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Q2 2016 Outlook and Update

Q2 2016 Return Information

Q2 2016			Full Year 2016		
LPG Cap Part*	Russell 2000	Excess Return	LPG Cap Part*	Russell 2000	Excess Return
5.37%	3.79%	1.58%	8.44%	2.22%	6.22%

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

Fund and Market Recap

Is anyone else getting tired of this? Q2 2016 saw a continuation of the market theme that has been playing out over the last several years. In short, steady sailing interrupted by a macro environment scare that causes a dramatic spike in volatility and market decline. Shortly after, the market decides that all is well and losses are retraced. This time the cause was the British decision to exit the European Economic Union and some weakness from the U.S. employment picture. Our decision to position the fund defensively last year and stick with those investments through market volatility has been rewarded. Recently we sold our biggest position in the senior housing segment because of reduced financial performance expectations. We have used recent volatility to reinvest the majority of the proceeds and continue to look for additional opportunities.

Economic Performance and Outlook

Economic performance has been weakening during the first half of 2016 relative to expectations at the end of 2015. This has shown up in below consensus Q1 GDP growth of 1.1% and a number of weak employment reports. While the market consensus is that this will again be transitory, with the U.S. economy improving in the second half of the year, economic performance combined with the recent macro events has pushed back expectations for the timing of interest rate increases.

Market Valuation

As of the end of the second quarter, 2016 small cap stocks were trading just over 8% higher than their historical average PE ratio, roughly comparable to the large cap market segment. Again, while this does not say that the market is susceptible to a major correction (more likely when valuations are 35%

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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 the U.S. and global economic outlook, market performance expectations of high single digit returns continue to look achievable. While the recent Brexit vote has the market concerned, this will take time to show up in economic performance. Again, because GDP growth is not expected to be a particularly robust number by historical standards, any event that brings these numbers into question is expected to cause spikes in volatility.

Global Economic Outlook

Global economic performance continues to underachieve relative to market expectations at the beginning of 2016. Europe has not changed dramatically, but the Brexit vote points to downside in the near term due to the uncertainty it has created. U.S. economic performance has been weak, but expectations are that this will not continue past the summer and into the fall.

Rising U.S. Interest Rates

Lethargic economic growth and global uncertainty has clouded the interest rate picture dramatically. Previous expectations of two 25 basis point increases during 2016 looks very unlikely, with one 25 basis point increase right now looking less likely than a flip of the coin. This is a very fluid part of the broader market thesis, and is sure to change over the next few months.

Strong Dollar

Recent global and economic events have led to a return of strength in the dollar, although there is a long way to go before we revisit the levels of late 2015. While this has put marginal pressure on commodities and may cause a slight drop in U.S. economic activity, nothing dramatic is expected from the changes to date. Further strengthening from here would be of concern.

Fund Positioning and Outlook

During the second quarter, the primary change to the portfolio was exiting our position in the Senior Housing space. While macro trends still favor the industry, competitive dynamics have been more pronounced than expected, making it very challenging for companies to generate top line growth. Without this, we have decided to exit this position and wait for valuations to get more appealing in the space. In the near term, we expect to look for opportunities in attractive industries to re-invest the proceeds.

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Energy

Oil price volatility seems to have calmed down from the first quarter. Our bond investment has performed quite well, with the recent benefit of a fall in interest rates providing an additional kick to returns. We continue to research companies and monitor valuations in this space. There are a number of additional distressed debt and equity opportunities that have the potential to be very interesting if the markets sell off again.

Specialized Materials

We rounded out this position in order to have a healthy exposure to the company as production ramps and cash distributions begin. Again, this company is expected to show dramatic growth in financial performance over the course of the year. Industry fundamentals have stabilized and operations have begun at their joint venture with DeBeers and all indicators are that it will be a very lucrative business. Valuation work on this investment suggest 2-3x upside as operations reach full capacity.

Financials

We have spoken to this sector in the past and recently valuations have become very attractive with concerns about the Brexit vote and the decline in interest rate expectations. We have focused on the regional banks that have fewer regulatory hurdles, consolidation upside and organic growth opportunities. We will be looking for well capitalized entities that are in a positon to grow their cash distributions. We recently added a company that was divested by a European bank and traded at an extremely attractive valuation. We will look for additional ideas to add exposure as warranted.

Broadcasting

This sector has taken a few black eyes from the market over the last 6 months as concerns over falling pay tv subscriptions has seen subscriber counts drop at certain large cap media companies. Due to less competitive dynamics and local news content, this concern is expected to be much less of a threat to small/mid cap broadcast companies. We expect to be a bit patient with this space because near term news flows out of the largest media companies are not expected to be positive going through Q2 earnings season. We are expecting a healthy ad environment during the upcoming presidential election season and excitement about the wireless spectrum auction in 2016 to provide momentum to some of these companies.