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LPG INVESTMENT MANAGEMENT

# Q1 2023 Update

**Fund and Market Recap**

First quarter 2023 started off with a reversal of many of the themes of 2022. Most investments that performed well in 2022 did poorly, and the majority of assets that had a rough 2022 started well. However, as we got to the end of February, this began to break down as concerns about inflation and rising interest rates led investors to reduce risk across most asset classes. When the regional banking issues came to the fore in March, investors motivation to reduce risk accelerated dramatically. Other than the top technology names, there were very few places to hide as selling accelerated through the month.

At its peak, the Russell 2000 Index was up 13.7%, but it finished the quarter up just under 3%. This was driven by a small number of companies considered high quality growth. The Russell 2000 Value Index was off .7%.

We trailed the markets and the hedge fund index because of our exposure to the energy industry. Oil was particularly volatile during the quarter. While we have recovered the bulk of this loss during April, we expect markets to continue to be volatile until questions around inflation, banking and recession become clearer.

We continue to monitor employment numbers as a key indicator for the probability of avoiding a recession. We also know that any recession will not mirror what took place in 2008/9. We continue to view a soft landing/mild recession as the most likely outcome.

**Q1 2023 Return Information**

| Q1 2023 | | | Full Year 2023 | | |
|---|---|---|---|---|---|
| LPG Cap Part (1) | HF Comp Ind (2) | Russell 2000 | LPG Cap Part (1) | HF Comp Ind (2) | Russell 2000 |
| -7.27% | 2.99% | 2.72% | -7.27% | 2.99% | 2.72% |

(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**

Inflation and the interest rate necessary to reduce it continues to be the top concern for the economy. In addition, we now have the banking system problems to factor in. Understanding the impact both will have on the trajectory of the markets is difficult for the best strategists to understand. What we do know is that inflation needs to be closer to 2% before the Fed will stop raising rates. When we get closer to that milestone, volatility should calm down.

**Regional Banking Problems**

Crises is an overstatement of the situation. Several large regional banks got into trouble by borrowing short term and lending at much longer maturity dates. As interest rates increased last year, those loans fell in value. When depositors got scared and left, banks were forced to sell securities to fund withdrawals and realize losses. At this point, they didn't have enough capital to operate and were shut down by regulators.

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While this will invariably have an impact on the economy through reduced lending, the impact of this will be nothing close to the global financial crises in 2008/9. Economists have said this could reduce GDP by .5% to 1%, nothing close to what happened previously. Expectations are that this will help the FED achieve its goal of slowing down the economy and getting inflation under control.

**Market Expectations**

Markets have mostly returned to the lows that were tested during 2023. The only exception from this is the NASDAQ, which is more than 25% off the highs set late in 2021. Given our expected economic performance, we view current trading levels as attractive. However, the economic uncertainty discussed should lead to heightened volatility during the year. Adding up all this, we expect low to mid-single digit returns for the various equity indexes.

**Fund Positioning**

We continue to be overweight in the energy space. Our investments are focused on companies with very strong balance sheets and cash flow dynamics. In addition, we have a decent cash position to add exposure when volatility presents opportunities. Our work is focused on companies and industries that have dramatically increased their debt during the financial crises. As those liabilities reset to higher interest rates, we expect markets to fully reflect the challenges those companies face.

**Investment Updates**

**Energy**

Our investments in this space have not changed in theme. We look for companies with very strong balance sheets, financial profiles and operations in regions of the country where they can generate strong cash flow at sub $60 oil prices. Coming off a year of record cash flow, we see very interesting opportunities for companies in this industry to create value through consolidation and shareholder friendly activities. Furthermore, OPEC+ has shown that it will work to keep oil prices at reasonable levels. We feel this bodes well for the performance of securities in this sector as the year progresses.

**Telecom/Media/Communications**

We continue to look at opportunities in this sector. Again, focus on cash flow and balance sheet dynamics are providing more questions than answers at present. Companies are struggling to find a good path to fix this problem.

**Airlines**

Demand continues to be strong in this space, but most companies have significant debt issues to deal with. We are looking for those that have manageable debt loads and a path to attractive financial performance in the near term.

**Outdoor Recreation**

In spite of some acquisition activity in this space, we continue to see opportunities. Again, our primary issue is lack of company motivation to address balance sheet issues.

**Leveraged Equities**

We have found a plethora of opportunities in this space, but plan on taking our time. Most companies have very strong liquidity and limited near-term maturity issues. Catalysts for equity and debt performance are too far out to pique our interest. At this point we are putting together a shopping list of interesting opportunities.

**Outlook**

2023 has proven to be an interesting year right out of the gates. We do not view the regional banking situation as a major threat to the economy, but expect it to provide more market volatility. Given where valuations started the year, we are expecting solid returns from the market over the course of the year.