TRIUM BLACKWALL EUROPE L/S FUND

European Long/Short Equity

QTD: -0.88%* YTD: 2.83%*

AUM: EUR 167.5M*

Q3 2016

Dear Investor,

Although the aggregate returns for August and September were slightly positive, the performance in July on the back of a risk-on rally in equity markets, post the Brexit referendum, led to a quarterly performance of -0.88% and a YTD net return of +2.83%.*

Since inception in December 2014, the Fund has generated net returns of +12.6% versus a Stoxx 600 index performance of +0.1%. The Fund has not employed leverage and has had an average net exposure of 9% since inception.*

Assets under management increased significantly from EUR 64.8m at the end of Q2 2016 to EUR 167.5m at the end of Q3 2016. Our investor base resides predominately in Germany, UK, Switzerland and Austria, with several institutions making investments into the fund in Q3.

We are also very pleased to report that the fund received two awards from independent providers in September. Firstly, the German investment house SAUREN awarded us two Gold medals for Fund Management Excellence in the category Long/Short Europe. Secondly, we also received an award at the "Legends 4 Legends" conference in Amsterdam organised by Laven Partners. Our Fund won in the category "Pioneers: Legends of today and tomorrow".

ORGANISATIONAL ANNOUNCEMENTS

I am very pleased to announce that Heinrich Lammer and Bernd Laux joined Blackwall Capital in Q3 2016.

Heinrich Lammer joined on 1 September as Partner and Chief Operating Officer. In this role, Heinrich will be in charge of risk management, compliance and operations. He holds a PhD from WU Vienna, an MBA from the Anderson School at UCLA and has been involved in research and strategy projects throughout his career. Heinrich is a very experienced manager having spent over 20 years with Goldman Sachs, mainly in Switzerland, where he was Chief Investment Officer and a member of the management committee. He also ran a fund management company for several years and most recently worked for JPMorgan in Switzerland.

Bernd Laux joined on 1 October as Partner and Head of Equity Research. Bernd will work with me on the investment research side, bringing with him a wealth of bottom-up stock picking experience. He graduated from Munich University (LMU) with a MBA diploma and started his sell-side equity research career in 1993 at Sal. Oppenheim. Over the past six years, Bernd had been Head of Kepler Cheuvreux's European Semiconductor Sector Research, where he was consistently top-ranked across all major investor surveys. From 2004, he also ran Cheuvreux's/Kepler Cheuvreux's German Research team, which he had successfully rebuilt and positioned as a leading provider of high quality German equity research.

THE SAFE HAVEN OF QUALITY STOCKS

"Things only have the value that we give them"
- Molíere (1622-1673)

Alice laughed:

"There's no use trying," she said; "one can't believe impossible things."

"I daresay you haven't had much practice," said the Queen.

"When I was younger, I always did it for half an hour a day. Why, sometimes I've believed as many as six impossible things before breakfast."
- Lewis Carroll, Alice in Wonderland (1865)

With currently more than USD 10 trn of bonds trading at negative interest rates globally and central banks continuing to widen their respective programs, especially in Europe, the hunt for low risk returns is entering a new era.

When the Swiss National Bank invests billions of dollars into Apple, Alphabet and Facebook (among others) and the Bank of Japan is indirectly becoming a top 10 shareholder in many Japanese companies, investors are increasingly shifting capital from (corporate) bonds into equities. While central banks might prefer a non-discriminatory view on the selection of companies they want to own, most other, what would typically be, bond investors, seem to prefer conservative, earnings generating and dividend paying companies, with an emphasis on sustainability.

The late 1960s and early 1970s were famous for the so called Nifty Fifty, known as "one-decision" stocks – buy and hold forever. Investors fell in love with these consistently fast earnings generators, propelling their valuations to an average P/E of 42 (some up to 80x+) in 1972 - about twice as high as the average market then. We all know how this ended in the subsequent bear market of 1973/74.

With investors chasing the "safe haven" quality stocks, and some even arguing that dividends are the new interest payment, we believe that history might repeat itself. I recently read an article about WD-40. Some of you might know this company, either by using its product or by the case study about competitive advantages issued by Prof Bruce Greenwald. About 80% of US households use WD-40 to prevent things from squeaking. Lacking any meaningful competition, this company is almost a perfect example of a low-to-mid single-digit growth company with a massive moat and with dividend yields of slightly above 3%. Between 1984 and 2012 the company valuation traded 13 - 20x P/E, and although its growth prospects haven't changed recently, the P/E ratio currently stands at a lofty 33 - 35x – about twice as high as the past 28 year average.

However, we don't need to go across the Atlantic to find such examples. With corporate bond yields being pushed into negative territory in Europe, we are increasingly finding examples here too e.g. the German company Rational.

*Source: Trium. The figures refer to the past. Performance is quoted net of fees based on unaudited figures. Performance from launch (19 December 2014) to 31 December 2014 was -0.10%. Inception date: 19 December 2014. All at 30 September 2016.

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Rational produces high-end kitchen accessories and amongst others, the two key products are the "Self-Cooking Center" and the "Vario Cooking Center". You'll find their Cooking Centers at canteens, caterers and restaurants – including Michelin starred restaurants and the White House. These products are certainly more exciting than penetrating oil and also allow for slightly higher single digit growth. However, their success may attract competition over time, and disruptive technologies, like virtual reality, might not only change people's job descriptions over time, but also reduce the need for canteens. What both companies, Rational and WD-40, have in common is a perceived quality that is expressed by a staggering valuation. Since listing, Rational has mostly traded around 15 - 25x P/E and 10 - 16x EV/EBIT. Since QE started in early 2015, the valuation has increased to new recent highs of 40x P/E and 28x EV/EBIT.

As highlighted in our Q3 2015 newsletter, we only invest in what we consider great companies on the long side of the portfolio. In light of the previous paragraphs, we acknowledge that it has become rarer to find great companies at reasonable prices. Nevertheless, we are pleased to have a strong portfolio of long investments, as illustrated below, of superior quality stocks at below market average valuations. However, the potential collective upside of our long investments is not compelling enough to justify a larger net exposure, especially as such valuations also make it easier to find attractive short candidates.

In addition to the typical overvalued, overleveraged companies with cyclical and commoditised business models disrupted by new technologies, recent market developments have allowed us to start looking at a new breed of potential shorts: quality stocks trading at substantial valuation premium to any reasonable fair value. After all, quality stocks at very high levels of valuation are not risk free investments; irrespective of how much the Queen of Hearts might believe in them.

Portfolio Structure

As usual, we consolidate our portfolio holdings on the long side – as well as on the short side – into a notional combined entity allowing us to better illustrate to investors the economics of an average company in the portfolio. Our 'average company' looks like the following:

Long Investments: Typical Company Economics

Financials* (EUR m)	2014	2015	2016E[1]	2017E[1]
Sales	4113	4275	4445	4621
Gross Profit	2251	2382	2602	2718
EBIT	674	761	868	923
Net Income	471	546	582	633
FCF	418	468	501	574
Net Financial Debt	1548	1037	698	306

Valuation Ratios* (EUR m)	2014	2015	2016E[1]	2017E[1]
P/E	21.0	21.1	17.6	15.5
P/BV	2.9	3.2	2.8	2.6
EV/EBIT	18.4	16.4	13.8	12.6
Net Debt/EBITDA	0.9	0.5	0.3	0.1
Dividend Yield	2.8%	2.6%	2.7%	2.9%
ROE	23.6%	25.0%	24.9%	25.1%
ROCE	17.2%	15.3%	15.6%	17.6%

Short Investments: Typical Company Economics

Financials* (EUR m)	2014	2015	2016E[1]	2017E[1]
Sales	18855	21637	22189	21791
Gross Profit	5471	6202	6576	6059
EBIT	1895	2321	2424	1912
Net Income	1451	1544	1603	1052
FCF	355	466	759	588
Net Financial Debt	8261	7777	6591	7571

Valuation Ratios* (EUR m)	2014	2015	2016E[1]	2017E[1]
P/E	26.3	28.6	21.8	33.2
P/BV	3.9	3.8	3.7	3.9
EV/EBIT	18.4	21.7	17.3	21.9
Net Debt/EBITDA	1.6	1.5	1.3	1.7
Dividend Yield	2.5%	2.5%	2.5%	2.5%
ROE	15.3%	15.3%	14.8%	9.7%
ROCE	12.4%	11.4%	12.1%	8.0%

*Source: Bloomberg, Blackwall Capital Investment AG.
[1] Note that there can be no assurance that these estimates will be achieved.

Our investment philosophy is to go long great companies, with mid-caps being our sweet spot, and to short weak companies, preferably in the large cap area. In terms of size, as the tables illustrate, investors in the fund typically hold a mid-sized company on the long side, while the average company shorted is about 5x bigger in terms of revenues.

Let's focus on 2016 numbers to compare data as 1) H1 results have already been reported, leaving less room for error on either side of the forecasts and 2) we expect some recessionary headwinds to impact earnings in 2017, which may or may not come:

- Gross Margin: the average gross margin of our longs is 59% versus just 30% for our shorts (in fact, this is close to the Stoxx 600 average of 29%).
- EBIT Margin: our longs show an average EBIT margin of 20%, substantially higher than that of our shorts with 11% (Stoxx 600 average: 8%). It's worthwhile pointing out that 2016 is likely to be a good year for cyclical companies which comprise a larger part of shorts. Thus their margins are rather close to the peak and certainly above the mid-cycle level.

- Net Profit Margin: In 2016 our average long is likely to generate a net profit margin of 13% versus 7% for our shorts.[2]
- Return on Equity: the average long in the fund generates a ROE of about 25% compared to 15% generated by the average short. The latter isn't bad, but again, it's near the peak with the mid-cycle level being closer to high single digit.
- Leverage: when compared with the broader equity market that shows a net debt/EBITDA ratio of 3.4x, both our longs (0.3x) and our shorts (1.3x) are rather low in 2016. However, while longs are soon to become net cash positive, shorts are likely to post higher net debt/EBITDA levels in a recessionary scenario.

In terms of valuation, we use various metrics, with our preferred ratio being EV/EBIT. On average our long portfolio trades at 13.8x for 2016E, with the short portfolio trading at 17.3x. On average we argue that longs are more attractively valued, especially with a recessionary backdrop 2017.

Overall, we believe that our fund holds companies with low debt levels, a strong franchise and superior margins on the long side, thus generating substantially higher ROEs. As for the shorts, we believe they are companies with weak business models that are particularly vulnerable to the next economic downturn and are liquid enough to avoid most market short squeezes.

[2] Note that there can be no assurance that these estimates will be achieved.

Best regards,

Thomas Karlovits

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FOR MORE INFORMATION, VISIT
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