

October 8, 2020

## Quarterly Report - Kalo Capital Management, LP

Net Performance	Jul'20	Aug'20	Sep'20	Q1'20	Q2'20	Q3'20	YTD 2020	Trailing 2 Year (Oct'18-Sep'20)
<b>Kalo Capital Management, LP</b>	<b>0.7%</b>	<b>7.6%</b>	<b>(2.1%)</b>	<b>(11.8%)</b>	<b>19.4%</b>	<b>6.1%</b>	<b>11.7%</b>	<b>11.7%</b>
Russell 2000 (IWM)	2.9%	5.5%	(3.3%)	(30.6%)	25.5%	5.0%	(8.6%)	(8.6%)
S&P 500 (SPY)	5.9%	7.0%	(3.7%)	(19.4%)	20.2%	9.0%	5.5%	19.8%
Small Cap Momentum ETF (DWAS)	6.3%	4.5%	(0.0%)	(28.6%)	31.5%	11.0%	4.3%	3.7%
Gross Alpha Performance	0.0%	7.0%	(1.1%)	4.9%	14.6%	6.0%	27.4%	36.3%
Gross Beta Performance	0.9%	2.4%	(1.3%)	(15.2%)	6.2%	2.0%	(8.1%)	(11.8%)

### Performance

In the third quarter, Kalo gained +6.1% net versus a 5.0% gain for the Russell 2000. This brings our year-to-date net performance to +11.7% vs -8.6% for the Russell 2000.

The stock market continued to be strong this quarter but gave back some of the quarter's gains in September. The big picture is mostly unchanged from the end of the second quarter. Phased reopenings continue at various rates throughout the country, and we remain consistent with our view from June that Covid is manageable. The aggressive Fed stimulus measures and prolonged low interest rates continue to support the market, with the S&P 500 and Nasdaq near all-time highs. There remain several over-arching concerns: prolonged lockdowns, racial tensions, election apprehension, and persistently high unemployment. However, these concerns are well known and acknowledged in the marketplace. Despite the high index prices, we continue to feel investor consensus is pessimistic about the future direction of the country and the markets. These contrasting indicators of high index prices and high investor exposure, balanced by significant investor pessimism leave us somewhat comforted, that the market does not have a complacent euphoric outlook.

### Covid/Lockdowns

First, we hope you and your friends/family have stayed safe from Covid. It is clear that fatality rates from Covid are significantly better than initially feared. Despite this, Covid-driven lockdowns continue to dramatically alter life across most of the globe.

Covid and the Covid-induced lockdowns have obviously had dramatic effects on business. The travel and hospitality industry remain significantly impacted, but we have little exposure to these verticals. When we focus on general business outside of travel and hospitality, we believe there is lots to be excited about. We have been spending significant amounts of time reviewing company earnings calls and speaking with management teams. Generally, our view of the Covid/lockdown impact looks like this: initially, business activity froze in March/April, slightly improved in May/June, and became stronger in July-September. In fact, some companies are at or very close to pre-Covid levels of activity. A consistent theme is that Covid/lockdowns are forcing companies to act, to adjust their systems, to become more efficient and reduce costs. We have always focused on companies with a product/service that is an improvement over existing practices looking to penetrate a market. One of the biggest challenges to growth for these industry changers is how to motivate potential customers to make a change versus sticking with the status quo (even if the alternative is better). It's our belief that Covid/lockdowns has flipped this on its head. Now potential customers can't stick with the status quo and are seeking better alternatives (whether it be for cost cutting or revenue generation). Now that businesses are getting back to operating in

their new normal, we believe this will accelerate growth for many of our investments. We expect that this awakening to change for potential customers that is occurring will continue even after the Covid situation improves and lockdowns are lifted.

### **Improved Efficiency at Kalo**

While much of the investing industry historically attended conferences in person and visited company offices, our research/due diligence process has always focused on virtually attending conferences and speaking with management via phone because we can achieve greater efficiencies this way. In the new Covid/lockdown world, we are finding improved access to accomplish this due diligence. Now that conferences are only occurring virtually, we are finding much improved access to all content (while in past some was only made available to in-person attendees). Further, calls with management now tend to be done via video conference (Zoom)... even this simple upgrade from an audio phone call we find helps us gain better perspective on management. Broadly, we feel these changes have materially improved our efficiency in finding new ideas and performing due diligence. This thesis has followed through in results, as we found a significant number of new investments this past quarter that we are very excited about.

### **Current Positioning**

Driven by an abundance of new stock ideas, we have raised our gross exposure to typical/high levels, currently 97% gross long. In conjunction with this increase, we have increased our hedges for protection, bringing our net exposure to 53% (delta-adjusted). We decided to raise our gross long exposure due to a plethora of new ideas we believe will fundamentally perform well even in a continued Covid lockdown scenario. These stocks have excellent risk/reward and are generally far off their historical highs.

Our greatest concern may lie in over-reaching lockdowns that push the economy over the edge. At this stage in our understanding of Covid and its limited fatality rate, we believe current lockdowns are excessive and generally expect lockdowns to gradually ease. However, it is unclear who will be in the White House and what new actions our state and federal political leaders may take. Consequently, we expect to continue to maintain significant hedges and utilize puts for extra protection for the portfolio.

### **New Investment Spotlight: Mohawk Group Holdings (MWK)**

Mohawk Group uses artificial intelligence to efficiently target and sell products via e-commerce sites (mostly on Amazon). Their AIMEE software (Artificial Intelligence Mohawk Ecommerce Engine) processes huge amounts of data in real time to determine how to best target likely purchasers and new product opportunities. Utilizing data shared by Amazon and other ecommerce sites, the AI is able to recognize demand patterns based on keyword searches, reviews, time of day, ranking in search results, search keywords, geography, even items like weather. By understanding the buying habits of e-commerce shoppers, Mohawk can more efficiently spend marketing dollars and determine what product lines are prime to enter and optimize cash flow generation.

Having now developed their distribution capabilities and demonstrated the effectiveness of the AI system, they are planning to accelerate new product launches significantly increasing their SKU count and earnings power. While exciting on its own, the Covid-driven shift toward increased online purchasing further enhances the growth potential for Mohawk. It is important to stress that we believe that their AI driven analysis gives them a distinct advantage in selecting and directing capital ...which we believe will be sustainable and not dependent on macro economic forces. The stock is not widely followed and remains relatively unknown. We believe the stock has significant upside (over 200% upside), based on cash flow generation looking out 1-2 years and a conservative valuation multiple.

### **Conclusion**

We appreciate your confidence in us and will continue to strive to protect and grow your assets. If any like-minded investors are interested in investing, please contact us.

We will close with the same positive thoughts as last quarter: Hopefully a vaccine is coming, improved treatments methodologies for Covid-19 and other viral pathogens will continue to evolve, and the world will soon return to normal.

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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