SUNCOAST EQUITY MANAGEMENT, LLC

April 2, 2019

Dear Client:

First quarter 2019 market returns caught up with the earnings progress of last year, with the SEM portfolio up +17.5% versus +13.7% for the S&P 500. Earnings growth in the fourth quarter and for all of 2018 was stronger than expected, supporting the stock market's strength in the first quarter. Earnings growth forecasts in early 2019 are trending below long term averages due in part to the very strong growth from last year, including the benefit of corporate tax reform, and this year's trade and global economic uncertainty.

If the economy progresses unevenly or slows down, SEM can still do well relative to the overall market. The **SEM-Disciplined Investment System** (SEM-DIS) owns a small collection (20 or so) of growth businesses, rather than a market index that is exposed to the entire economy. While the global economy is no longer growing in sync, some businesses continue to do well while others may struggle. This is evident in recent comments by Darius Adamczyk, CEO of **Honeywell (HON),** and a company we have owned for nearly five years**.** He noted strength across all of HON's business platforms, including Aerospace, Building Technologies, Performance Materials and Safety/Productivity Solutions. Although the Unites States is leading the growth, China and Europe are also up.

With no portfolio changes in the first quarter, we highlight two of our holdings' recent innovations. We also build upon our "earnings growth matters most" comments from the January letter, by showing the positive impact over time of the allocation of those earnings toward one of several paths, share buy backs.

<u>Innovative Solutions as Growth Drivers</u>

We wanted to highlight two of our holdings, one a leader in products, the other a leader in services that continue to innovate and execute well further strengthening their economic moats. **Stryker (SYK)** is an industry leader and is gaining market share with its innovative new products in Orthopedics, MedSurg, and Neurtechnology/Spine. In particular, its game-changing Mako Robotic-Arm Assisted Technology is executing very well as it becomes the gold standard for partial knee, total knee and total hip procedures. Mako Technology helps surgeons personalize patients' surgeries using 3D printing of their joints to perform minimally invasive techniques. In fact new clinical data released in March shows a Mako Total Knee Arthroscopy (TKA) compared to a manual TKA reduces post-operative pain leading to less need for opiates, a 26% reduction in hospital length of stay, and less need for physical therapy. All of these factors lower the physical cost as well as the financial cost for patients and insurers. SYK has trained 1600 surgeons using Mako TKA Technology and installed more than 642 robots, 40% of which are in competitive accounts. Once SYK gets its foot in the door with Mako, it is able to cross sell many of its other products and services. As a result, SYK's organic sales growth should be up 6.5%-7.5% this year. We continue to watch for the opportunity to increase our position.

CBRE Group (CBRE) is the global leader in commercial real estate services. The company is a "one stop shop" for clients with 80,000 professionals operating in 100 countries. CBRE recently launched a flexible workspace solutions initiative, its new venture Hana which is an independent subsidiary. Hana is a partnership with landlords that allows them to offer flexible work space directly to their tenants, eliminating middlemen like WeWork. Hana executives believe the prior model for flexible workspace misaligns incentives for tenants and may make them more loyal to middlemen rather than the property owners themselves. This new partnership offers tenants the same services and allows Hana and landlords to share expenses as well as profits. For example with Hana Meet, a company can rent a conference room or event space on an hourly, daily or weekly basis. Hana plans to expand to multiple properties in 25 markets over the next 3-4 years and we will be watching closely to see how this opportunity unfolds.

Earnings Growth Matters Most – And Allocation of Earnings is Quite Important

Last quarter we discussed how long term ownership of businesses with strong earnings growth is the main driver of stock prices. This quarter we want to take a deeper dive into earnings and cash flow, and how the reinvestment of excess cash flow can further enhance stock prices. Our requirement that all the businesses we own earn more cash than they spend is at the core of our **SEM – Disciplined Investment System** (SEM-DIS). The excess cash our companies generate, over and above what they need to operate and reinvest in the business, gives them flexibility, safety and strength. But whether wealth is created by that excess cash flow depends on how it's invested next. Our first preference is for our companies to continue to grow at above average returns on capital by expanding their products or services, expanding geographically or doing opportunistic acquisitions. Beyond investing back into the business, companies may accumulate cash on the balance sheet or pay down debt, and our companies typically carry very little debt if any at all. Once all those cash flow needs are sufficiently funded, oftentimes companies will buy back their shares. So how do buybacks benefit current owners? As owners we benefit as the share count falls and therefore our stake in the profitable business increases without us taking any action at all. The way it works is imagine we had three owners in a business with equal ownership, or about 33% each. If for over a decade the company used its excess cash to buy out one of the owners, the two remaining owners would then share in 50% of the profits of the business, without reaching into their own pockets or borrowing from a bank to buy out the third owner.

Below is a list of some of our holdings and the share count reduction over a ten year period as a result of allocating cash back to us as owners.

Growth 2008 to 2018

Portfolio Holding	**Share Count Reduction**	**Net Profit**	**Net Profit Per Share**	**Stock Price**
Home Depot	-34.3%	296%	502%	646%
Visa	-34.1%	506%	819%	906%
Check Point Software	-27.6%	153%	250%	441%
Apple	-23.5%	1132%	1510%	1194%
Accenture	-12.5%	155%	192%	330%

You can see how significantly reducing shares outstanding enhances profits per share and ultimately stock prices. Without the share count reduction the increase in net profit per share would be very similar to the net profit increase. But more importantly than reducing shares, is that these companies compounded their intrinsic value by 10%+ a year due to their increasing net profits. Most pay dividends, so their total returns for the 10 year period are even higher. Now that's how an owner builds wealth!

Heading into spring with an Inverted Yield Curve

With stock prices catching up to last year's earnings growth, we will be observant of the global economy and corporate profits as we head into spring. Growth in the U.S. remains steady albeit not robust and it has clearly slowed in the Eurozone and China. As a result of slowing global growth and evidence of low inflation, Europe's Central Bank and the Federal Reserve in the U.S. have decided for now to keep short term rates at low levels. Due to these announcements and concerns, the market has driven long rates back down as the 10-year U.S Treasury yield closed at 2.41% at quarter-end, down from 3.24% reached this past November. This caused a very slight inversion (whereby long rates are lower than short rates) as compared to the six month yield of 2.44%. In Germany the yield on government debt is slightly negative, implying the investor needs to pay the government!

The positive impact of low long term rates is that it results in lower borrowing costs for businesses and consumers, and of course our Federal Government debt which needs some attention. Positive developments in the continuing trade talks between the U.S. and China and progress over the Eurozone Brexit process would be welcome in the coming quarter.

We thank you for your continued confidence over the long journey of growing and preserving your wealth, along with our own and that of our colleagues, as we invest in the same companies together!

Sincerely,

Don	Amy
Donald R. Jowdy	Amy Lord, CFA
President	Senior Vice President

Suncoast Equity Management, LLC

Performance results versus the Standard & Poor's 500 Index

Time Period	**SEM % Return***	**S&P 500 % Return**	**SEM - Value of $1,000,000**	**S&P 500 - Value of $1,000,000**
First Quarter (2019)	+17.5%	+13.7%	$ 1,175,300	$ 1,136,500
One-Year	+15.8%	+9.5%	$ 1,158,200	$ 1,095,000
Three-Year	+14.9%	+13.5%	$ 1,515,100	$ 1,462,500
Five-Years	+11.7%	+10.9%	$ 1,737,000	$ 1,678,100
Ten-Years	+15.7%	+15.9%	$ 4,296,400	$ 4,380,900
Inception (21 ¼ Years)	***+9.1%***	***+7.2%***	***$ 6,379,500***	***$ 4,361,200***

* Composite results of all SEM managed accounts, net of all fees.
Note: Performance for the three, five, ten, and since inception year periods represent the annual average rates of return

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