CRESCAT CAPITAL®
VALUE-DRIVEN PERFORMANCE

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June 30, 2016

Crescat Capital Quarterly Investor Letter, Q2 2016

Dear Investors,

The markets have been turbulent in the wake of the unexpected Brexit vote. Crescat's hedge funds were well prepared for the shock based on our diversified global macro themes, well hedged long/short positioning, and disciplined risk model. As evidence, our Global Macro Fund posted gains on both Friday and Monday when the S&P 500 was down 3.6% and 1.8% respectively. Crescat Large Cap, our long-only strategy, was also well prepared for Brexit with its large cash position, precious metals exposure, and ample defensive equity holdings. Even after the sharp snap back rally on Tuesday and Wednesday, all three Crescat Strategies are ahead of the S&P 500 in June month to date through yesterday's close with the S&P 500 down 1.1%.

Far and away, our best performing macro theme year to date remains Global Fiat Currency Debasement, our long precious metals theme across all three strategies. Gold, the world's perennial reserve currency, remains near a historically low valuation relative to the global fiat monetary base. Meanwhile, silver remains near a historically low valuation relative to gold. The problems caused by debt-to-GDP excess in Europe, China, Japan, and elsewhere auger well for further global central bank fiat money debasement and substantial future hard money, i.e., gold and silver, appreciation. Brexit is just one of the catalysts.

Despite a broadly rallying market in April and May, we also saw positive returns in the hedge fund strategies from our short-oriented China Currency and Credit bubble theme. We believe that this theme, along with our New Oil and Gas Resources and Asian Contagion themes represent significant opportunities for the second half of 2016. In addition, our Yahoo/Alibaba Spread trade has continued to be a low volatility and high return winner for the hedge fund strategies. We think this has much further to play out in our favor as we show below.

Three New Macro Themes

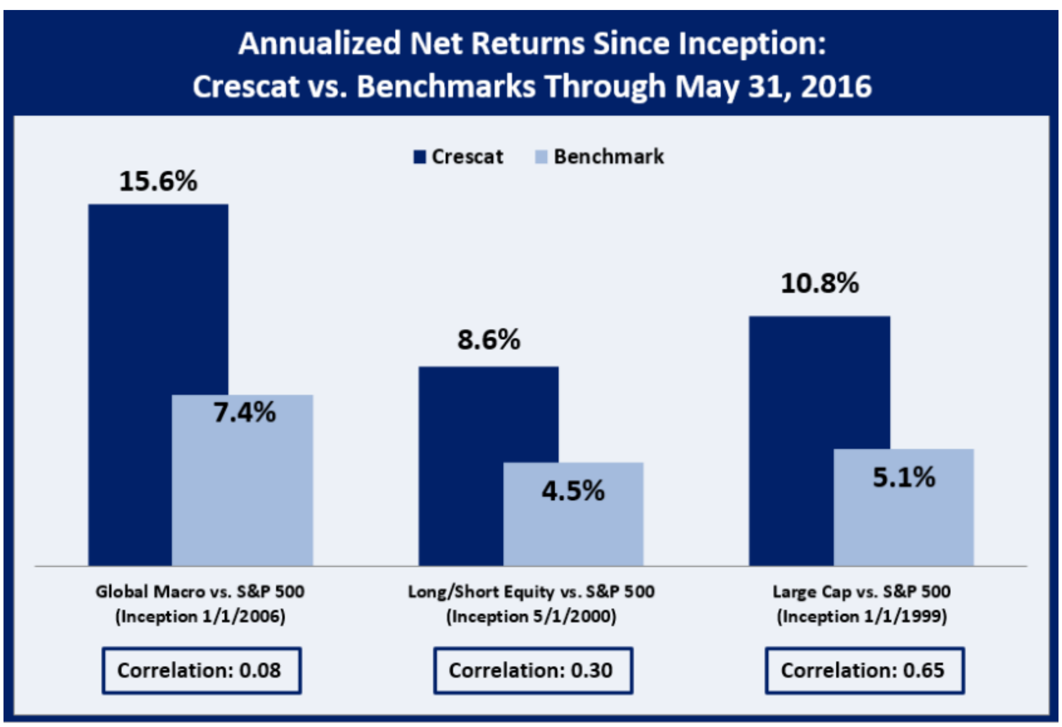
We are now introducing three new themes: **Rise of the Machines, European Disunion, and Asian Contagion**. Rise of the Machines has been carved out of our Digital Evolution theme and is focused on companies at the forefront of developing and capitalizing on artificial intelligence (AI) technologies. Our new AI theme is fortified by one of our long-term core holdings, NVIDIA, a highly profitable, high growth, low valuation company with over 7,000 patents in visual computing. NVIDIA invented the graphics processing unit (GPU) and enjoys a leadership position in the development of an entire computing platform for artificial intelligence.

European Disunion is a spin-off from our Global Debt-to-GDP Resolution theme and currently houses our newly fortified short exposure to the euro and British pound in our Global Macro Fund. Euro and pound sterling had long been Crescat shorts relative to the dollar. We had covered this exposure ahead of the UK vote due to heavy bookmaker odds of a Bremain vote. The surprise Brexit vote has provided the confirmation for us to reenter these positions. These, along with our other currency shorts, including Chinese yuan, Japanese yen, Australian dollar, New Zealand dollar, Canadian dollar, are also a means of diversifying our long precious metals exposure in the Global Macro Fund.

Our new Asian Contagion theme is a reformulation of our Aussie Debt Crisis theme. It includes countries that have their own unique set of problems, such as the Australian housing bubble, but are also highly likely to be affected by the crisis that we see unfolding in China.

Below is a summary of results for Q2 2016 through May and since inception for the three Crescat strategies. Please note our substantial, persistently high risk-adjusted returns compared to the market and other managers across all strategies over the long term. We will have preliminary June and Q2 performance out soon.

Net Returns through 5/31/2016					
Crescat Strategy/Benchmark	Year to Date	Annualized			Cumulative Since Inception
		1 Year	3 Year	Since Inception	
Global Macro Hedge Fund	**1.6%**	**10.9%**	**13.6%**	**15.6%**	**354.5%**
--Benchmark: HFRX Global Hedge Fund Index	-1.0%	-7.0%	-1.1%	0.0%	-0.5%
Long/Short Hedge Fund	**2.5%**	**7.4%**	**11.7%**	**8.6%**	**275.9%**
--Benchmark: HFRX Equity Hedge Index	-2.5%	-7.7%	0.2%	-0.6%	36.6%
Large Cap SMA	**6.5%**	**2.5%**	**11.1%**	**10.8%**	**493.6%**
--Benchmark: S&P 500 Index	3.6%	1.7%	11.1%	5.1%	137.0%



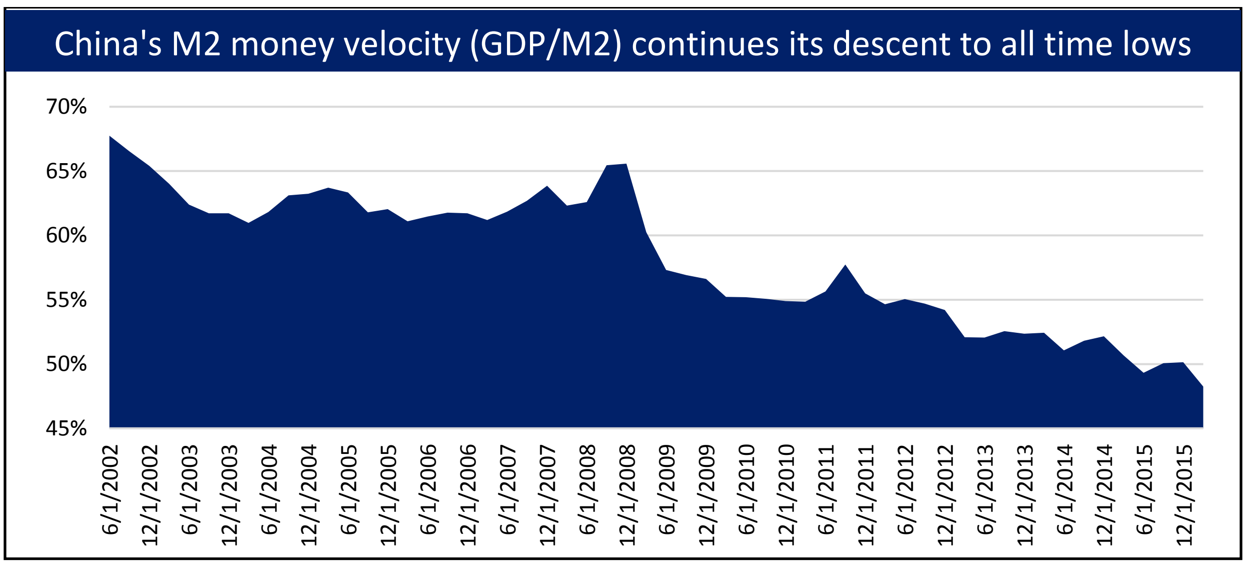
More information on each strategy can be found on our website. In the remainder of this letter, we discuss three of our high conviction macro themes: China Currency and Credit Bubble, New Oil and Gas Resources, and Yahoo/Alibaba Spread.

China Currency and Credit Bubble

The Chinese economic bubble is poised to burst and continues to represent an even bigger risk to the global financial markets than European Disunion.

In July of 2014, we wrote about the huge imbalance with respect to China's M2 money supply and nominal GDP relative to the US. At the time, China's M2 money supply was 71% higher than the US but its economy was 44% smaller, which we said was an indication of the overvaluation of the Chinese currency. Since that time, the yuan has fallen by only 6.8% relative to the dollar. We haven't seen anything yet.

Today, the circumstances have significantly worsened. Money supply has continued to grow faster than GDP. With over $30 trillion of assets in its banking system and an underappreciated non-performing loan problem, we are convinced that China is headed for a twin banking and currency crisis. Money velocity has reached historically low levels which reflects China's extreme credit imbalance and its crimping impact on its ability to generate future real GDP growth.



Just as worrying as the immense amount of credit built up, China has been reporting major downward revisions in its balance of payments (BoP) accounts. For more than a decade, China had been reporting an impossible twin surplus in its BoP accounts. When we wrote about this issue in 2014, we emphasized the likelihood of massive illicit capital outflows that not been accounted for. At that time, according to the State Administration of Foreign Exchange of China (SAFE), China had accumulated a BoP imbalance that was close to $9.4 trillion surplus since 2000 which we believed represented capital outflows that should have been recorded in the capital account.

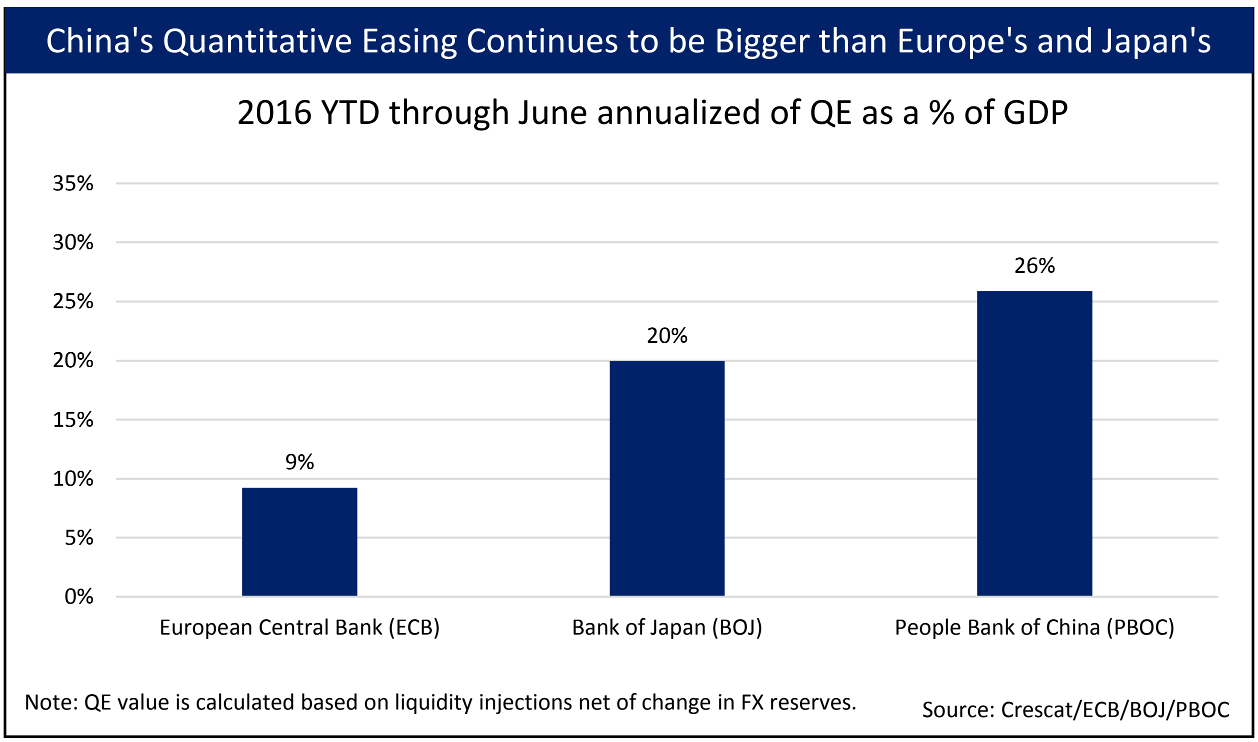
The same accumulated BoP number today, revised by SAFE several times since, is now a deficit of about $2.8 trillion. Essentially, with its revisions, the SAFE has acknowledged even more capital outflows over the last 16 years than we had initially identified.

On the capital account side, there was a downward revision of $10.1 trillion – from a $4.2 trillion surplus to a $5.9 trillion deficit. On the current account side, the revisions show that Chinese exports have not been as strong as initially reported over the last decade and a half. China's current account surplus has been reduced by $2.1 trillion– going from $5.1 trillion to $2.9 trillion over the last 16 years.

What we initially considered to be a $9.4 trillion imbalance has been more than proven by a $12.2 trillion revision.

In continuation of our analysis, we had previously pointed out how the purchase of assets by the People's Bank of China (PBOC) was actually quantitative easing (QE) or outright money printing and was larger than any other major central bank in the world. With China's year to date cash injections this condition has only become more explicit.

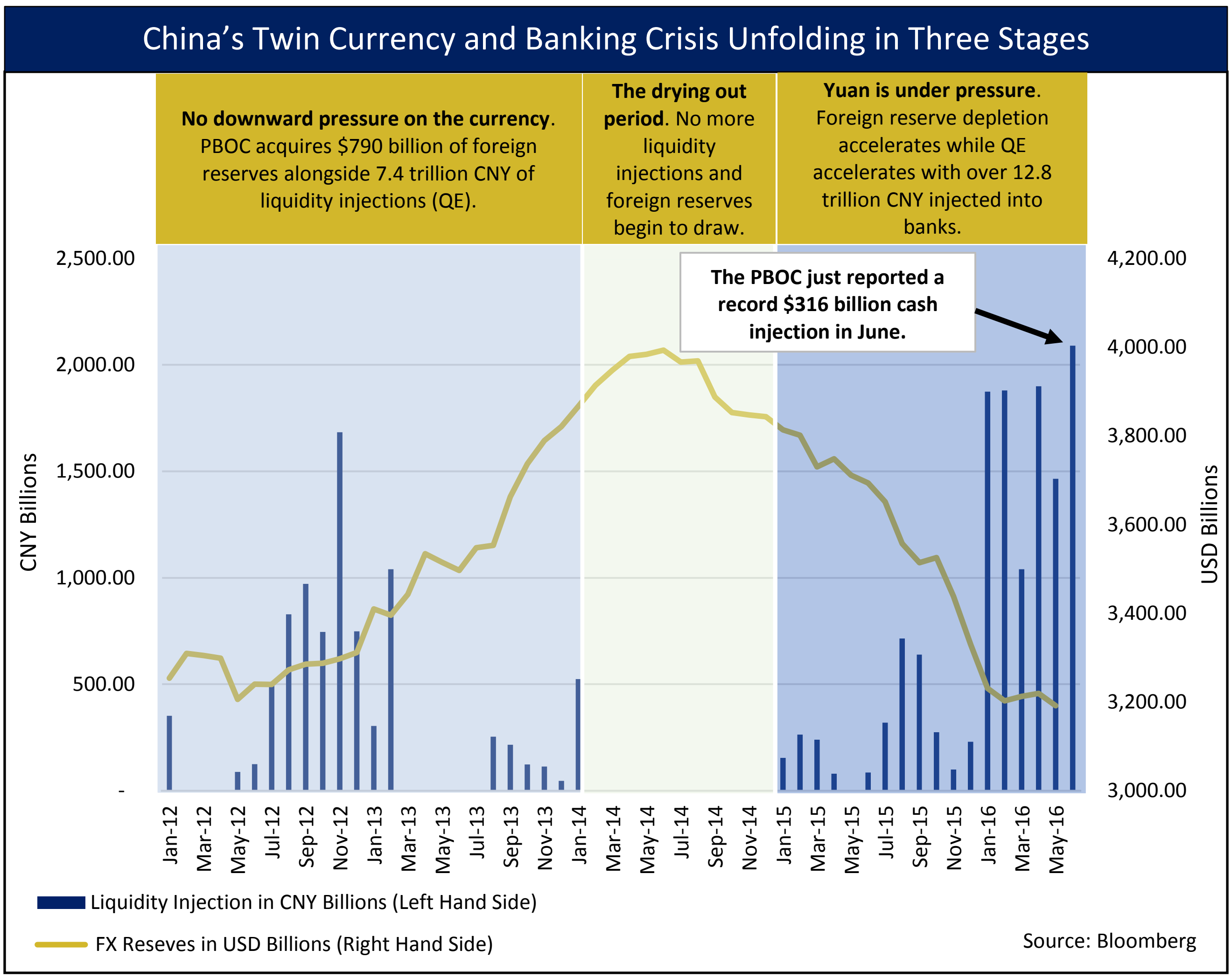
The PBOC has injected over $1.6 trillion of cash into the Chinese markets this year through the repo market. This intervention (net of foreign reserve changes) is approximately $2.8 trillion annualized, or about 26% of its nominal GDP. This annualized net level of QE is beyond any other major central bank stimulus program today. It exceeds both that of the European Central Bank (ECB) and the Bank of Japan (BOJ).



Just like today, back in 2012, the PBOC significantly intervened through the repo market. Then, the PBOC injected almost 7.4 trillion CNY into the banking system and was able to acquire about $800 billion in foreign reserves at the same time. The Chinese central bank was only able to intervene without diminishing demand for its own currency because there was little foreign speculation against the yuan. The conventional view outside of China at the time was that the yuan was artificially undervalued. For the past two years, Crescat has been at the forefront of changing this misguided view.

From 2014 to 2015, there were no cash injections provided by the PBOC. Instead, Chinese equity markets rallied substantially -- because of large expectations for more government stimulus -- and the yuan depreciated significantly versus the dollar for the first time since 1993. As a result, the Chinese central bank was forced to sell foreign reserves in order to defend its pegged currency. We refer to this time as the drying out period in the chart below.

In 2015, the PBOC resumed its intervention in the repo market, but it wasn't enough to cover up the monetary tightening impact of its foreign reserve depletion. Consequently, the Chinese stock market crashed while the yuan continued to face downward pressure from capital outflows.



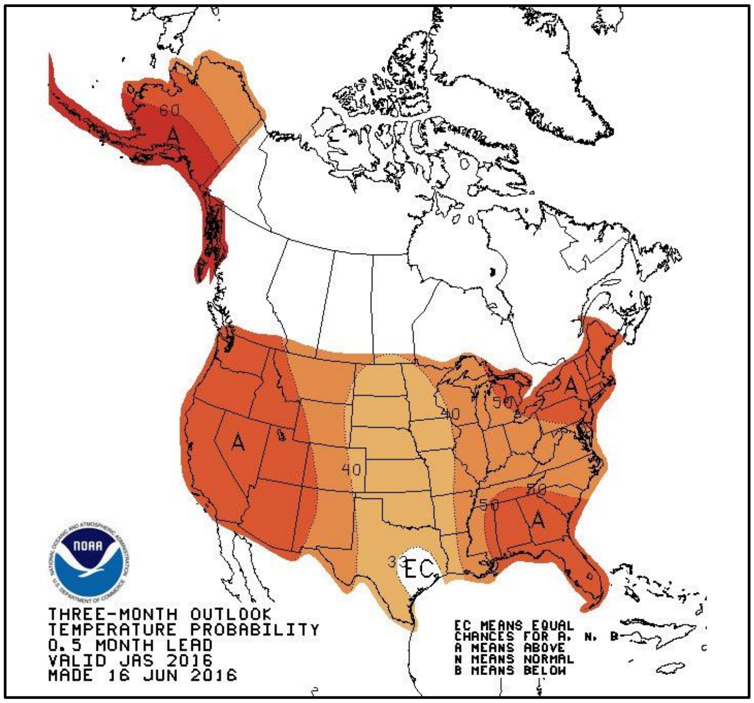
Credit bubbles can continue as long as banks are willing to lend and borrowers are willing to borrow. When either side falters, credit stops growing, and the economy collapses. In 2015, the annual M2 money supply grew by 16 trillion CNY -- the highest annual change in history. What suggests the possibility of a peak level is the fact that year to date, relative to prior years during the same period, this value has begun to decline. Similarly, total social financing has already begun to decelerate its annual growth. This broader measurement of money supply increased by 15.3 trillion CNY in 2015, which is 2 trillion CNY smaller than the 2013 figure. We are most comprehensively positioned to take advantage of this theme in our Global Macro given where we own yuan put options as well as various Chinese equity shorts that we also have in the Long Short fund.

New Oil and Gas Resources – New Bulls on US Natural Gas

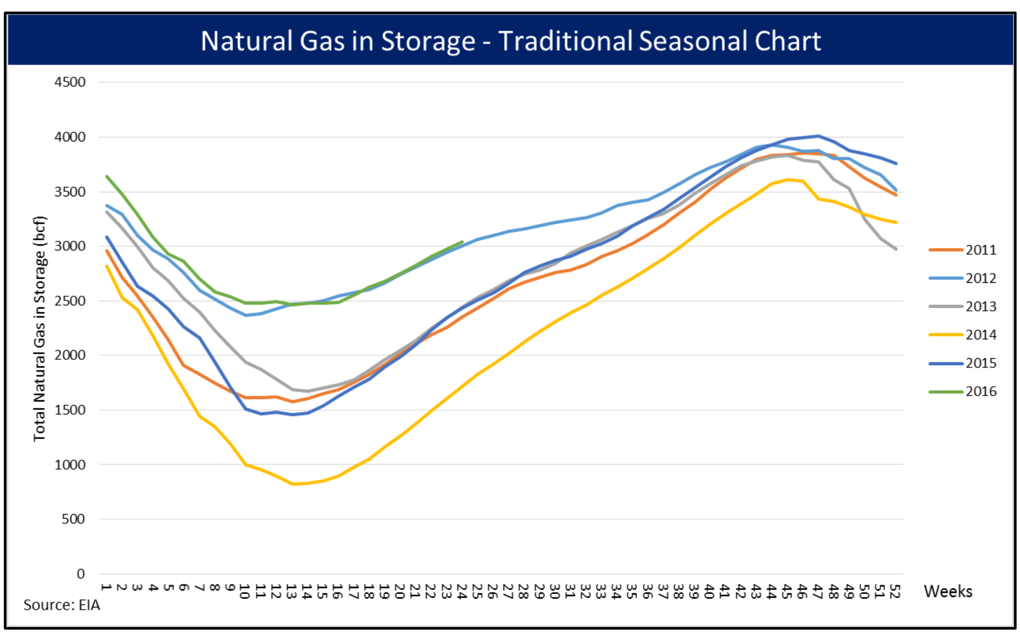
After two successful years of concentrating on oil-related short positions, our energy focus shifted to long positions in natural gas in early 2016. Barron's picked up on our idea in early June, and despite the rally since March, we see further upside for natural gas.

Over the past several years, many of the positions in our New Oil and Gas Resources theme have been based on what we call the "BTU Spread." In energy equivalent terms (BTUs), crude oil became historically expensive relative to natural gas in 2011-2012. Since then, we have generally been short oil futures and long natural gas futures, adjusting the relative weight as opportunities presented themselves. For example, as crude oil prices dropped during much of 2014 and 2015, we were heavier on short oil related positions, with a smaller amount of long natural gas futures acting as a hedge. In February 2016, we closed out numerous successful oil-related shorts. We kept some short positions in a small basket of overvalued E&Ps, and also increased our exposure to natural gas futures, with contracts spread out across the curve to reduce volatility and minimize weather impacts.

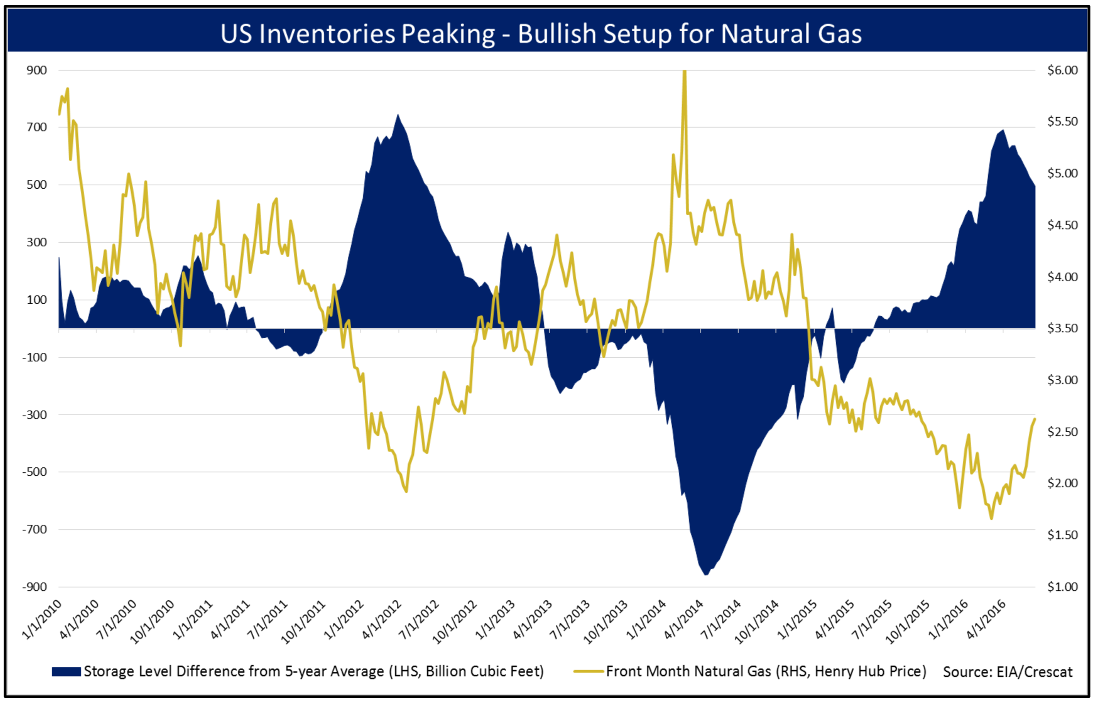
The near doubling of crude oil prices off their February lows have garnered most of the headlines in the energy space, but we believe a more sustainable rally is underway in natural gas. Production is visibly rolling over in key shale basins. Residential and industrial demand remain strong, coal plants continue to be retired, and exports via pipeline and LNG continue to grow. Storage levels just started to retreat from multi-year highs and managed money remains net short, leaving plenty of room for bullish sentiment to return. Weather of course is an important factor in natural gas prices, and a warmer than average summer outlook from NOAA serves as an extra boost to the improving supply and demand fundamentals.



While barrels of crude oil can circle the globe to find a refiner in need of a particular grade at a particular time, natural gas is a much more uniform product supplied to more regional markets. This generally remains the case even as trade is becoming more global thanks to growing use of LNG. Since we focus on US-based Henry Hub prices, we concentrate on the US market and EIA data released on a weekly and monthly basis. Changes in storage levels are paramount because natural gas consumption is highly seasonal and weather-dependent. Throughout each year, production remains relatively stable while consumption swings dramatically, necessitating the extensive use of storage. Below is an example of the standard seasonal storage chart that generally shows storage levels increasing in the summer (lower demand) and decreasing in the winter (higher demand).

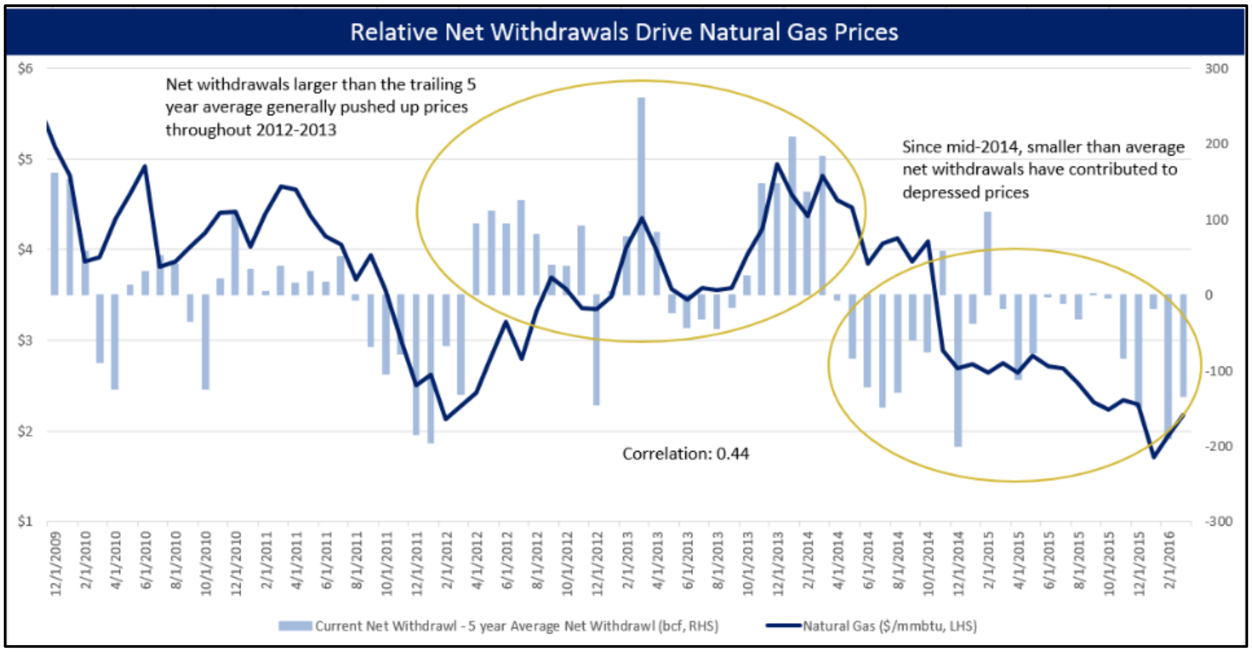


While it is easy to see in the chart above that we currently have high levels of natural gas in storage, it is more difficult to see how storage levels are changing on the margin. For example, how much more gas is in storage this June compared to the last several Junes? On a month-over-month basis, are we chipping away at the large surplus, or adding even more to the glut? To address these important questions, we analyze natural gas data by comparing each period's observation to the trailing 5 year average for that period. This comparison allows for easier analysis of longer term trends that could be missed by looking at a traditional seasonality chart. Looking at the chart below, using the relative surplus/deficit analysis, it is clear that we are beginning to draw down from a big relative surplus after a prolonged drop in natural gas prices. This mirrors the beginning of the bull run-up in natural gas seen in 2012.



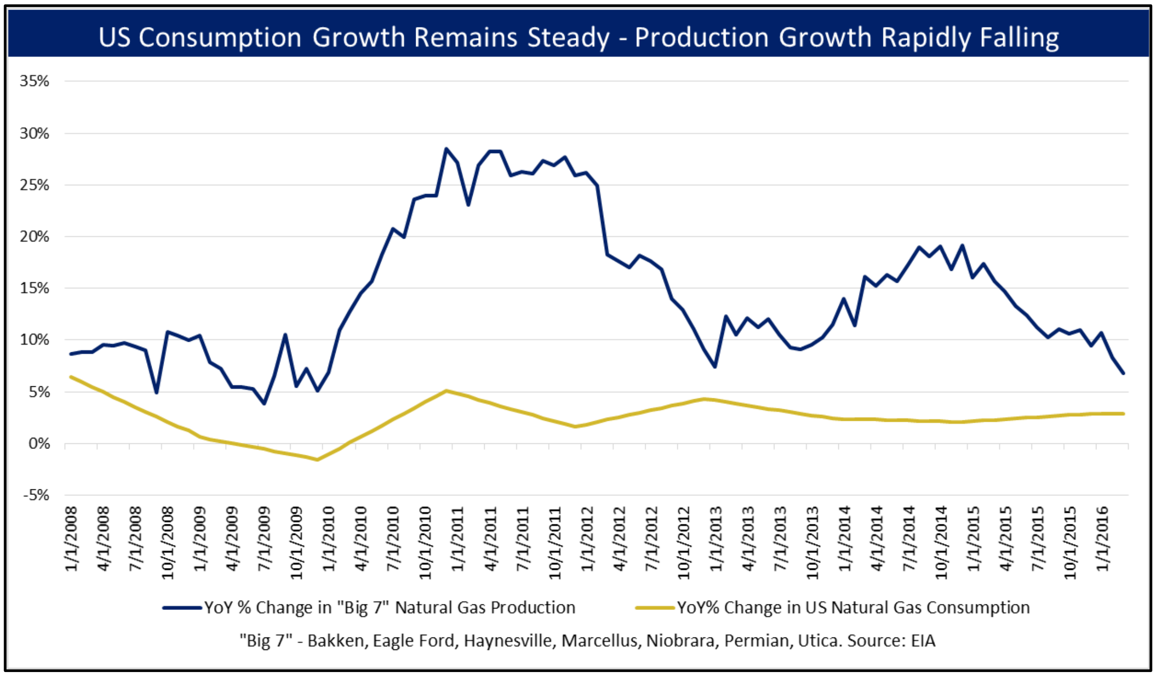
To anticipate these changes in longer term storage trends, it is instructive to look at net withdrawals, defined as withdrawals minus injections. We expect this number to be positive in the winter and negative in the summer. However, we are interested in the longer term trend instead of seasonality, so we compare each period's data to its trailing 5 year average.

If this relative net withdrawal measure is consistently positive, it is indicative of increasing demand and/or slowing supply. This can be seen in the graph below from approximately April 2012 to March 2014, when relative net withdrawals were large and natural gas prices rallied. Conversely, from April 2014 to present, net withdrawals have been smaller than their recent average, contributing to the currently depressed prices.



Clearly, net withdrawals that are consistently larger than the recent average are bullish for natural gas. What will cause these numbers to grow again and support prices after nearly two years of contributing to bearish sentiment? Again, net withdrawals are defined as withdrawals from storage minus injections into storage. First, withdrawals are likely to continue their historically steady growth, with a slight extra tailwind due to LNG and pipeline exports, alongside continued expansion of natural gas use in power plants and industrial applications. A potentially warm summer is a bonus on top of these improving demand fundamentals.

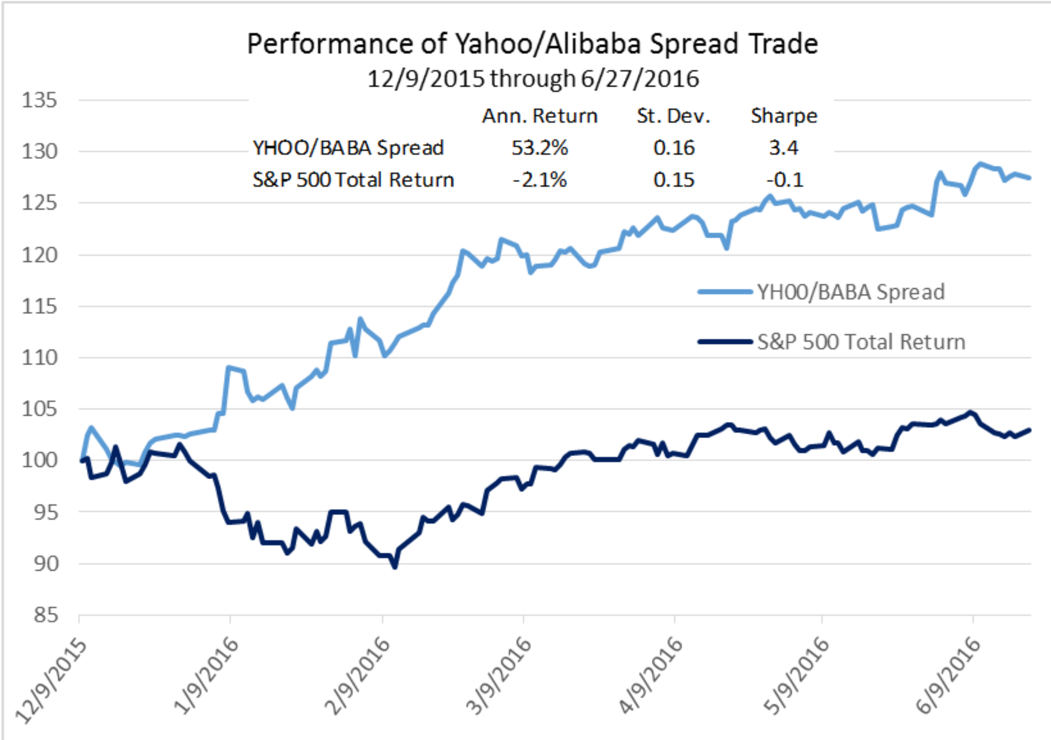
Second, injections are poised to decrease. With all the focus on oil, it is easy to forget that the natural gas bust began before the oil downturn of 2014. Many large natural gas producers have been distressed for years forcing them to cut capital investment. For example, Chesapeake Energy (CHK), the largest independent natural gas producer in the US, has slashed its capex budget dramatically in each of the last five years and is saddled with so much debt that it is at risk of bankruptcy. Production growth in the seven largest shale regions defined by the EIA is deteriorating. These regions accounted for essentially all of the US natural gas production growth since the beginning of the shale boom, but that high growth cannot continue because capex budgets industrywide have been cut to the bone.



The argument for higher natural gas prices is fairly simple, but the bullish fundamentals for demand and especially the slowing supply are underappreciated by the market. Storage is king. Injections into storage should decrease and withdrawals from storage should increase, resulting in overall decreases in storage levels and higher prices. Since most gas-focused (and oil-focused) exploration and production companies score poorly in our fundamental equity model, we are expressing this view largely through long positions in natural gas futures contracts in our Global Macro Fund. We have positions spread out across the futures curve to reduce volatility and to avoid short term swings due to the weather, as we continue to benefit from the longer term improving fundamentals.

Yahoo/Alibaba Spread Trade: 50+% Appreciation Potential

In our Q4 2015 quarterly letter, we outlined what we believed was a low-risk arbitrage trade from going long Yahoo (YHOO) and short Alibaba (BABA). We said at the time that it had a 59% return potential. This trade has been a consistent performer with positive returns in six of the last seven months in both of our hedge funds. We initiated the position on 12/9/15 and increased our exposure to it in May. There is ample room for the trade to successfully play out further. The performance in the chart below shows the theoretical returns of a long position in Yahoo hedged with a short position in Alibaba from 12/9/15 to 6/27/16 prior to transaction costs with daily rebalancing at the hedge ratio. This is largely what Crescat has been doing, but we also have an outright short position in BABA that we initiated last month following the announcement of the SEC investigation.



The catalyst for this trade to continue working is that Yahoo is under pressure from activist investors to sell its core business, its patent portfolio, and possibly its real estate, which by our estimates after taxes would leave it with more than $12 per share in cash, a 15.4% stake in Alibaba that today in the market is worth $30.01 per Yahoo share, and a 35.4% stake in Yahoo Japan that today in the market is worth $9.42 per Yahoo share. There is a possible tax free spin off at that point of Alibaba and/or Yahoo Japan. Otherwise these stakes can just be maintained and Yahoo could trade like an ETF. Furthermore, at that point, Yahoo could just use its cash to buy back stock until the value is recognized.

The key to achieving high risk-adjusted returns from this trade comes from being able to hedge out the risk of owning Alibaba and capturing the hidden value of the non-BABA parts. The hedge ratio is the market value of Yahoo's Alibaba stake relative to the market value of Yahoo. At the time we initiated the trade, the hedge ratio was 1:1 Alibaba to Yahoo meaning that one could buy all of the non-Alibaba parts of Yahoo for a price zero and hedge out the entire Alibaba risk by shorting an equal amount of BABA. In our Q4 2015 letter, we valued the non-BABA parts at $19.50 per Yahoo share, while the market valued them at $-0.51. Today, we value the non-BABA parts at $22.29 and the market values them at $5.21. We see another $17.93 per Yahoo share or 50.9% appreciation potential available from this trade. See the table below.

CURRENT VALUES PER YAHOO SHARE (6/27/2016)	
Yahoo Current Market Price	$ 35.22
Yahoo Stake in BABA	$ 30.01
Hedge Ratio	85.2%
Yahoo Stake in Yahoo Japan	$ 9.42
Yahoo Cash	$ 6.19
Est. After Tax Value of Yahoo Real Estate	$ 1.00
Est. After Tax Value of Yahoo Patent Portfolio	$ 1.00
Est. After Tax Value of Yahoo Core Bus./10x Fwd FCF Est.	$ 4.68
Yahoo Sum of Parts Valuation	$ 53.15
Appreciation Left to Fair Price	$ 17.93
% Appreciation Left to Fair Price	50.9%
Crescat Valuation of Non BABA Parts	$ 22.29
Market Value of Non BABA Parts	$ 5.21

Some investors have said to us, "This is a great idea but why hedge out the BABA?" We hedge out the BABA because the Alibaba valuation is where the majority of the risk lies. BABA is a richly valued stock with an 11.6 EV/Sales ratio and P/E of 53. Furthermore, it is operating in China, a country poised to fall from the heights of a twin currency and credit bubble. Finally, BABA is engaged in aggressive and questionable accounting practices for which it is currently under SEC investigation. We don't want to hedge out the Yahoo Japan because its value appears sound and that value is not being reflected yet in the Yahoo price. It is trading in the Japanese markets a much more reasonable 3.4 EV to sales and 15 P/E. This is an arbitrage trade. The beauty of it lies in being able to hedge out the BABA in order to let the value of the remaining pieces materialize.

Sincerely,

Kevin C. Smith, CFA
Chief Investment Officer

Tavi Costa
Emerging Markets Analyst

Nils Jenson
Energy and Materials Analyst