governance issues, but we would suggest four responses to this objection. First, we believe the short-term cost of higher volatility is worth paying in return for the potential long-term reward of outsized returns. Second, among those U.S. stocks that demonstrate minimal volatility, there is currently little opportunity for outsized return, as an enormous amount of capital has moved into “low-volatility” ETFs in recent years, and many of the companies that are widely regarded as low-volatility stocks are grossly overvalued. Third, our allocation to emerging market stocks is still less than 30% of Appleseed’s investment portfolio. Fourth, in recent years the availability and awareness of ESG data for emerging market companies have greatly improved. This gives us confidence in our ability to evaluate the sustainability profile and ESG risks of emerging market investments. In addition, we do not own the shares of any emerging market companies in extractive industry sectors.

In contrast, we believe those U.S. companies which have benefited greatly from globalization trends, such as Apple and Boeing, will probably have a difficult time maintaining current profit margins going forward. The ongoing trade war between the United States and China compromises their end markets and their supply chains alike. In addition, stocks that are expensive and trade at elevated P/E ratios should also have a difficult time performing well, as P/E ratios tend to contract when inflation expectations increase. We are still buying selected U.S. stocks for the Appleseed portfolio, but they are generally not the stocks of large-cap U.S. companies that have benefited so much from the globalization trend of the past 30 years; we are buying shares of small-cap and mid-cap U.S. companies that already have low P/E ratios.

Despite inflation accelerating, we expect interest rates to remain low, thanks to U.S. Treasury purchases by the Federal Reserve that should cap interest rates and provide funding for increasing budget deficits. This has happened before, in the years following World War II, when the United States also had a large debt load relative to GDP (see right chart). Because inflation could very well remain at a level above that of long-term interest rates, long-term bonds remain unattractive investments.



### Performance and Portfolio Changes

Over the past twelve months, Appleseed Fund (APPIX) has generated a return of -0.28%, underperforming the MSCI World Index, which generated a total return of 1.83% over the past twelve months. Appleseed Fund continues to exceed our long-term goal of outperforming the market. Through 9/30/19, Appleseed Fund has outperformed the MSCI World Index since its inception in 2006.

Over the past year, Appleseed Fund has benefited by the strong performance of its gold trust holdings. Gold has outperformed most stock markets during the past twelve months as the interest rates of long-term bonds have declined and, in many cases, generate negative yields to maturity. The complaint that many investors have about owning gold is that, unlike many financial investments, gold does not generate any income. While certainly true,



compared to many long-term sovereign bonds which are *guaranteed to generate a negative long-term return*, gold's yield of 0% looks relatively attractive. Also, because central banks simply cannot will more gold into existence and because central banks are currently buying gold rather than U.S. Treasuries, we have strong conviction that gold's price should rise relative to most currencies including U.S. dollars.

Our stocks, on the other hand, have not fared so well this year. Investors continue to shift money into ETFs which hold low-volatility stocks, dividend stocks, high-tech growth stocks, and S&P 500 Index stocks, leading to overvaluation and, in our view, a strong likelihood of poor future returns going forward. We own mostly value stocks, during a period in which growth has outperformed value. We own an equity portfolio which is increasingly foreign with a large allocation to emerging markets, during a period in which U.S. stocks have outperformed foreign stocks and emerging market stocks have underperformed both. Within emerging markets, we have a particularly large allocation to East Asia (South Korea, China, and Hong Kong) during a period in which emerging market stocks in these countries have underperformed other emerging market countries. We also own a large allocation to small cap stocks, during a period in which small cap stocks have been out of favor.

As a result, most of the stocks we owned at the beginning of the year, already undervalued, have become even cheaper, while our opportunity set has also expanded. While current year returns have been anemic, we are finding outstanding opportunities that we believe will set up Appleseed shareholders for better returns in the future. Our allocation to equities has increased to more than 75% of the portfolio, which is the highest that it has been in a decade. This allocation has increased not because we see blue skies ahead, but because we are finding investment opportunities to buy what we believe are high quality companies at very attractive prices. We do not know how long this window of opportunity will remain open, but we are taking advantage of it while we can while also leaving some dry powder to use if the opportunity set becomes even more attractive than it is at the present time.

Within our equity portfolio, the biggest contributors to the Fund's performance over the past twelve months were **Ardelyx (ARDX)**, **Oaktree Capital (OAK)**, and **Spirit Airlines (SAVE)**. All three of these companies experienced strong returns for Appleseed shareholders during the 2019 fiscal year, and we continue to own a significant position in Ardelyx and Spirit Airlines for reasons that we will explain below.

- **Ardelyx**, a biotech company based in Fremont California, is in the process of launching a late-stage product, Tenapanor, which has demonstrated the potential to treat two separate conditions: irritable bowel syndrome with constipation (IBS-C) and hyperphosphatemia in end-stage renal disease (ESRD). We accumulated a small position in Ardelyx last fall, after which the share price declined sharply. At the end of December 2018, the company's shares were trading for less than the value of the cash on its balance sheet, despite the company's promising pipeline. We significantly added to our position as the share price declined. In 2019, the share price has subsequently more than doubled, and the FDA has approved Tenapanor for IBS-C. As the company is gearing up for a Tenapanor product launch, we believe our Ardelyx shares are tremendously undervalued.
- **Oaktree Capital** was a distressed debt manager we owned for years and was acquired by Brookfield Asset Management in 2019. While Oaktree generated a strong return for Appleseed shareholders during FY 2019, management sold the company for far less than it was worth, in our view, and we are disappointed by the long-term returns that Oaktree generated while we owned it. We blame ourselves for trusting that Howard



Marks would treat Oaktree's minority shareholders just as well as he would treat himself, which turned out not to be the case. Management received a sweetheart deal from Brookfield, at the expense of Oaktree's minority shareholders.

- **Spirit Airlines** was a fantastic stock for Appleseed Fund. We originally purchased Spirit's shares when they were depressed in 2017 and trading in the low \$30s. As the price war that was occurring at the time between Spirit and United dissipated, Spirit's operating results improved quickly along with investor sentiment. In November 2018, a little over a year after we bought our Spirit position, we liquidated Appleseed's position in the low \$50s. Since then, the company's market share has only increased, but investor sentiment took a turn for the worse again due to temporary factors, including a runway closure in Ft. Lauderdale, Spirit's most important airport, along with bad weather. We reinitiated a position in Spirit in recent weeks after the share price dipped backed down into the mid \$30s.

Within our long equity portfolio, the most significant detractors to performance over the past year have been **Mosaic (MOS)**, **Titan International (TWI)**, and **Sina Corporation (SINA)**.

- **Mosaic** is a leading fertilizer producer while **Titan International** is a leading manufacturer of tractor tires. Both companies generate revenues and earnings which go up and down with the profits of farmers and especially the profits of U.S. farmers. Unfortunately, due to a strong dollar, terrible weather during this year's planting season, and the trade war with China, it has been an awful year for U.S. farmers and for these two companies. Because Mosaic and Titan should benefit when agricultural commodity prices rise with a weakening dollar, we have maintained our positions in these companies.
- **Sina Corporation** is a technology holding company that owns a majority stake in **Weibo**, the leading social media platform in China. Unfortunately, Chinese social media companies have become increasingly out-of-favor by investors this year, and Sina shares have come under pressure as a result. We recently sold most of our position in Sina and replaced them with Weibo shares, which have performed even worse than Sina shares have this year. By switching our investment position from Sina to Weibo, we were able to realize some tax losses and own a more undervalued investment. The fundamentals of Weibo's business remain exceptionally strong, and it is currently the largest holding of Appleseed Fund.

During the most recent quarter, we liquidated the Fund's position in **Paramount Bed Holdings** after our most recent meeting with management where we concluded that investors might have to wait a generation before Paramount Bed management decides to return some of the company's excess cash to shareholders. We did not sell any other equity positions during the most recent quarter.

We also initiated new positions in Spirit Airlines, **Sony Corporation**, Weibo, and **Ryanair Holdings**. We have already discussed our purchases of Spirit Airlines and Weibo, but we will share our investment thesis for Sony and Ryanair Holdings below:

- **Sony Corporation** owns market-leading businesses in both video games and music, both of which we believe should continue to grow at a healthy rate and earn attractive returns on capital for years to come. While profits and cash flows from these businesses have increased during the past several years, Sony's share price has not



kept up with earnings growth. The Sony management team has been making astute capital allocation decisions, reducing exposure to money losing, low growth electronics businesses through a series of divestitures and restructuring measures and investing capital in the company's more profitable, faster growing businesses such as gaming and music. The company is also returning cash to shareholders through share buybacks. We initiated Appleseed's position while Sony's shares were trading at a multiple of less than nine times cash flow, which we believe is a fantastic price for such a high-quality business.

- Ryanair is Europe's largest airline and operates with a low-cost business model, much like Spirit Airlines in the United States but with far more regional market dominance. Given the company's low-cost position in the industry, Ryanair has continually taken share from the higher cost carriers throughout Europe. Despite competing in a cutthroat industry, Ryanair has earned attractive returns on capital over a long period of time, and we believe that this growth should continue, given both the scale and the remarkably low-cost position of the company. While European commercial airline traffic is expected to grow at a low single-digit rate over the intermediate period ahead, we believe Ryanair should continue to grow more quickly given its ability to capture incremental market share. After Ryanair's share price declined by more than 50% over the past 18 months due to Boeing 737 Max delays, Brexit uncertainty, and a temporary price war in Germany, we initiated Appleseed's position. At our purchase price, Ryanair was trading at less than 9x our estimate of normalized earnings.

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We know that you have many investment options, and we remain humbled and honored by your decision to invest a portion of your capital in Appleseed Fund. Because we are shareholders ourselves, we are more careful about the investments we make and more disciplined about the price we pay for those investments. We remain dedicated to investing your hard-earned capital carefully, and we remain dedicated to constantly improving upon our research efforts.

In periods of history where it sometimes feels like everything might be falling apart, such as the one we are all currently living through, trust comes at a premium. Our primary goal is to act as a trusted steward for our shareholders in managing Appleseed Fund, during good times and especially during challenging times. We thank you once again for your ongoing trust.

If you have any questions, please do not hesitate to reach out to Colin Rennich, our Director of Sales. His email address is [colin@appleseedfund.com](mailto:colin@appleseedfund.com).

Sincerely,

Billy Pekin, CFA

Adam Strauss, CFA

Josh Strauss, CFA

Shaun Roach, CFA





ANNUALIZED RETURNS- as of 9/30/2019					
	1 Year	3 Years	5 Years	10 Years	Since Inception
Investor Class (APPLX)	-0.44%	4.80%	2.88%	5.65%	5.76%
Institutional Class (APPIX)	-0.28%	4.98%	3.09%	<i>5.84%</i>	<i>5.91%</i>
MSCI World Index	1.83%	10.21%	7.18%	9.01%	5.28%

*Fund Inception Date: 12/8/2006.*

*Fund's past performance does not guarantee future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 1-800-470-1029. Italics indicates extended performance, as APPIX did not exist until 1/31/11. APPIX extended performance is an estimate based on the performance of APPLX, adjusted for the difference in fees.*

*As of 09/30/2019, the Fund's Top Ten Holdings can be found at: [www.appleseedfund.com](http://www.appleseedfund.com).*

*The gross expense ratio of the Fund's investor class is 1.55%, and the institutional class is 1.30%; the net expense ratio after contractual fee waivers through January 31, 2020 is 1.35% and 1.16%. The Fund's ninety day redemption fee is 2.00%.*

*The S&P 500 Index is a widely recognized, unmanaged group of stocks that is representative of a broad market. The index provides returns in U.S. dollars, assumes reinvestment of all distributions, and does not reflect the deduction of taxes and fees. The MSCI World Index is a widely followed, unmanaged group of stocks from 23 international markets and is not available for purchase. These indices provide total returns in U.S. dollars with net dividends reinvested. These index returns do not reflect the deduction of expenses, which have been deducted from the Fund's returns. These index returns assume reinvestment of all distributions and do not reflect the deduction of taxes and fees. Individuals cannot invest directly in these indices, however, an individual can invest in exchange traded funds or other investment vehicles that attempt to track the performance of a benchmark index. The Consumer Price Index (CPI) is an unmanaged index representing the rate of the inflation of U.S. consumer prices as determined by the U.S. Department of Labor Statistics.*

*The use of options involves substantial higher risks and may subject the Fund to higher price volatility. Investments in international markets present special risks, including currency fluctuation, the potential for diplomatic and political instability, regulatory and liquidity risks, foreign taxation, and differences in auditing or other financial standards. Risks of foreign investing are generally intensified for investments in emerging markets. Value investing involves the risk that an investment made in undervalued securities may not appreciate in value as anticipated or remain undervalued for long periods of time.*



*Small and Mid-Cap investing involve greater risk not associated with investing in more established companies, such as greater price volatility, business risk, less liquidity and increased competitive threat.*

*Diversification does not ensure a profit or guarantee against loss.*

*Investments in commodities such as gold may be affected by overall market movements, changes in interest rates, and other factors such as embargoes and international economic and political developments. Commodities are assets that have tangible properties, such as oil, metals, and agricultural products. These instruments may subject the Fund to greater volatility than investments in traditional securities.*

*The views and opinions expressed in this material are those of the authors. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate. These opinions are current as of the date of this letter but are subject to change. There is no guarantee that any forecasts or opinions in this material will be realized. Information should not be construed as investment advice nor be considered a recommendation to buy, sell or hold any particular security.*

***You should carefully consider the investment objectives, potential risks, management fees, and charges and expenses of the Fund before investing. The Fund's prospectus contains this and other information about the Fund, and should be read carefully before investing. You may obtain a current copy of the Fund's prospectus by calling 1-800-470-1029.***

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