225 South Cabrillo Hwy
Suite 200D
Half Moon Bay, CA 94019

415.710.6310
info@lpgim.com

LPG INVESTMENT MANAGEMENT

Q1 2016 Outlook and Update

Fund and Market Recap

Q1 2016 began with more of the volatility that the markets experienced in the fall of 2015. This was caused by concerns that the global economy was imminently entering a recession. As it became clear that global economic activity was only slowing, financial markets performed much better, retracing most of the losses from January and February. Our performance benefitted from defensive positioning and purchases that we made during the depths of the market sell off in February.

Q1 2016 Return Information

Q1 2016			Full Year 2016		
LPG Cap Part*	Russell 2000	Excess Return	LPG Cap Part*	Russell 2000	Excess Return
2.91%	-1.52%	4.43%	2.91%	-1.52%	4.43%

*Certain expenses are estimated for quarterly returns, annual returns are actual

Economic Performance and Outlook

While we have not seen Q1 GDP numbers, consensus estimates point to sub 1% U.S. Q1 GDP growth and roughly 2% for all of 2016. While this continues to lead the various developed economies around the world, it is by no means robust. Any event that could cause further slowing in economic growth is expected to cause continued market volatility as we progress through 2016.

Market Valuation

As of the end of the first quarter, 2016 small cap stocks were trading roughly 7% higher than their historical average PE ratio. This is similar to valuation levels seen in the large cap market segment. While this does not say that investors should be overly concerned that the market is susceptible to a major correction (more likely when valuations are 35% above the long term average, 1 standard deviation), it does say that trading will continue to be volatile based on global events.

2016 Market Expectations

Given economic expectations for the U.S. and global economy, market expectations for high single digit returns continue to look achievable. While a few months ago, there were doubts about this, the recession that many market participants were worried about does not look to be the case in the near term. Again, because GDP growth is not expected to be a particularly robust number by historical

225 South Cabrillo Hwy
Suite 200D
Half Moon Bay, CA 94019

415.710.6310
info@lpgim.com

Q1 2016 Outlook and Update

standards, any event that brings these numbers into question is expected to cause spikes in volatility.

Macro Market Factors

Global Economic Outlook

Global economic performance on the fringe has weakened since our last update. Europe has not changed dramatically in spite of more accommodation from the ECB, and Chinaȏs 1st quarter growth was marginally weaker than expected. While U.S. GDP is expected to be roughly 2% for 2016, the first quarter is looking to be weaker than that, under 1%. As previously stated, achieving these numbers is a primary driver of market returns for the year and this will be monitored closely as we position investments in the fund.

Rising U.S. Interest Rates

While the market digested the December interest rate increase, we saw what would happen if the FED followed through on its intended four 25 Bps increases. January and February market weakness was a reflection of a lethargic U.S. economy and the likelihood that such a large increase in rates would cause a recession. Markets recovered once the Fed lowered their interest rate increase expectations for the year. It is interesting that the market thinks there will only be one rate increase during 2016. Current economic performance would seem to align with this school of thought.

Strong Dollar

We have seen a reversal of the strong dollar theme as U.S. interest rate policy has become more in line with the rest of the world. This has begun a reversal in a number of the market dynamics in place as of our last update, including:

- Weak commodity prices
- Pressure on non-dollar earnings going forward
- Pressure on emerging markets with commodity focused economies and excessive dollar denominated debt

While these factors have improved somewhat, they have not changed enough to dramatically alter the outlook for entities that are overly exposed to these factors. As they have historically been a cause of market volatility, we will continue to monitor these risks and potential impact on our investments.

Fund Positioning and Outlook

During the first quarter of 2016, we took advantage of some of the very attractive valuations to build positions in the energy and the specialized materials mining spaces. We also exited our tanker position due to poor financial results.

Senior/Assisted Living Housing

Our performance finally benefitted from our investment in this defensive industry. As the market came to terms with a much lower interest rate trajectory, equity prices of companies in this space benefitted. In addition, the growth characteristics of this industry segment are starting to be appreciated given the lower overall economic growth environment.

225 South Cabrillo Hwy
Suite 200D
Half Moon Bay, CA 94019

415.710.6310
info@lpgim.com

INVESTMENT
MANAGEMENT

Q1 2016 Outlook and Update

Our specific investment has also begun to benefit as some of the technical factors it experienced last year are no longer present. They settled with the activist shareholder, giving the group a seat on the board of directors. Selling pressure from hedge funds has gone away (several of the sellers were going out of business last year). We will be looking at first quarter financial performance in a few weeks as a primary driver of our investment.

Energy

Oil price volatility continued in the quarter and we were able to take advantage of some very attractive opportunities that resulted. While we still expect a significant amount of bankruptcies in this industry during 2016, we found companies that are cash flow neutral at current prices with very strong liquidity profiles. We have been watching security prices in these companies and finally had some very attractive entry points during the quarter. Specifically, we purchased the bonds of a company very well positioned to weather the storm and profit as oil prices recover. This investment may not sound too interesting, but return expectations are in excess of 30%, with dramatically less volatility than the overall equity market.

As previously stated, we excited our investment in the tanker space when the company reported weaker than expected fourth quarter numbers.

Specialized Materials

We also took advantage of volatility in this space to build a position in a company that is expected to show dramatic growth in financial performance over the course of the year. Operations have begun at their joint venture with DeBeers and all indicators are that it will be a very lucrative business. Industry fundamentals have improved dramatically as market leaders have held up new supply to get the supply/demand dynamics more in line. Valuation work on this investment suggest 2-3x upside as operations reach full capacity.