

# KALO CAPITAL MANAGEMENT, LP

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September 7, 2016

## **Monthly Report - Kalo Emerging Growth with Reduced Volatility Strategy**

Dear Investor:

For the month ended August 31, 2016, the Kalo Capital Management, LP fund gained 1.5% net, versus a gain of 1.6% for the Russell 2000.

	August 2016	YTD
Kalo Capital Mangement, LP	1.5%	2.9%
Russell 2000	1.6%	9.2%
S&P 500	-0.1%	6.2%

## **Market Update**

The broader stock market continued to show stability though August. For the month ending August 31, 2016, the large cap S&P 500 was roughly unchanged and remains at all-time high levels, while the smaller cap Russell 2000 continued to rebound, but still remains a few percent below its highs from 2015. The Federal Reserve continued its recent message that they are in no hurry to materially raise interest rates and calm seems to have asserted itself over the stock market. Volatility measures are at extreme lows.

We have written extensively in past letters about how smaller cap stocks have been neglected in much of the recent years' strength, including the stock market rebound from the February 2016 drop. Last month, we mentioned that these smaller cap stocks with strong fundamentals were starting to see more investor interest and liquidity. This trend continued through August. We are optimistic that our performance will continue its recent strength. The larger cap markets have finally seemed to level off after their rapid rise from the February lows. This is creating the environment for investors to seek out interesting growth stories at reasonable prices, many of which we already own. We continue to find this to be an encouraging sign regarding the overall health of the stock market. However, we still have what we view as a significant unknown in the upcoming presidential election. Regardless of its outcome, there could be a shift in the stock market environment and investor attitudes, positive or negative. As has been the case for the past couple of months, we have continued to gradually increase our exposure levels and are now close to typical levels. However, we remind you that we are quick to react to market changes and are more focused on creating returns from alpha generation through strong stock selection. In fact, we have already reduced our net exposure in early September based on some recent volatility.

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## August Performance

In the month of August, the Fund generated roughly 217 gross bps from long positions and lost 15 gross bps from short exposed positions. As can be seen on the chart below, the Fund's longs outperformed the Russell 2000, gaining 3.2% on average vs. the Russell's 1.6% gain. The shorts performed worse than the index, gaining only 0.5%. This combined for roughly 1.6% of gross alpha generation.

	Bps Gain/Loss	Avg Exposure	Average Performance
Longs	217	67%	3.2%
Shorts	(15)	-30%	0.5%
Russell 2000			1.6%

Alpha (Gross performance from stock selection)	1.6%
Beta (Gross performance from exposure)	0.4%

Our gains were led by Control 4 (CTRL), Energy Recovery (ERII), Datawatch (DWCH), ZAGG (ZAGG) and Avid (AVID). Losses were led by Rubicon Project (RUBI), Points International (PCOM), and ARC Document (ARC). Control4 is an example of a growth & value blended investment. Control4 is a developer of smart home automation systems that control lights, entertainment, security, energy and other devices, and is generally recognized as a leader in the field. Despite continued double digit revenue growth, the stock had fallen out of favor over the past couple of years, partially due to concerns about competition and some slight guidance disappointments. We were attracted to the stock despite these concerns as we believe revenues will continue to rise given the continuing trend toward efficient and smart homes (even with competition), and we viewed this as an "all boats rise with the tide" scenario. In addition, the stock had become so out-of-favor, its valuation had become quite inexpensive. When looking at our baseline projections, we found that the stock was trading only around 8x free cash flows out 1-2 years. Plus, we expected the company to continue to run in the 10-20% revenue growth per year levels. Given these fundamentals, we would more typically expect a stock like this to trade near 15-20x free cash flows, with the potential for even higher if it became an acquisition target or accelerated its growth. In late 2015, we began building a large investment position and added a trading position. We were also encouraged management had announced a significant stock buyback program and had communicated a new product rollout which was expected to grow the target market for its products (they introduced a lower priced product which expanded the market size). The stock has moved up about 80% from our original investment levels and still appears inexpensive to us. While we still believe there is significant upside, we have reduced our ownership level as the risk/reward is not as strong as it once was.

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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## Historical Kalo Performance - Emerging Growth with Reduced Volatility \*

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year	Incep.
<b>2011</b>			0.4%	0.8%	-2.2%	-0.2%	-1.7%	-2.7%	-5.1%	2.1%	-2.2%	-0.9%	<b>-11.3%</b>	<b>-11.3%</b>
<b>2012</b>	5.1%	2.2%	0.7%	-2.6%	-2.9%	3.6%	-2.0%	3.5%	-0.3%	0.1%	0.3%	0.3%	<b>7.7%</b>	<b>-4.4%</b>
<b>2013</b>	2.2%	2.5%	1.2%	0.9%	3.4%	2.4%	3.2%	0.8%	1.6%	1.4%	1.1%	2.7%	<b>26.0%</b>	<b>20.5%</b>
<b>2014</b>	2.0%	5.0%	1.7%	-1.4%	1.2%	2.3%	-2.0%	0.1%	-1.6%	0.5%	-2.6%	2.2%	<b>7.7%</b>	<b>29.8%</b>
<b>2015</b>	-5.3%	4.9%	1.1%	0.8%	1.4%	-1.8%	-4.3%	-2.2%	-2.5%	8.5%	4.6%	0.8%	<b>5.3%</b>	<b>36.7%</b>
<b>2016</b>	-5.1%	2.4%	0.5%	1.7%	-2.6%	0.4%	4.3%	1.5%					<b>2.9%</b>	<b>40.7%</b>

NOTE: The above returns are net of fees. Past performance is not a guarantee of future returns. Annual performance is through December 31 of each year. Returns since inception represent the return since the Fund inception March 1, 2011.

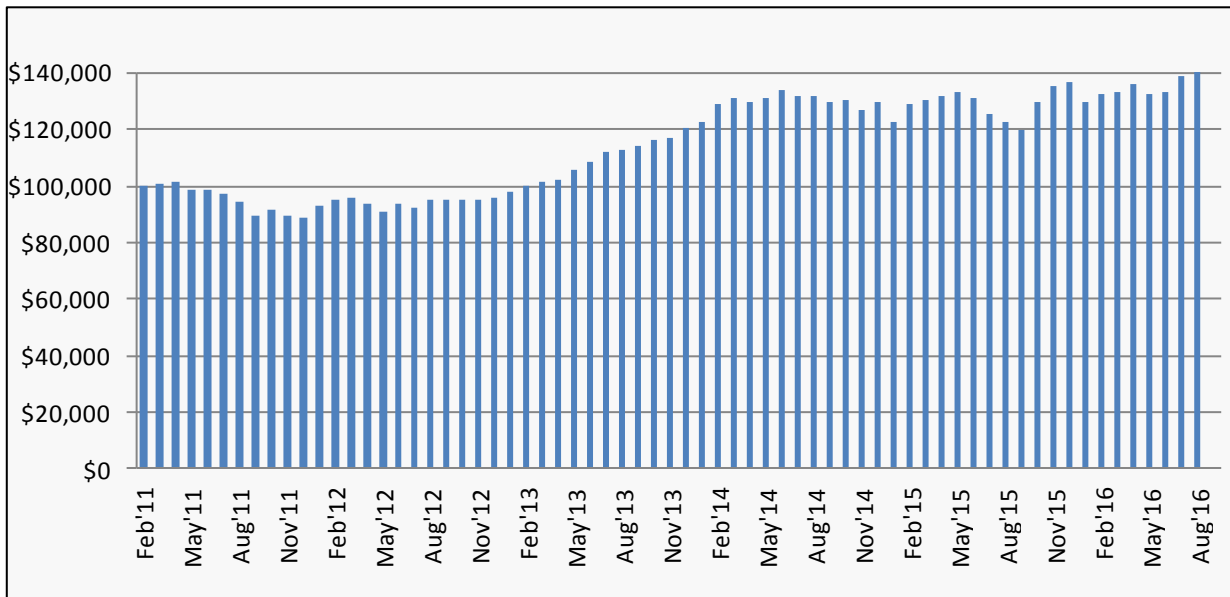
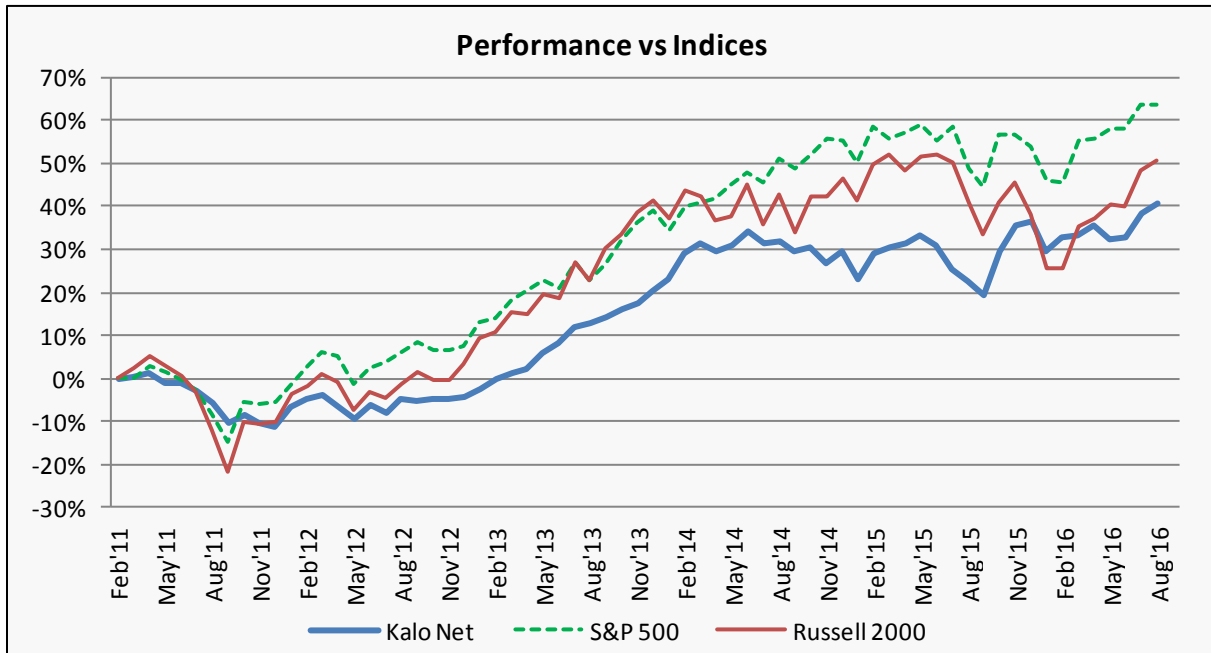
## Assets Under Management - Emerging Growth with Reduced Volatility

<b>Kalo Capital Management, LLC AUM (\$M)</b>	
LP Fund (EGRV)	\$6.5
Separately Managed Accounts (EGRV)	\$5.5
<b>Total AUM EGRV Strategy</b>	<b>\$12.1</b>

Note: Kalo Capital Management, LLC also manages separately managed accounts for clients using alternative strategies which sometimes invest in the same positions as those held by EGRV strategy (Emerging Growth with Reduced Volatility) used by the Kalo Capital Management, LP fund. The Fund utilizes several methods to ensure all accounts are treated equally.

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## Historical Performance - Emerging Growth with Reduced Volatility



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## OVERVIEW OF KALO CAPITAL MANAGEMENT

### **Strategy**

Kalo manages a hedged long/short equity portfolio composed of emerging growth investments complemented by a shorter term trading overlay. Long investments consist of companies where fundamental growth will drive significant cash flows not reflected in the stock price. Kalo focuses on those stocks where downside risk is limited due to current valuation. We look to make short investments where valuation is expensive and fundamentals show signs of cracking. As a complement to our investments, we quickly execute shorter term trades in reaction to events where we see a high probability for returns over the coming one to twelve weeks. This trading overlay consists of both long and short positions when we believe a stock, driven by fundamental news, is in the early stages of a directional move or has had a recent exaggerated move that we expect to revert. Being small and nimble enhances our ability to take advantage of these opportunities.

We primarily invest in the smaller market cap sweet spot of \$200 million to \$5 billion, where larger funds have limited investments due to their size. Generation of stock ideas and research are both performed by Kalo helping us avoid herd mentality. We seek situations where we have a contrarian view, or situations in which a stock has become overlooked by the general market. We find opportunities where the general market overemphasizes near term results and where investor psychology exaggerates stock action.

### **Risk Control**

Kalo places a strong focus on limiting downside risk while generating returns. In addition to our focus on limiting downside risk in each individual name, we use a diversified and unlevered portfolio. Individual position sizes typically range from 1-6%, and the portfolio's typical net exposure is 40%, gross long exposure is 70%. We will reduce net and gross exposure levels when we view market risks as high. For those investors who desire a more aggressive risk/return profile, we offer the Kalo PLUS strategy which increases all positions 1.5x.

### **Transparency**

Kalo believes it is critical to have investors and management interests aligned. The majority of the Portfolio Manager's personal assets and significant family assets are invested. Kalo utilizes an independent third party administrator and a different independent auditor. The Investment Manager also offers the ability to invest via separately managed accounts.

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## **Investment Team**

### **Steven D. Friedman, CFA**

Steven D. Friedman is the founder and Chief Investment Officer of Kalo Capital Management, LLC and Kalo Capital Management, LP. Prior to founding Kalo in 2010, he spent ten years in the hedge fund industry as a Portfolio Manager and Senior Analyst, focused on the Emerging Growth space. Mr. Friedman was Portfolio Manager at Manalapan Oracle Advisers (2009-2010), a Proprietary Trader \* (Aug-Dec 2008), Portfolio Manager at Pequot Capital Management within the Emerging Manager program (2006-2008), senior analyst at Feirstein Capital Management (2001-2006), and financial analyst at Lazard Frères & Co. (1996-1998). Mr. Friedman earned a BBA from the University of Michigan (1996) and a MBA from Columbia Business School (2001). Steven has also been a CFA Charterholder since 2005 and is a Registered Investment Adviser in New Jersey.

\* The proprietary trading desk was part of the Market-Making business at Bernard L. Madoff Investment Securities LLC, separate from the fraudulent investment management business. Federal prosecutors have stated the proprietary trading arm of the firm was legitimate. (Reuters Article, "Market-Making Arm of Madoff's Firm to Be Sold Off", 3/27/09).

### **Tony Alaimo, CFA**

Tony Alaimo is an analyst at Kalo Capital Management. Prior to joining Kalo in 2014, he spent seven years as an equity research analyst at Axiom International Investors, a \$12 billion dollar global equity manager. He has experience as a global equity generalist and financial services specialist. Tony graduated from Sacred Heart University (2006) with Bachelor of Arts degrees in Finance and Economics. He has been a CFA Charterholder since 2011.

## **LEGAL DISCLAIMER**

This document is intended for information purposes only. It is not an invitation or offer to purchase interests in any Fund. Any representation to the contrary is not permitted.

Performance and other quantified metrics shown here are estimates. Actual investor returns will differ. Past performance is not necessarily indicative of future results.

Any Fund or investment involves risk. Potential investors must familiarize themselves with the offering materials related to such investment and must meet certain investment sophistication levels in order to make such investments and must be able to fully absorb the risk associated with such investments. The Offering Memorandum for the Fund and related Subscription Agreement and Limited Partnership Agreement will be made available to those who demonstrate the capacity to evaluate the risks and merits of this investment.

The past performance of any Fund or investment discussed herein is no indication of future results that may be achieved by an investment in the Fund. The Benchmark indices presented in these materials may or may not hold substantially similar securities to those held by the funds referred to herein, and thus, little correlation may exist between the Funds' historic return and those such indices and there is no guarantee that any correlation which may have existed will continue to do so in the future.