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Q3 2020 Update

Fund and Market Recap

Markets in the third quarter of 2020 continued to recover from the economic damage that the Covid lockdowns inflicted during the first half of the year. Although not as strong as the second quarter, returns continued to be robust. However, at the end of the quarter the markets gave back some gains as it became apparent it is going to take some time for the Covid situation to be fully taken care of. One of the leading health experts looks to have described the situation best with the analogy "We're about in the 7th inning. We should see several vaccines by the end of the year, and they should be broadly available in the United States by April/May of 2021."

Our fund is positioned to benefit from the economic recovery that should take place as we progress through the final phases of the Covid pandemic. Our biggest exposures are to the energy, media, telecommunications and chemicals industries. These are segments that have performed reasonably well during the initial phases of the economic recovery and are expected to only do better going forward.

Specifically, our energy investments have made it through the oil crash in the first half of the year and are rightsizing their business operations for the current oil price environment. Our chemicals business has seen demand growth from the lows it experienced in Q2 and our media/telecom companies have benefitted from stay at home viewing and election advertising.

Q3 2020 Return Information

Q3 2020			Full Year 2020		
LPG Cap Part (1)	HF Comp Ind (2)	Russell 2000	LPG Cap Part (1)	HF Comp Ind (2)	Russell 2000
26.86%	5.39%	3.34%	56.20%	0.15%	-9.64%

(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

Economic Performance and Outlook

If we are in the 7th inning of the pandemic, the economic recovery looks to be a few innings behind. Once a vaccine is broadly available, we should see the next leg of the recovery. This is expected to be broader based and sustainable.

A large added risk is the current election. Markets seem to be pricing in a democratic sweep of all three branches of government. This looks to be a good outcome for the economy because expectations are that increased spending will more than offset the tax increases that have been talked about.

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Market Expectations

Equity market performance has been divided into the haves and have nots. Market leaders such as technology have done very well, with the Nasdaq up 25% YTD. Other segments, like value and small caps have lagged dramatically, with the Russel 2000 Value index returning (30%) compared to the S&P 500 return of 5.6%. As we go through the final innings of the Covid pandemic, this dynamic should reverse, resulting in healthy double digit returns overall.

Fund Positioning

We are positioned to benefit from the economic recovery that should follow as the United States gets through the final innings of the Covid pandemic. We continue to see very attractive opportunities in the energy, chemicals and media/telecommunications industries. Investments continue to be focused on segments of the economy that have seen a partial recovery. We are also looking at segments of the economy that require a more complete solution to the pandemic given the expectation for a vaccine to be broadly available in the next 6 months..

Investment Updates

Distressed Energy

With oil stabilizing around $40/bbl, both of our investments have exited the distressed market segment. One has completed the bankruptcy process and we received equity for our bonds. This investment has performed well but remains very attractive relative to other comparable opportunities. As oil demand continues to recover with economic activity, we expect this investment to generate very strong financial performance. We have also seen consolidation accelerate between companies in various shale regions. These two factors combined lead to expectations for dramatic outperformance of this investment.

We also continue to hold our second investment in the bonds of the largest operator in the Permian basin. In addition to benefiting from the recovery in the price of oil, they have sold non-core assets to reduce debt. With more asset sales expected as the economy recovers and good financial performance, an improving credit profile is expected to drive strong performance here as well.

Media

Media companies have seen a decent recovery in traditional advertising channels along with very strong political advertising. Streaming businesses continue to be a highlight. Again, as we work through the last innings of Covid and the economic recovery gains ground, we expect improving financial performance in our investments. This should drive strong investment performance over the next 12 months.

Chemicals

Another very attractive investment is in the specialty chemicals space. They sell inputs into the refining, packaging, pharmaceuticals and lubricants end markets. Throughout the pandemic induced recession, they have generated very strong free cash flow and paid dividends. We expect them to return to growth next year and see dramatic upside from the current stock price.

Outlook

If expectations for a successful vaccine are accurate, a dramatic improvement in economic performance should follow. With the election looking to be a positive for the markets as well, solid double digit returns over the next twelve months should be achievable.