January 18, 2020

Quarterly Report - Kalo Capital Management, LP

Net Performance	Oct'20	Nov'20	Dec'20	Q4'20	YTD 2020	Trailing 2 Year (Jan'19-Dec'20)
Kalo Capital Management, LP	2.4%	6.5%	13.4%	23.7%	38.2%	60.0%
Russell 2000 (IWM)	2.2%	18.2%	8.6%	31.3%	20.0%	50.5%
S&P 500 (SPY)	(2.5%)	10.9%	3.7%	12.1%	18.3%	55.3%
Small Cap Momentum ETF (DWAS)	(0.3%)	18.3%	7.5%	26.9%	32.3%	73.9%
Gross Alpha Performance	1.7%	0.6%	13.5%	16.3%	48.2%	72.7%
Gross Beta Performance	1.4%	7.4%	2.4%	11.5%	2.5%	7.1%

Quick Highlights

- **Market exuberance is at extreme levels driven by a multi-year outlook for low interest rates and an investor "chase" mentality into hot sectors.**
- **We have avoided shorting high-flying overpriced stocks (we plan to do more shorting of these individual names in the future, but not the right market environment for it now).**
- **Sparked by the changing economic landscape and our refined idea generation process, we are finding more new ideas than any time I can recall. These new ideas are in overlooked disruptive stocks that are only just starting to move higher. We are continuously cycling these new ideas into the portfolios as we scale down or scale out of other names when the stocks move higher and the risk/reward becomes less intriguing.**
- **We continue to be extremely bullish about our individual longs and continue to run with a high gross long exposure (near 100%). However, we are concerned by the extreme euphoria across the market and consequently have significant hedges (mostly index-based today) to bring net exposure to typical levels (near 35-40%), as well as out-of-the-money put options.**

Performance

In the fourth quarter, Kalo gained +23.6% net versus a 31.3% gain for the Russell 2000. The 2020 full year net performance was +38.2% versus +20.0% for the Russell 2000.

The stock market saw a large post-election move up and exuberance for high flying companies reached new heights. Specifically, stocks with disruptive products and great long-term stories are being bought with little regard for valuation. If investors are looking at valuation, they are doing financial models looking very far into the future or using extreme multiples. All broader economic concerns, political worries, and datapoints appear irrelevant and money continues to flow into the stock market. Retail millennial investors stuck at home due to Covid with extra stimulus money have been very active. Investment platforms like Robinhood have created a gambling and gamification aspect to "investing." These platforms zero commission stock, options and crypto currency trading services offer a flashy and trendy user interface which appeals to younger audiences focused on chasing momentum in "hot" sectors. This reminds me of how retail investors helped drive up dotcom names in 1999 as E-trade and other online platforms spread. Many hot stocks are also being driven by massive inflows to popular ETFs such as the ARKK ETF.

While we've seen this concept of more investment money flowing to the best companies (Facebook, Apple, Netflix, Google) for years, it is broadening to other segments and moving down

from mega-caps to mid-cap stocks. Retail euphoria is building. For example, QuantumScape is an electric battery company that is 4-5 years away from revenues and came public recently via a SPAC. QuantumScape saw its stock rise from $12 to $120, then drop back down to $50 which is still a $25 billion valuation. As always, we are focused on disruptive, but overlooked/out-of-favor stocks with reasonable risk/reward valuations and are thus not invested in these names. Strategically, we have avoided shorting names such as this (at least in the current market environment).

Our stock idea generation process is firing on all cylinders. This new world of virtual presentations and virtual conferences has enhanced our ability to identify new ideas. Lockdowns have caused dramatic shifts in the operations and market shares across many industries. These changes are opening areas of opportunity! We are finding more new ideas than at any other time I can remember. We feel that while mid/large cap well-known disruptive stories are at extreme valuations, there are a plethora of smaller and still overlooked disruptive stocks that are only just starting to move higher and have significant upside to come. We are continuously generating these new ideas and cycling them into the portfolios as we scale down or scale out other names when the stocks move higher and the risk/reward becomes less intriguing.

Buoyed by the strong idea generation, we have benefitted from running a high gross long exposure level (near 100%) for the past couple of months, and continue to do so. However, we are concerned about extreme bullishness in the investor community and the unknowns of the incoming Biden administration and remain uneasy about the broader market euphoria. Consequently, we have been running a significant index-based hedge for the last couple of months, keeping our net exposure near 30%-35% (lower than our typical 40%), as well as holding additional out-of-the-money puts for further portfolio protection. Despite the frustration of losses from these hedges, they are being more than made up for with the extra gross long exposure, leading to significant performance this past quarter. In the current environment, we view these losses like an insurance premium to protect the portfolio and limit any potential drawdown if the market rapidly turned downward. While the majority of our shorts are index-based today, we haven't given up shorting individual names and will look to ramp up the stock-specific shorts as the market environment changes.

Investment Spotlight: Voxeljet (VJET)

Voxeljet is a 3D printing company that can be used for industrial manufacturing. VJET sells the machines and consumables used by manufacturers to create 3D print sand molds. These molds can then be cast with metal via traditional means or used for laser sintering of synthetic parts. We believe that their technology is advantageous vs their peers for specific applications that require cost efficient mass production of large complex designs.

While most other companies in this sector have reached extreme valuations, VJET has remained overlooked and forgotten. VJET suffered from years of investor disappointment, the stock is tightly held with limited float, and has been ignored by most sell-side firms. VJET, as we like to call it, was "left for dead".

We first warmed up to VJET in August 2020 as we were browsing for beaten down depressed stocks. VJET is on the smaller side market-cap-wise and has thinner liquidity than we typically hold, but we gained comfort to make an investment due to multiple indicators significant customer adoption was on the horizon. Many management calls, earnings transcripts, and models with various assumptions have been part of the process in getting comfortable with VJET's current

financials (which appear lackluster with a balance sheet rather low on cash). The shareholder base is sticky and aligned with shareholders with a focus on avoiding equity dilution, order backlog is growing, and a recent cost cutting plan has management guiding toward positive cash flow in the near term.

More recently, after years of testing, long-time partner BMW has purchased more machines and appears on its way to adopting broader use of VJET's binder jetting machines for engine parts for upcoming automotive models. VJET also has relationships with and is working towards opportunities with several other industry leaders including Daimler, Volkswagen, Porsche and Nike.

While the stock has risen significantly since we first entered, it still sits at a market cap of only $75 million today. If things go as well as we anticipate, VJET will see a significant adoption and the stock could increase to multiples of the current price.

Conclusion

2020 was the most unusual year I have experienced, both professionally and personally. The dramatic swings of the stock market are a reminder to us to stay even-keeled and focus on our strengths. We continue to find overlooked, fundamentally disruptive stocks that we expect to rise regardless of the broader markets and economy. As we conclude 2020 with our strongest performance since inception, we turn to 2021 with excitement and optimism that 2021 will be even better.

We are honored to welcome our new investors. To all investors, we appreciate your confidence in us and will continue to strive to protect and grow your assets. We encourage you to share this newsletter with your colleagues who may be interested in investing with us in the future.

Please feel free to call to discuss anything.

Sincerely,

Steven D. Friedman, CFA
Founder and Portfolio Manager

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

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