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INVESTMENT
MANAGEMENT

Q4 2016 Update and 2017 Outlook

Fund and Market Recap

Q4 2016 is a difficult one to put into words. Election results obviously drove the markets, with the Republican sweep of the white house and congress dramatically changing the expected direction of the global economy. This was quickly reflected in various financial markets in the six or so weeks following the election. With the majority of the new branches of government taking almost the exact opposite view on issues such as regulation, taxes and economic stimulus, investment themes that dominated in October were turned on their head.

Q4 2016 Return Information

Q4 2016			Full Year 2016		
LPG Cap Part*	Russell 2000	Excess Return	LPG Cap Part*	Russell 2000	Excess Return
11.01%	8.81%	2.20%	26.03%	21.31%	4.72%

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

Our investments benefitted almost across the board from this switch. Most had attractive valuations that were in some way related to regulatory challenges that were in place. With anticipated changes in this area, they performed very well post-election.

Specifically, we generated an 11% return for the quarter and 26% for the year. This outperformed our benchmark 220 basis points for Q4 and 472 basis points for the full year.

Economic Performance and Outlook

Anecdotal evidence during the quarter says that there was tremendous uncertainty in general leading up to the election. Many companies, big and small, talked about putting hiring and spending plans on hold until they had a better understanding of the election results and what this would mean to the broader economic environment. As we can all see from market activity, there now is a tremendous amount of confidence in the economic outlook for the next 12 to 24 months. A recent measure of small business confidence levels show it at the highest

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level since December 2004. Recent projections from Wall Street economists are saying that if the Republicans are successful implementing their various policy proposals, economic growth could double from current levels by as early as 2018.

We will be watching developments that indicate the degree to which the new government will be able to implement its objectives.

Market Valuation

Market valuations are all higher from our Q3 update. Russell 2000 forward PE is trading at a 25% premium to the historical median. Valuations relative to large cap indexes tell us that the forward PE ratio for large caps compared to small caps is right about at the historical median, implying there is no real valuation difference between the two equity market segments. Iôm sure it will not come as a surprise to most readers that the markets have priced in a decent amount of economic/earnings growth from the new government, and we will be closely watching how this plays out. Any changes to plans, both positive or negative will move the markets and we will be watching in order to take advantage. We expect volatility to be higher in the short term as we are at a maximum point in uncertainty with respect to the impact of the new government policies.

12 Month Forward Market Expectations

Current market valuations say it is going to be hard to have another double-digit return year. However, if the new government successfully implements the proposed policy changes, it is not unreasonable to expect healthy single digit market returns. As mentioned, we do expect more volatility in the short term until uncertainty surrounding policy implementation is reduced.

Global Economic Outlook

So much for the developing school of thought that 1.5% was roughly the new normal for U.S. economic growth. As discussed, we could see this double in the near future. We have also begun to see renewed strength in economic growth in China and very early signs of growth in Europe. If these changes materialize with any amount of durability, we could see continued upside surprises in equity market performance.

Rising U.S. Interest Rates

Because of the election and the expected increase in U.S. economic growth, we have seen an increase in the future expectations for interest rates. While there is some debate on the number of increases and the timing, there is consensus that future rates will now be higher than the markets thought they would in October. Interest rates, while still very important, are no longer the primary driver of financial market performance. As the new political landscape in the United States looks to use other tools at their disposal to accelerate economic growth, increases in interest rates should have less of a governing impact on the economy. We will be watching to make sure the actual implementation of these expansionary policies occurs and will outweigh any negative higher interest rates would have on the broader economy.

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Fund Positioning

During the 4th quarter, when the market sold off before the election, we built out positions that we discussed in previous updates. Specifically, we dramatically increased our exposure to the European financial institution, continued to build our exposure to the broadcasting sector and increased our exposure in the specialized materials segment. After the election, we fine-tuned our investment in the European financial institution as the equity performed very well (we sold) but the preferred stock lagged (bought more). We continue to own our position in broadcasting and specialized materials as they have very attractive valuations and many catalysts during 2017 that should help realize their valuation discounts.

Investment Updates

Specialized Materials

This position has been built up to be a one of our bigger investments. We are excited about the prospects for the stock over the coming several quarters. Full commercial production at their diamond mine is expected to commence any day. Diamond auctions are set to begin at the end of the month and take place every four to six weeks thereafter. Diamond pricing has continued to strengthen during the 4th quarter and diamond quality from the companyȏs mines has outperformed expectations thus far. There has been no change to our valuation work, which continues to suggest 2x-3x returns from current levels.

Financials

This was our best performing sector during 2016. Our approach of having a list of attractive companies to invest in if valuations reached the right point worked out well. Investments made during the summer when Brexit fears peaked performed very well during the following six months. Our European investment also performed well once cooler heads prevailed over media reports that sensationalized legal risks faced by the company.

Broadly speaking, this is an industry that is poised to benefit from the new political environment of less regulation and more pro-growth economic policies. All this should lead to an acceleration of earnings growth and shareholder friendly actions. We have somewhat reduced our exposure as our positions performed well, but it is a very big industry exposure for the fund. Any hint of challenges in achieving policy goals by the new government would cause us to revisit this exposure.

Broadcasting

We built a very substantial position in our favorite company in this industry when valuations were most attractive before the elections. Looking forward, broadcasters should be a major beneficiary of the election results. Consolidation should accelerate because of a friendlier regulatory environment. Financial performance should accelerate as economic performance improves. Failure of these two changes to materialize would lead us to re-evaluate this investment.

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2017 Outlook

While current valuation levels leave the market exposed to heightened volatility; there are a number of factors that point to strength in the economy and corporate financial performance and we will look for interesting opportunities to add to positions in our portfolio over the course of the year.