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LPG INVESTMENT MANAGEMENT

Q3 2016 Outlook and Update

Fund and Market Recap

Q3 2016 was one of the more sedate endings to the summer markets we have experienced in a while. What began with a bang around the Brexit vote ended in a steady grind higher as the world markets concluded that this will mostly be a U.K./European concentrated issue. Market strength has been primarily driven by the U.S. economy regaining its footing.

Fund performance continued to be good as our value purchases during pockets of volatility recover to more reasonable trading levels. Specifically, our regional bank purchase during the Brexit volatility has been a good addition to the portfolio and our energy purchase during the first quarter of the year has performed very well.

Economic Performance and Outlook

The U.S. economy seemed to regain its footing during the summer, with second quarter GDP growth coming in at 1.4% (revised up from 1.1%). This is an improvement from the revised Q1 GDP number of .8%. Market expectations continue to be centered on GDP growth numbers roughly around 2% for the year, which implies continued improvement in Q3 and Q4. As this seems reasonable given the statistics that are coming out, there is no major reason to position the fund for a different scenario.

Market Valuation

Market valuations are a bit higher than they were at the end of the 2nd quarter, with the Russell 2000 trading at a 20% premium to its trailing 12 month PE ratio. However, its valuation becomes more reasonable when looking at the 12 month forward PE, only trading at a 13% premium. Given current interest rate levels, market valuation levels do not look concerning. As previously stated, this says there is a relatively low probability of a major market correction (more likely when valuations are 1 standard deviation above the long-term average, 1 standard deviation

Q3 2016 Return Information

Q3 2016			Full Year 2016		
LPG Cap Part*	Russell 2000	Excess Return	LPG Cap Part*	Russell 2000	Excess Return
5.05%	7.91%	-2.86%	13.49%	10.13%	3.36%

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

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being 35%), it does say that trading will continue to be volatile based on global economic events.

12 Month Forward Market Expectations

Given the U.S. and global economic outlook, market performance expectations of high single digit returns over the next 12 months continue to look like the most likely outcome. As we have seen, any event that brings current economic growth expectations into question will lead to volatility. We look for these pockets of volatility to create attractive value opportunities for us to invest in.

Global Economic Outlook

There is a developing school of thought that current economic performance is going to be the most likely path forward for the foreseeable future. This means in the United States we should look for 1.5% to 2% annual growth, not much growth in Europe overall and 3x that in China. These are the goal posts that we will be using to decide if a company is experiencing healthy growth or not. This also appears to be the number that will need to be exceeded for the Federal Reserve to be more aggressive with their interest rate policy.

Rising U.S. Interest Rates

Market expectations continue to do a better job of predicting future interest rate levels than Federal Reserve projections. Over the course of the year, we have seen market expectations drift to one 25 Basis Point increase in rates during 2016 and 2017 and a much lower long term equilibrium rate. This coincides with the new probable economic performance previously discussed. As this seems reasonable, we will be looking for deviations from this path as drivers of overall market and interest rate performance.

Strong Dollar

As the U.S. dollar has found its new level of equilibrium relative to various international currencies under this new economic environment, I expect this aspect to be less of an issue going forward. Since trading levels have been relatively consistent over the last 18 months or so, unless there is a dramatic change in the future, this subject will most likely be dropped from the discussions in this news letter.

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Fund Positioning and Outlook

During the third quarter, we implemented a number changes to the portfolio as situations became attractive and current investments achieved their return target. At the beginning of the quarter we made a significant purchase in the regional bank sector when it experienced a dramatic selloff due to concerns over the ramifications of the Brexit vote. We also revisited the broadcast television space as it sold off over concerns about lower election cycle advertising spend. As our energy investment achieved its price objective, we sold that position and at the end of the quarter we made a significant investment in a European bank that was unduly punished from concerns about a possible capital raise.

All this comes together as we continue to expect pockets of volatility to create opportunities for attractive investments and we expect to perform well as long as the global economy cooperates.

Energy

Oil prices appear to have put the lows of the first quarter permanently behind them. Expectations for an OPEC production agreement has gotten WTI above $50 again. Our investment in distressed energy bonds earlier this year performed well and we recently exited this position with very attractive returns.

Specialized Materials

We continue to selectively add to this position if trading levels warrant, with the expectation of very attractive returns as operations are fully launched in Q1 of 2017. Diamond sales have begun with good results and the diamond industry in general continues to improve. Valuation work on the company continues to suggest 2x-3x returns from current levels as cash flows accelerate and distributions to shareholders begin.

Financials

We have spoken to this sector in the past and recently valuations have become very attractive. Previously we focused on the regional banks (see previous notes), but recently expanded our target universe to European banks as they have become particularly attractive on a valuation basis. We will be looking for well capitalized entities with strong asset bases that can be liquidated in the event additional capital is needed. Most of these banks have extensive capital structures that we will evaluate to find the most attractive investment opportunity (equity, preferred stock, junior bonds or senior bonds)

Broadcasting

As discussed last quarter, this sector has seen stocks fall as lower political spending this cycle has led to lower near term cash flow expectations. This has led to very attractive valuations as the underlying business continues to perform well relative to overall economic growth (2x GDP growth rates for revenues and 4x for cash flows). In addition, consolidation should pick up post spectrum auction, leading to much higher equity prices.