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LPG INVESTMENT MANAGEMENT

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Q3 2019 Update

Fund and Market Recap

Q3 2019 saw financial markets experience plenty of volatility, with multiple swings in the equity markets of over 5%, both positive and negative. On good days, the markets were happy that while the economy was slowing, it was still showing healthy growth. Markets also like that the fed is once again lowering interest rates to support economic growth. On bad days, the markets worried that the continued trade battle with China and other countries will lead to a recession. By the end of the quarter, there were more bad days than good, with the Russell 2000 falling just under 2 ¾%, the hedge fund index doing a bit better and our fund doing a bit worse.

One market segment that was hit particularly hard was consumer cyclicals, with views that these companies would perform badly in a contracting economic environment.

During the quarter, our energy positions struggled due to demand concerns driven by the slowing economy and continued oversupply of the markets. This was particularly concerning to us given the dramatic supply disruption event that took place in Saudi Arabia. We will discuss this later in the recap, but this caused us to change our thesis on most of our energy related investments. We also took advantage of the weakness and revisited the broadcast television companies and also found a very interesting opportunity in the outdoor leisure/recreation industry.

Economic Performance and Outlook

Economic performance for 2019 looks to be coming in around the 2% level. As the we move to 2020, the economy appears to have a very solid foundation for this to continue. Unemployment is at record lows, corporate profitability continues to be very strong and the Federal Reserve has shown that it is focused on policy that will help the record expansion continue.

However, the trade war that is making it harder for companies to develop long term expansion plans and the presidential election will certainly increase uncertainty in the short term.

Combining these positives and negatives get most economists to predict a continued slow growth of around 2%, down from 2018 but not enough to push the United States into a recession.

Q3 2019 Return Information

Q3 2019			Full Year 2019		
LPG Cap Part (1)	HF Comp Ind (2)	Russell 2000	LPG Cap Part (1)	HF Comp Ind (2)	Russell 2000
-3.79%	-1.47%	-2.72%	7.46%	8.00%	14.18%

(1) Certain expenses are estimated for quarterly returns; annual returns are actual
(2) Hedge Fund Composite Index the hedge fund index ticker HFREIHI as reported by Bloomberg

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2019 Market Expectations

As we move into the last quarter of the year, market forecasters don't seem to be looking for dramatic moves in either direction. Returns have been good so far for 2019, seeming to limit upside in the near term. It would take some meaningful resolution to trade issues to move things to the upside or some dramatic economic weakness to move things to the downside. More important at this point is how corporate and economic data come together for the 2020 economy and corporate earnings.

Market Valuation

Market valuations ended the third quarter not much different than the second. Combine the market selling off a bit with a small amount of corporate earnings contractions leaves valuation multiples about 5% above their 40-year average for various broad market indexes. It would take a dramatic move higher before the markets would look extremely overvalued. However, these levels do leave the market susceptible to spikes in volatility and corrections. As previously stated, as long as there is no recession, any selloff would be short lived.

Fund Positioning

During the 3rd quarter, we significantly increased our exposure to the market during the selloff. Our thesis being that cyclical sectors have been excessively punished because the U.S. economy does not look to be entering a recession in the near term. We specifically added to the outdoor leisure and broadcast television industries. We also liquidated most of our energy positions. Specific reasoning for these changes is discussed below.

Investment Updates

Pipelines

We sold the majority of our position in this sector because most companies have been slow to address governance issues and capital allocation priorities continue to be at the expense of equity investors. Business fundamentals continue to be good, but these issues need to be addressed before pipeline equities can dramatically outperform the market. We will maintain investments in those companies that have properly addressed these concerns.

Exploration and Production

We also liquidated this investment due to concerns about oil prices and their inability to sustain levels that imply healthy profitability for most companies in this industry. After the major supply disruption in Saudi Arabia and other oversupply concerns, there appears to be little that can happen to maintain significantly higher commodity prices.

Telecommunications Providers

We continue to hold onto this position as the company remains particularly attractive on a valuation basis. Sprint/T-Mobile merger is now being reviewed by certain states and resolution there looks to be an early 1st quarter event. No matter the resolution, our thesis remains. We expect our investment to find a way to realize the dramatic value the company has in wireless spectrum.

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Broadcasting

This is an industry that should look familiar to readers. It got hit particularly hard when the markets sold off in the 3rd quarter, but the business fundamentals remain solid. 2020 has a presidential election and summer Olympics, which implies very strong advertising demand. Core business continues to be stable and balance sheet levels are good relative to history as companies have paid down debt from various acquisitions. We expect all this to lead to strong cash flow dynamics and shareholder friendly actions with some of that free cash flow.

Outdoor Leisure

Boating equities got taken to the proverbial "woodshed" during the quarter. As concerns about a recession heightened, these stocks sold off in dramatic fashion, many trading 70% below their 52 week high. These companies are extremely profitable in most economic environments. They have profit margins that are in the top quartile of the S&P 500. Boat manufacturers have highly variable cost structures that allow them to quickly respond to changing consumer demands. Valuations were implying sales at 2014 levels. Given that economic factors and sales trends implied nothing close to this type of performance, we built a meaningful position during the quarter.

Outlook

Market volatility is not surprising given the stage of the economic cycle and equity market valuations. We continue to maintain focus on the job market as the primary indicator for economic health. As long as this remains in decent shape, economic growth should continue. This should lead to healthy equity market returns looking forward.