

# LPG Investment Management, LLC

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## 1<sup>st</sup> Quarter 2015 Update

### Fund and Market Recap

Financial market performance in Q1 2015 proved to be a struggle between challenges faced by a strong dollar and falling oil prices, versus the benefits of a decent domestic

March. Companies in that industry segment reported better than expected earnings and more progress on the consolidation front.

### Economic Performance and Outlook

international economies more exposed to exporting product to the U.S., but not enough to dramatically shift macro-economic performance expectations. This continues to be a strong domestic U.S. economy and relatively weak international economies.

### Q1 2015 Return Information

LPG Cap Part (Est. After Fees/Exp)	Russell 2000	S&P 500	LPG Cap Part Excess Return vs.	
			Russell 2000	S&P 500
9.95%	4.32%	0.44%	5.63%	9.51%

economy and slower than expected interest rate increases by the Fed. Depending on which day or week you look at, financial markets reacted with decent volatility to information flow, both negative and positive. We were able to take advantage of that volatility to build a healthy position in the broadcasting space during January, which performed quite well during February and

Health of the U.S. economy appears to have slowed a bit from the 4<sup>th</sup> quarter, with estimates pointing to just under 2% GDP growth. Slowdown in economic activity can be attributed to a number of factors including falling commodity prices and continued strength in the U.S. dollar.

On the margin, the strong dollar appears to have helped

### Market Valuation

Overall market valuations have increased marginally since year end 2014, with the Russell 2000 trading for just over 19x PE for projected YE 2015. This is not much different than the S&P 500, which is currently trading for around 17.5x PE for projected YE 2015. Looking back to 1980, the Russell 2000 forward PE is still in the 2<sup>nd</sup>

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quintile, not as blatantly overvalued as last year when it was in the 1<sup>st</sup>.

### 2015 Market Expectations

Consensus market expectations for the mid cap/small cap market segment continues to be mid to high single digit positive returns for the year. This would broadly mean returns sourced from earnings growth while market multiples remained constant. This seems reasonable given the economic backdrop and the current market valuation. That being said, there continue to be a number of risks that could lead the market to underperform these expectations, as discussed below.

### 2015 Risks and Uncertainties, Updated

During the 1<sup>st</sup> quarter, we obtained some tangible pieces of evidence pertaining to our previously discussed concerns for the market and how it would impact security prices. Issues previously discussed, particularly commodity price declines and the strong dollar were negatives for the market and led to volatility before

earnings season began. However, as Q4 2014 earnings season progressed, security price performance followed earnings results and projections. Broadly speaking, we do not expect this to change for the balance of the year.

### Commodity Collapse

Q4 earnings season gave the markets the first good look at how weaker commodity prices will impact profitability and economic activity. As expected, earnings performance and 2015 outlook were not good. Energy companies are projected to show 65% profit decline this year and material companies are expected to show 5% declines. How low prices go and how long they stay there will dictate if there is worse to come.

### Rising U.S. Interest Rates

This was the one positive surprise to the markets during the first quarter. They seemed to be convinced at the beginning of the year that June would see the first rate increase. However, the Fed

has sounded more dovish than expected, as the economy has slowed a bit from the end of 2014, pushing back rate increases. We will be watching this as the year progresses.

### Strong Dollar

Q4 earnings also showed how we can expect this to play out through the balance of the year. Large multinationals struggled with earnings, citing the strengthening of the dollar as a major factor.

### Non-U.S. Developed Market

As previously highlighted, most developed economies outside the U.S. are evaluating or implementing various tools to expand economic growth. While there has been a bit of improvement in Europe and Japan, it is not enough to expect much change in their accommodative economic policies.

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### **Fund Positioning and Outlook**

Integrating these views and risks into the portfolio, we continue to focus on companies that have strong U.S. based businesses.

Specific thoughts on our areas of focus:

### **Broadcast Television**

Our expectations outlined in last quarter's update came to fruition during Q4 earnings season. Most companies in this space experienced earnings and cash flow growth at least 2.5x the rate of the relevant indexes and the overall economy. We also saw consolidation start to pick up again, and expect this theme to continue during the course of 2015. Companies have also begun to talk about 2016 political advertising and how this is expected to break all previous records. While valuations have recovered from the lows of the fall of 2014, continued strength in operating performance and consolidation expectations have us holding our current positions.

### **Senior/Assisted Living Housing**

Q1 2015 did not see anything that changed the macro view on the industry or the micro view on our particular investments. We continue to expect this segment of the economy to consolidate and our investments in particular to benefit from the scale they are creating through this process.

### **Energy Dislocation**

Our last words here were 'I stay Tuned'. Well, as my two little girls would say 'Daddy, the water is too hot!'. For a number of reasons, after giving careful consideration to the various pros and cons, we decided patience was the best approach. While there are some interesting opportunities, large caps in this segment have not become cheap enough to become interesting. Most small cap stocks have aggressive balance sheets and look to be in a lot of trouble unless oil recovers sooner rather than later. Given the difficulty in predicting that, we have decided to continue with

our work and wait for more clarity on the situation.

### **Asset Sales from European Banks**

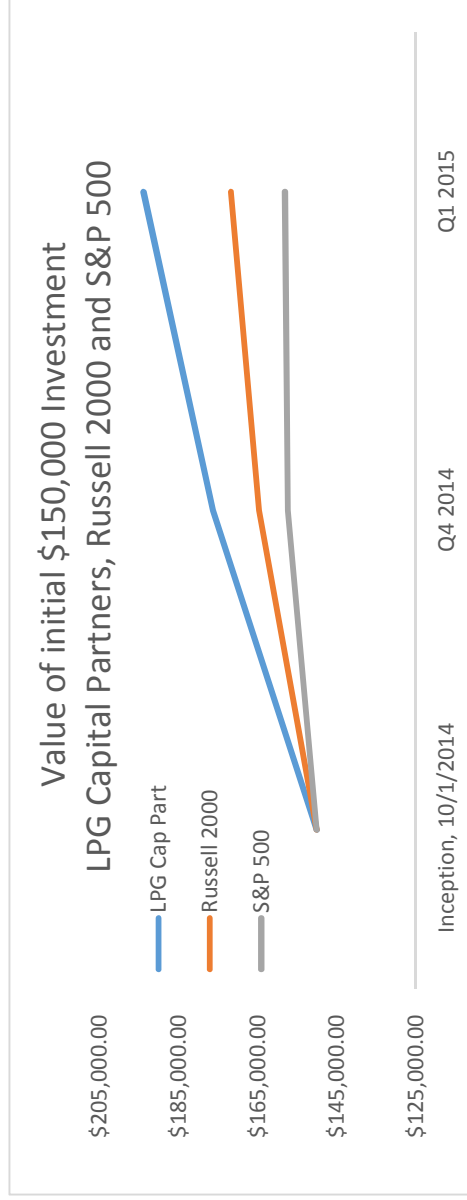
One interesting theme that continues to present itself is the deleveraging of the European Financial System. As these banks choose their path to meeting the more restrictive capital requirements, some are deciding to sell or list certain assets deemed not core to their business. We saw one particularly interesting financial institution sell a large piece of a U.S. Regional bank at a particularly attractive valuation, 30% to 50% cheap to its peers depending on the valuation metric used. Share price performance is expected to be driven by earnings improvements from cost rationalization, business expansion, interest rate (albeit modest) increases and increased shareholder friendly activity. We have built a healthy position and will add if incremental supply or market weakness presents a particularly attractive opportunity.

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	Returns	
	Q4 2014	Q1 2015
LPG Cap Part	17.52%	9.95%
Russell 2000	9.73%	4.32%
S&P 500	4.90%	0.44%
		Since Inception
		29.21%
		14.47%
		5.36%

## LPG Alpha to Indexes

Russell 2000	7.79%	5.63%	14.74%
S&P 500	12.62%	9.51%	23.85%