October 10, 2019

Quarterly Report - Kalo Capital Management, LP

Recent Performance

Net Performance	Q1 2019	Q2 2019	Jul 2019	Aug 2019	Sep 2019	Q3 2019	YTD 2019	Since Sep 30, 2018	Trailing 2 Year (Oct'17-Sep'19)
Kalo Capital Mangement, LP	**14.0%**	**1.9%**	**1.6%**	**1.1%**	**(2.7%)**	**(0.1%)**	**16.0%**	**0.2%**	**27.5%**
Russell 2000 (IWM)	14.6%	1.9%	0.7%	(4.9%)	2.0%	(2.3%)	14.1%	(9.0%)	4.8%
S&P 500 (SPY)	13.5%	4.2%	1.5%	(1.7%)	1.9%	1.8%	20.4%	4.1%	22.7%
Small Cap Momentum ETF (DWAS)	16.1%	6.9%	1.8%	(2.9%)	(6.2%)	(7.3%)	15.1%	(13.0%)	5.8%
Gross Alpha Performance	13.6%	3.1%	2.0%	2.8%	(3.5%)	1.2%	18.5%	8.9%	38.7%
Gross Beta Performance	4.0%	(0.5%)	0.1%	(1.3%)	0.4%	(0.9%)	2.6%	(5.8%)	1.0%

In the third quarter, Kalo lost 0.1% net versus a loss of 2.3% for the Russell 2000. The stock market continued to show significant volatility with large monthly swings. The Russell 2000 lost 7.9% in May, rose 7% in June, was flattish in July, fell 5% in August and was up 2% in September.

The current market environment is similar to last quarter, uncertain and volatile. The political arena continues to deteriorate and divide with nastiness in both parties and we do not expect any improvement heading into the 2020 election. The China trade war tensions continue with constant tweets and rumors that create significant market gyrations. Economic data is varied, but expectations persist that the Fed will lower interest rates and provide stimulus should the economic environment worsen. We remain concerned the dramatic stock market volatility since Q4 2018 could be a prelude to worsening market and economic conditions ahead.

Our current, lower than typical exposure levels, are designed to protect capital given the heightened market and global uncertainty, but still generate alpha and positive absolute performance.

Current View Ahead

Our current delta-adjusted exposure level is 81% long / 41% short for a positive 40% net. We have reduced our shorts as market pessimism has risen, but we continue to keep a lower than typical gross long exposure level given the significant uncertainty and recent market volatility.

Why do we remain conservatively positioned? Pretty much the same reasons we gave in our Q1 and Q2 letters, which we reiterate here again with one new addition. We continue to see mixed data on economic growth with several indications economic growth could be slowing. The Federal Reserve cited slightly slower U.S.growth conditions as well as slowed global growth. The China tariff uncertainties remain and have been a constant source of market volatility and headaches for certain economic sectors. Last quarter we mentioned that the recent stock market volatility was unhealthy and concerning. In addition, in September, there was a massive rotation out of over-loved high growth stocks that had previously been unfazed by market pullbacks. Consequently, we feel motivated to keep our exposure levels in check.

As always, our views are not set in stone and we will react to changing circumstances.

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Q3 2019 Review

In Q3 2019, we roughly broke even with total net performance of -0.1%. We roughly broke even on our longs and shorts as well, as we generated 1.2% of gross alpha in an up and down quarter that saw the Russell 2000 fall 2.3%. Bottom line: gross alpha performance of positive 1.2% drove the roughly break-even performance in the quarter.

Kalo Capital Management LP Net Performance			-0.1%
	Bps Gain/Loss	Avg Exposure	Average Performance
Longs	(22)	86%	-0.3%
Shorts/Hedges	41	-65%	-0.6%
Russell 2000 (IWM)			-2.3%

Alpha (Gross performance from stock selection)	1.2%
Beta (Gross performance from exposure)	-0.9%

Insight Into How We Think About Stocks

Below is an example of stock-specific commentary to give insight into how we think about stocks.

AQUA METALS (AQMS)

Aqua Metals has proprietary technology called Aqua Refining that recycles lead acid batteries in a more environmentally friendly and efficient manner than traditional smelting. Aqua Metals is one of the more speculative names that we consider. While it is common for us to use a small portion of the portfolio for more speculative stocks, it is rare that we will invest in one with essentially no revenues and a manufacturing process ramp, as is the case with AQMS. We were attracted to AQMS given the enormous upside opportunity if successful, the strong industry leader relationships, and the broad investor pessimism that surrounds the stock. We have a positive risk/reward viewpoint but will nevertheless limit the position size of a speculative name in order to control portfolio downside risk (we also limit the aggregate amount of all speculative names we will hold in the portfolio).

Below are the key reasons we like the stock:

Large potential market with real benefit to industry: The traditional smelting industry is large - ($20 billion/year market opportunity). At target performance metrics, the aqua refining process is up to 40% cheaper than traditional smelting and is better for the environment. It also provides other indirect benefits to existing smelters by allowing them to expand without breaching existing environmental limits.

Production is ramping and AQMS has a strong manufacturing partner in Veolia: For the past two years the investment community stock discussions have been littered with speculation that the aqua refining technology would never work. Admittedly, there have been many delays and missed targets (mostly by past management), however, the initial plant has finally had successful runs, confirming the aqua refining process does work and can output ultra-refined lead (which has been approved for use by Clarios/Johnson Controls – one of the largest lead battery producers). The team continues to fine-tune the process and synchronize steps to boost efficiency and meet target margins. Additional equipment to boost efficiency is being installed and synchronization of steps should be completed in early 2020. Further, Aqua Metals recently signed a contract with Veolia whereby Veolia will manage the improvements and operations of the plant

in exchange for AQMS stock. Veolia is a multi-billion euro transnational company. We believe their heavy involvement is a strong indicator that the process is special and will succeed and excel.

Key partner in Clarios: Clarios (formerly the power division of Johnson Controls), the largest battery manufacturer, became a key partner to Aqua Metals and an investor in 2017. This demonstrates a key proof of demand if Aqua Metals achieves its targets. They continue to maintain a strong relationship with regular interaction.

No near-term capital needs: AQMS has raised enough capital to cover cash burn as the initial plant is ramped and the processes synchronized. They will need more capital to expand the initial plant from sixteen to thirty-two modules, but this will likely occur after an official licensing deal with Clarios is completed and could be done through financing other than dilutive equity.

Future business model is capital light: Management has made it clear that once the initial plant is operating at specific performance targets, future growth will come from capital-light deals with other recycling centers. Aqua Metals has an established relationship with Clarios (formerly known as Johnson Controls), the largest manufacturer of lead-acid batteries. Aqua Metals and Clarios have already structured parameters for an equipment supply agreement to retrofit existing Clarios recycling facilities for aqua refining.. We expect an official licensing deal to be struck in early 2020.

Expectations are low. Prior management over-promised and under delivered by a wide margin, over several quarters. These disappointments and lengthy delays resulted in a significantly lower stock price. We feel investors have become overly pessimistic and with low expectations, setting the stock up for significant upside if successful.

Much improved management team: In early 2018 the board (spurred by an activist investor) removed the management team and brought back former employee Steve Cotton to lead the business. Prior management had a reckless pattern of over-promising and under delivering. We believe Steve Cotton is more financially disciplined, with a responsible plan of graduated roll out tied to success. He has also purchased shares personally in the open market.

Significant upside potential: Valuation work can often be a fruitless exercise for speculative stocks. Downside can be severe and upside multiple times higher. For us, when downside risk is large, we limit the size of a position regardless of the upside. Additionally, upside must be considerable and likelihood of success high for us to participate in the stock. In this case with a $20 billion per year market opportunity, key industry leader relationships, and only a $80 million company enterprise value, we believe there is significant upside potential warranting investment.

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Conclusion

We continue to find new long ideas and are optimistic in our ability to generate strong alpha return. We also continue to keep exposure levels in check as we remain uncertain about the next steps for the market and are concerned by the volatility that could accompany the upcoming 2020 elections.

The fund remains open to new investments and we encourage anyone potentially interested to reach out to us. We thank you once again for your belief in our process and performance. Please feel free to call to discuss anything.

Sincerely,

Steven D. Friedman, CFA
Founder and Chief Investment Officer

Please note that Kalo's expectations and strategy can change regularly and the views expressed here may change.

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