Quarterly Letter September 2016

Written September 27th, 2016

THALASSA CAPITAL LLC

"*A human being is not attaining his full heights until he is educated.*" **Horace Mann**

This quarter we shall like to start with the two topics of heights and education, as Horace Mann eloquently wrote, on the account of the stock market hitting new records and the importance of education in keeping a clear vision at such tricky times, ahead of what it may be the most bizarre election of all times.

In august, the trifecta of domestic indexes, S&P 500, Dow Jones and Nasdaq hit new highs simultaneously, an event unseen since 1999. Naturally, this should make us a bit nervous considering that glorious year practically marked the end of one of the longest and most rewarding bull markets in history. However, today's contingencies seem rather different than those at the end of the millennium as valuations are not quite that outlandish and investors' euphoria is akin to that experienced in a funeral parlor.

"Worried" is the word du jour as investors globally are either preoccupied with low growth everywhere, an unstable Middle East (was it ever a stable region, we would ask…) and an erratic presidential election in the US. This state of affairs is contrary to what is usually witnessed at market tops when people's euphoria is generally off the charts.

On the subject of valuations, while stocks are not a bargain, they are roughly in line or just above long term averages. On a relative basis, when compared to bonds, stocks are actually still quite competitive.

On a more granular level, technology is growing nicely and multiples are not even comparable to the 1999 framework. Master Limited Partnerships also still represent good value as their current yields and price to discounted cash flow are at a discount to their long term averages. Research from PIMCO implies that the average midstream MLP valuation is pricing a 10% reduction in cash distributions in 2016 and no growth of distributions until 2020. We find this valuation a disconnection with the realities of the business where we see distributions being increased regularly and a projection for domestic volumes of oil and gas production to significantly increase in 2018 when the world should start suffering from significant negative supply-demand imbalances.

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Conversely, REITs, which had a stellar year so far, may be a bit expensive as most sub-sectors are now trading at a premium to Net Asset Value. However, even in this case, their yield is still compelling and on a long term basis, the space still offers some of the best opportunities for diversification and distribution growth.

From a macro-economic perspective, growth is generally weak across the globe but expected to accelerate moderately in the US. Emerging Markets, especially on a selective basis, are also beginning to show signs of life. Nevertheless, disappointment is not missing in action as we still see some of the weakest productivity numbers since 1990. A cocktail of deteriorating demographics, negative regulatory environment and political uncertainty seem to be weighing on US productivity. A resolution of the political mess that has engulfed us for quite some time could help significantly in overcoming this burden.

Of course, the upcoming presidential election in the US is not doing much to assuage such political anxiety. Should Clinton win, the markets might cheer the status quo in the short term but the long term view will be very much contingent on HRC's dedication to a practical, rather than ideological, approach to the economy. Should Trump win, it is reasonable to expect market instability to reflect his instability in economic and political planning. A Trump win should play well for gold, a typical refuge from geo-political uncertainty and a good inflation hedge against what seems to be a political program as inflationary as it is erratic.

In light of the difficulties of the immediate time frame, we continue to advocate an opportunistic short term approach within the context of a long term well defined plan.

As always, we would like to thank you for the renewed confidence in our work,

Youri Bujko

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