CRESCAT CAPITAL
VALUE-DRIVEN PERFORMANCE

Crescat Capital LLC
1560 Broadway
Denver, CO, 80202
(303) 271-9997
info@crescat.net

August 26, 2015

Crescat Capital's Quarterly Investor Letter, Q3 2015

Dear Investors,

China's economic crisis is in full swing and Crescat has been well positioned for it. The People's Bank of China has begun unpegging its currency this month, just as Crescat had been predicting. As we explain below, we think it is only the beginning of further yuan devaluation. Through today's close, Crescat Global Macro Fund is up 6.5% net in August month to date and up 12.8% net year to date.

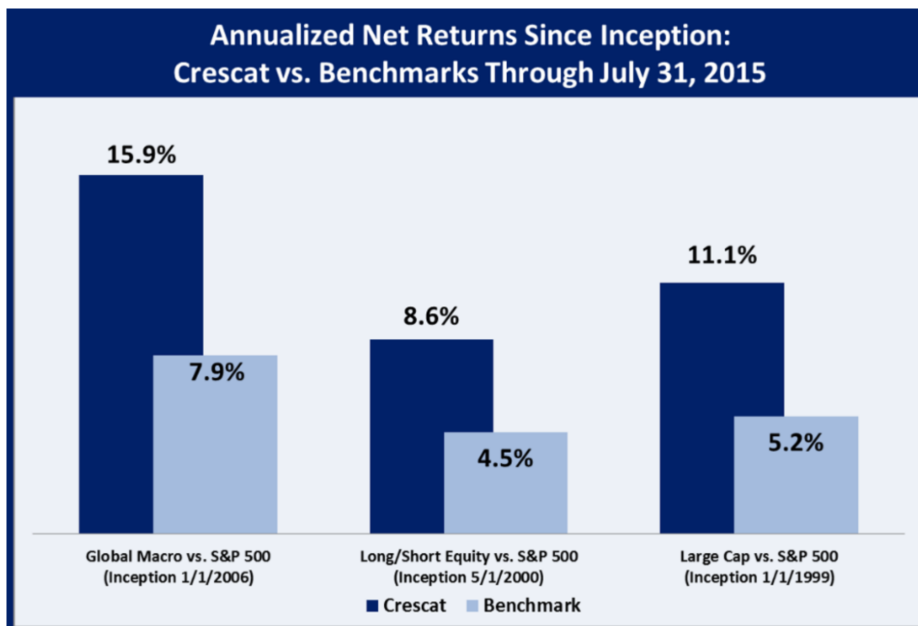
Among the dozen macro themes in our portfolios, China Currency and Credit Bubble has been the single highest conviction theme of ours for several quarters now. The Asian contagion has finally reached the U.S. In just four days through yesterday's close, Wall Street traders returned from their summer vacations to sell stocks with a vengeance, pounding U.S. large cap stocks by 10.2%. At yesterday's close, the S&P 500 was down 11.1% MTD and 8.1% YTD. Today, the S&P 500 bounced back by 3.9%.

Through today, the S&P 500 is down 7.6% month to date and down 4.5% year to date. Crescat Long/Short Fund is down 1.5% net month to date and up 3.0% net year to date through today while Crescat Large Cap, our equity long-only-SMA strategy, is down 4.8% net month to date and up 0.4% for the year. Crescat Large Cap is 4.9% ahead of the S&P 500 net year to date.

Based on our approach of combining diversified macro themes with a systematic bottom-up equity model across three diverse strategies, Crescat has substantially outperformed the market and delivered strong annualized net returns to our investors since inception in all three of its strategies.

Crescat's official net performance through July (last month end) and since inception through July is shown in the table and chart below.

Net Performance YTD through 7/31/15 and Since Inception		
Crescat Strategy	**2015 Through 7/31**	**Annualized Since Inception**
Global Macro	5.9%	15.9%
Long/Short	4.6%	8.6%
Large Cap	5.5%	11.1%
S&P 500	3.4%	(see graph below)



The U.S. market has been overdue for a 10% or more correction. It should come as no surprise. China's communist crack up should not come as a surprise either. We had been waiting for a broad global market correction and have been taking advantage of it in our hedge funds through a variety of shorts including our China-related short positions, Biotech Bubble themed equity shorts, and oil and gas E&P equity shorts that we have written about in prior letters. High yield bond ETF shorts and put options on the same have also benefited the Global Macro Fund as part of our Fed Moderation theme. And our precious metals related longs have also been doing well this month in all three strategies. While our outlook going forward may change, we see a choppy market ahead and plan to opportunistically and cautiously put some of our cash on the sidelines to work into long equities in all three strategies over the next few months. We also plan to take advantage of the market downturn by gradually unwinding some of our equity short positions in our hedge funds.

We are still bullish on the U.S. economy outside of energy and the overvalued biotechs. On a free-cash-flow (FCF) to enterprise value (EV) yield basis, many U.S. stocks trade at cheap valuations given the low interest rate environment. The Federal Reserve will remain highly accommodative even if and when it does begin raising rates. Many market participants and economists have already begun pleading with the Fed to revert back to Quantitative Easing (QE). We still own some gold-related positions to protect us if and when they do. We believe the U.S. economy is still in only the middle stages of a long, slow expansion in the aftermath of the Global Financial Crisis.

Regardless of market direction, our hedge funds are always hedged and our fundamental model guides us to the right stocks to be both long and short in any market. Meanwhile, our Global Macro themes help us further refine and risk budget our positions. In our Global Macro Fund, we budget risk according to theme buckets and constraints using a Conditional Value-at-Risk model. In that fund, we add long and short positions in currencies, commodities, and interest rate futures to supplement our long and short equity positions that otherwise make up our Long Short Equity Fund and are also included in our Global Macro Fund. We believe we have been well positioned and well prepared for this U.S. equity correction and even more so for the Chinese one where we remain positioned.

China Currency and Credit Bubble

In the Crescat Global Macro Fund, we own put options on the Chinese yuan that represent an asymmetric risk/reward trade. We entered these positions with minimal downside risk and substantial upside return possibility. Conventional wisdom was that the yuan was a both an undervalued currency and a pegged currency with extremely low volatility. We disagreed with that view based on our macro analysis of the Chinese economy, given its inefficient and corrupt command economy, its unsustainable real estate and infrastructure spending, world-record M2 money supply, slowing GDP, and substantial illicit capital outflows. We think the mere 4% devaluation of its currency this month is only the beginning. For the month so far, Crescat Global Macro Fund has earned 6.9% of gross return from its yuan put options while it had only 1% at risk prior to the devaluation. Furthermore, our China equity shorts have delivered another 3.8% of gross return to both of our hedge funds. We started shorting Chinese equities in late June after the Shanghai and Shenzhen stock market bubbles had already begun bursting. We determined that the median PEs on Chinese equities were still in the 80s at that time. We had been misled in prior months by Bloomberg aggregate data on Chinese PEs that was grossly understated.

Supported by our macro views in this market, we remain short three Chinese equity ETF's (MCHI, FXI and HAO) and six U.S. listed Chinese equities that trade on a U.S. exchange and are part of our China theme.

Ticker	P/E Ratio	P/B Ratio	FCF yield	Crescat Model Rank (0-100)
21VIANET GROUP (VNET)	236	2.7	-0.8%	5
QUNAR CAYMAN ISLANDS (QUNR)	Negative	12.8	-2.9%	25
58.COM (WUBA)	Negative	2.8	1.1%	47
JD.COM (JD)	941	5.8	2.1%	40
CTRIP.COM INTERNATIONAL (CTRP)	111	5.9	3.3%	23
YOUKU TUDOU (YOKU)	Negative	1.5	1.2%	56
MELCO CROWN ENT. (MPEL)	25	2.3	3.4%	12

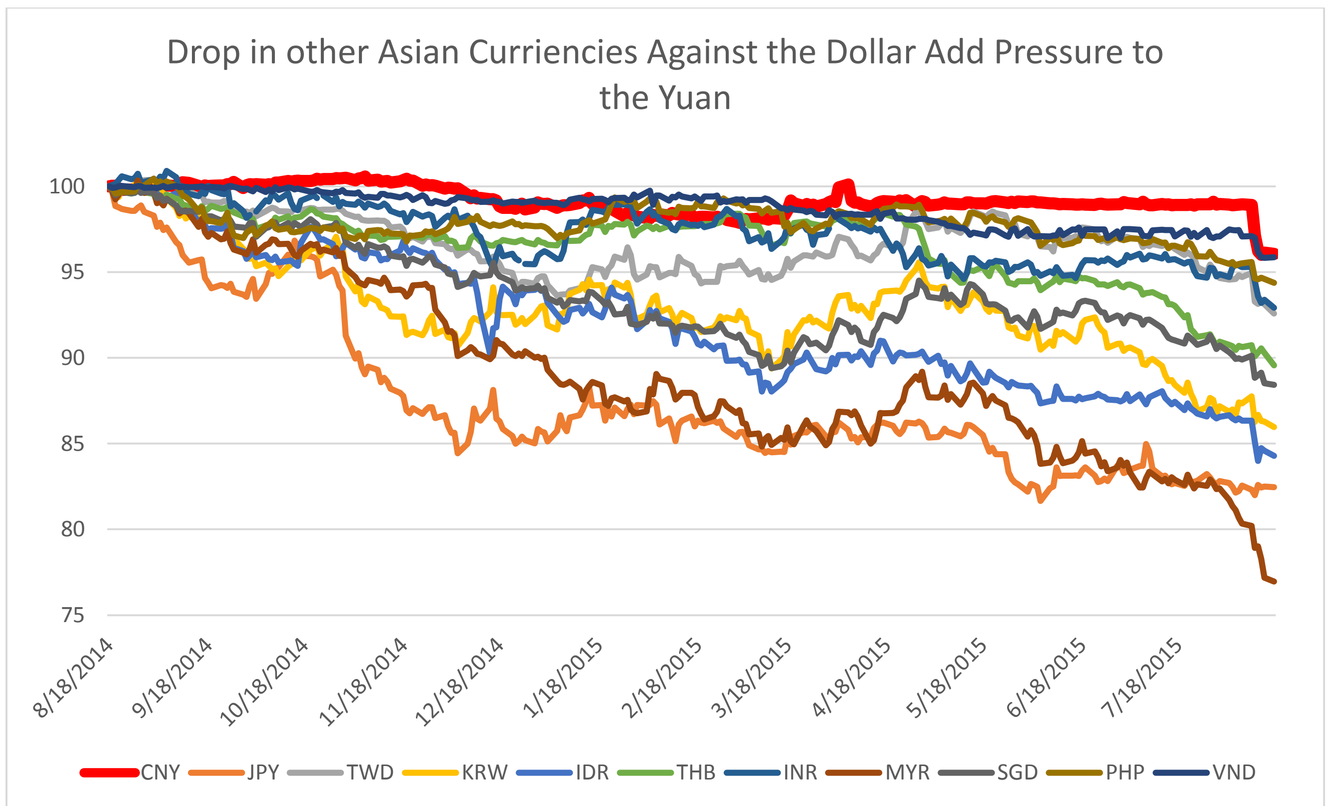
With the median Chinese equity still trading at a high 60 times earnings, credit problems brewing for China's wealth management products, and a housing market on the verge of collapse, we believe Chinese investors will persist in attempting to get their money out of the banks, out of the stock market, out of the real estate market, and out of the country. The need for additional PBOC cash injections to support its economy is greater than ever and will necessitate further weakening of the yuan. The PBOC cannot support its domestic financial markets and its currency at the same time.

As mentioned in a previous letter and macro deck, we think the Chinese economic bubble has three possible ways that it can unwind: (1) a banking and credit crisis, including a stock market and real estate crash, the deflationary economic hard landing scenario; (2) a currency crisis which is marked by massive money printing, domestic inflation, and capital flight; or (3) a twin crisis, which is a self-reinforcing combination of both. At this point, we think option 3 is fully in play. These are some important facts to consider:

- China's M2 money supply has reached a world record level of 21.4 trillion in USD equivalent at the end of July, accounting for almost 210% of its GDP;
- For $100 million or greater market cap companies in the Shanghai and Shenzhen composites combined, the median P/E ratio of Chinese stocks is still at a bubble high level, 60;

- The PBOC has already printed the equivalent of over 5.5 trillion USD since 2002. That's much more than any other central bank in the world, ever;
- Since 2000, China's cumulative imbalance in its balance of payments is close to 7.2 trillion USD indicating an overvalued currency and reflecting illicit capital outflows of an amount that is twice China's foreign reserves;
- The Shanghai composite is down 43% from its bubble peak in June dealing a major blow to Chinese retail investors even though it is only down 9.5% for the year. This is after rising from a level of 2000 to 5000 in just two years, levels reminiscent of the Y2K Nasdaq Composite bubble.

To give further support to our views on the future direction of the Chinese yuan, we looked at ten other Asian countries and currencies, many of which are both China's trading partners as well as its mercantilist-style trade competitors in the global economy. In the graph below, we show these ten currencies in addition to China's CNY, all relative to the U.S. dollar. These include Japanese yen, Taiwan dollar, South Korean won, Indonesian rupiah, Thai baht, Indian rupee, Malaysian ringgit, Singapore dollar, Philippine peso, and Vietnamese dong. We initially began preparing this graph and tracking these currencies prior to the yuan devaluation. We noticed at that time was that the other Asian currencies were already depreciating significantly while the yuan was still holding at its peg. We believed the yuan would follow, and now it has. The median depreciation rate of these ten other currencies is now close to 9% over the past year. What the graph shows is the proverbial "race to the bottom".



Many of these countries shown above were involved in the 1997 Asian Currency Crisis. Those hit most in that crisis tended to be excessively leveraged (mostly due to external debt) with very low foreign reserves and a large money supply relative to GDP. Among the most affected countries in the 1997 crisis, their respective currencies depreciated 30-50% against the dollar.

The circumstances of the countries caught up in the 1997 Asian Crisis compare most eerily with Australia today and have led us to resume our short position in the Australian dollar and Austrian equities in early June. This gave new life to an old theme, called Aussie Housing Bubble at the time, now re-branded as the Aussie Debt Crisis.

Aussie Debt Crisis

Australia has one of the largest credit growth rates among developed economies. Its money multiplier is near 19 times, and clearly, lending has been excessive. The Reserve Bank of Australia (RBA) has just begun printing money on a larger scale, but it's far behind any other advanced economy. The debt created through the run-up on credit expansion was mostly built up internationally. This is a country with $1.43 trillion worth of GDP, and $1.38 trillion in external debt. After netting external financial assets, Australia has about 64% of its GDP in external debt. In addition to this, RBA only owns $65 billion of foreign assets, or just about 5% of its GDP. These overvalued metrics have exposed the currency's vulnerability to a speculative attack.

Our negative macro views on Australia have strong links with the current issues in the Chinese economy. Knowing that China continues to experience more capital outflows, a large portion of this money has been flying into the Australian real estate market. As a result, a bubble has formed.

The RBA has recently kept the cash rate target at a record low. However, household debt to income ratio is 155%, and credit expansion could be reaching a limit. Banks' valuations are very concerning, and M3 money supply (Australia does not report M2) is almost 100% of its GDP. For instance, the largest Australian banks have 109% greater median price-to-book ratio than the largest 10 banks in the world. Also, the same Aussie banks have a 46% higher median price to book compared to the five major U.S. banks prior the Global Financial Crisis.

Largest 10 Banks in the World by Market Cap (2015)	
Price to Book	
Wells Fargo & Co	1.75
Industrial & Commercial Bank of China	1.09
JPMorgan Chase	1.16
China Construction Bank	0.98
Bank of China	0.89
Bank of America	0.81
HSBC Holdings PLC	0.92
Agricultural Bank of China	0.82
Citigroup	0.84
Mitsubishi UFJ Financial Group	0.82
MEDIAN	**0.91**

Four largest Australian Banks by Market Cap (2015)	
Price to Book	
Commonwealth Bank of Australia	2.60
Westpac Banking	2.04
National Australia Bank	1.75
Australia & New Zealand Banking Group	1.60
MEDIAN	**1.89**

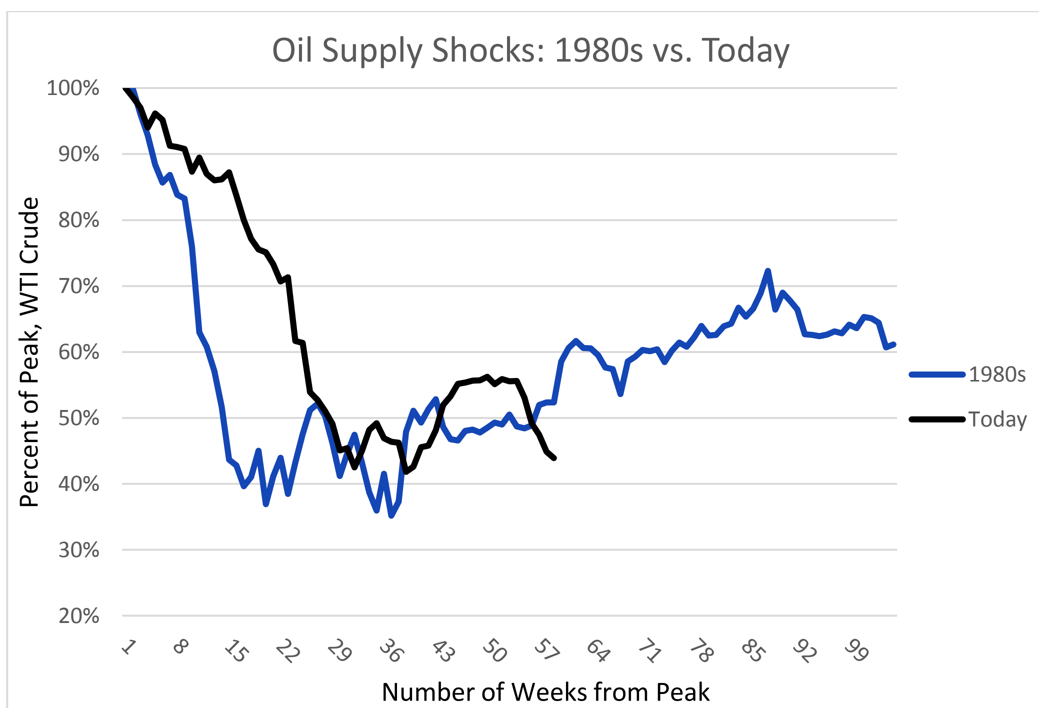
U.S. Banks Prior to the Global Financial Crisis (2007)	
Price to Book	
Bank of America	1.29
Wells Fargo & Co	2.11
JPMorgan Chase	1.19
Citigroup	1.30
Lehman Brothers	1.56
MEDIAN	**1.30**

The RBA has communicated about improving banks' capital ratios several times, but Tier 1 remains relatively unchanged. The high profitability of these banks is the result of inflated earnings based on a formerly strong economy. Their valuations are stretched, and their high margins are based on backward looking numbers at what is almost certainly the peak of the cycle. With extra pressure coming from the slowdown in the Chinese economy, we strongly believe these banks and their valuations are at risk of a meltdown.

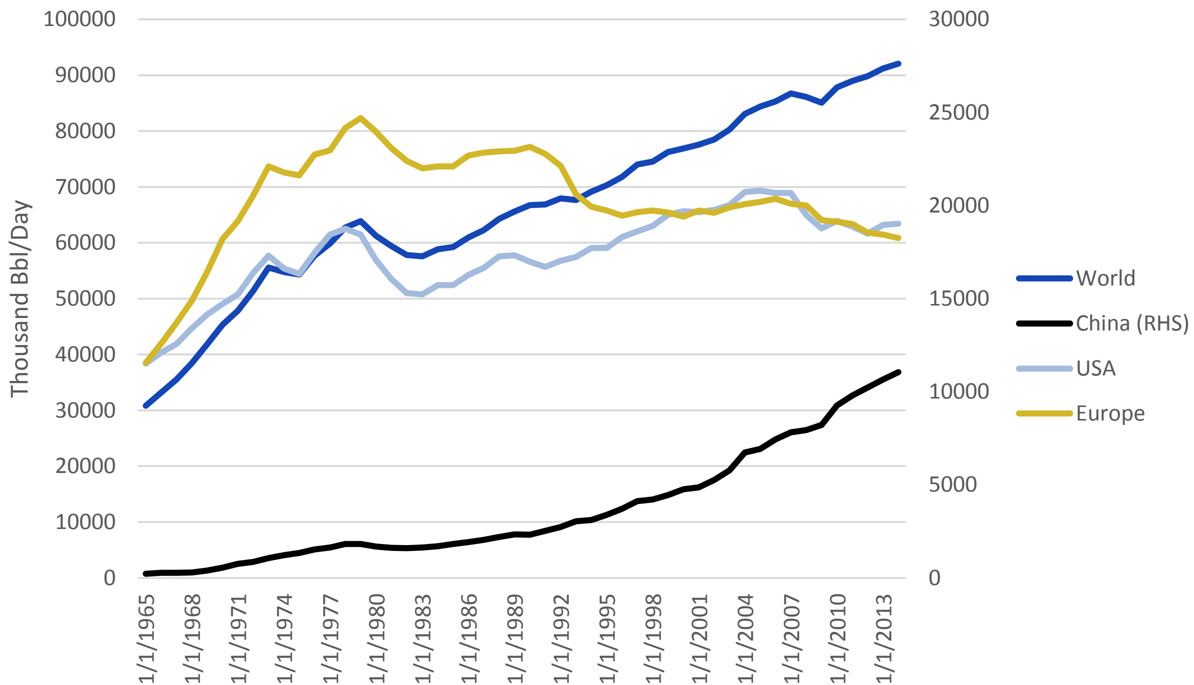
As far as our exposure to this theme, we hold a short position in EWA. This is an iShares MSCI Australia ETF, and 35% of which is composed of the major Australian banks mentioned above. We also added to Westpac Banking Corp (WBK), a $77 billion market cap bank. The company trades at 2.11 times book, and its top line growth has just turned negative. We believe this cyclical business is overvalued and will be negatively impacted by the economic downturn.

New Oil and Gas Supply

In the media as well as in our previous investor letters, there is much discussion of oversupply in world oil markets. Estimates range as to the extent, but signs of oversupply can be seen from Cushing to Singapore. Less discussed, however, is the demand side of the equation. We believe that slowing world oil demand will combine with excess supply to keep a lid on prices over the next few years. In our Q1 2015 investor letter, we dismissed the idea of a "V-shaped" oil recovery. Stories of managers getting long energy too early are starting to emerge. We remained bearish on most stocks in the industry and stayed short many oil and gas exploration and production companies to the benefit of our investors. As we indicated in an earlier version of this chart below, we believe that WTI crude oil prices will generally follow the trend of their last supply-driven crash that began in 1985:



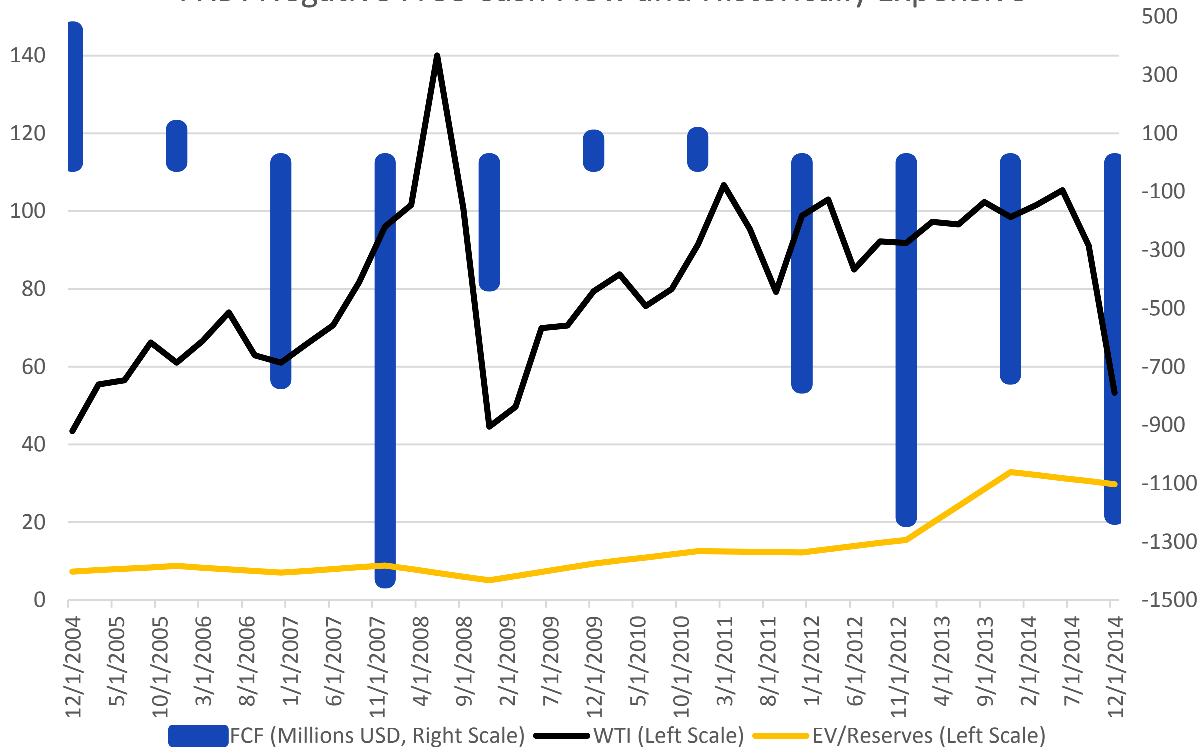
High prices encourage efficiency and substitution in oil consumption. High prices in the 70s encouraged both of these phenomenon, especially in Europe, where oil consumption peaked in 1979. Similarly, high prices seemed to have contributed to a peak in US oil consumption in the mid/late 2000s. New supply came online several years after each of those two consumption peaks, contributing to the oil crashes of 1986 and 2014. Both of these are widely considered "supply shocks" since over-production caused oil prices to collapse, but clearly consumption had slowed in major consuming areas several years before each crash. High prices encouraged consumers to conserve, leading to a peak in demand. Those same high prices encouraged producers to explore, leading to increased production. The combination of those forces crashed prices in both instances.



Since 2008, China has been the world's backstop source of demand for many commodities, growing consumption rapidly while the developed world's growth slows. Given our views on China's impending economic bust, which is now coming to pass, we have been more bearish on global demand for oil than most. The combination of a peak in US oil consumption in 2005-7, and the possibility of an imminent slowdown in Chinese oil consumption will keep prices suppressed in our view.

Over the next few years, the effects of cancelled and delayed projects will show up in production figures, giving more lasting support to crude prices. In the meantime, prices will remain suppressed and life will continue to be exceedingly difficult for highly-leveraged exploration and production companies, and many others in the energy sector as well. Banks have become more stringent and will get more so during asset revaluations in October and moving forward. The debt and equity capital markets that were so plentiful to these companies have indeed been shutting down as we had warned about in a prior letter. And rather than getting rescued by M&A buyouts, companies are going bankrupt as we also had warned.

Despite being well below their 2014 highs, many exploration and production equities remain overvalued by many metrics. Price-to-earnings ratios rival the hottest momentum names. Enterprise values remain high despite a loss in market cap due to rising debt levels, making many companies unattractive on an EV to Proven Reserves basis. Negative free cash flow still dominates the industry, and most companies are highly leveraged. These characteristics generally apply to Pioneer Natural Resources (PXD), as seen in the graph below. PXD had significant negative free cash flow when WTI crude was above $90/bbl, making an extended period of $50/bbl WTI sound unfathomable. Since 2013, EV/Reserves for PXD has tripled from its long term average. PXD trades at nearly 150 times forward earnings and has significantly negative free cash flow. Short positions in SPDR S&P Oil & Gas Exploration & Production ETF (XOP), PXD, Continental Resources (CLR), Whiting Petroleum (WLL), Penn Virginia (PVA), to name a few of our recent holdings, as well as many other energy E&P shorts have been highly successful trades for our clients in both Global Macro Fund and Crescat Long/Short Fund over the last year.



As expected, low prices have caused many non-US, non-OPEC deep water and other large conventional oil projects to be delayed. Shale producers are more flexible, but will eventually slow production after shifting to sweet spots and increasing efficiency loses its potency. These forces will gradually work to decrease supply and provide more lasting support to prices. In the meantime, crude oil supplies are at or near record highs around the world. We have benefitted from this imbalance with long positions in refiners (Valero, Western Refining) and a crude oil tanker company (Nordic American Tankers).

TV Broadcast Incentive Auction

And finally, we would like to highlight a bullish new U.S. long equity theme that applies to all three of our strategies. America's local broadcast television stations may appear to the Millennial generation as old-fashioned businesses in the digital media age, but they are strong media competitors with valuable content, valuable networks, and most interestingly, valuable wireless spectrum. The spectrum controlled by the TV broadcasters is essentially high-value, highly regulated airspace that allows signals to travel long distances and pass easily through obstructions like buildings and trees. The wireless carriers need this spectrum to build out next generation 4G and LTE broadband mobile services. The FCC is conducting an auction – dubbed the Incentive Auction – that is scheduled for the first quarter of 2016. The Q1 cash windfall to TV broadcast stocks from this auction could be $40 to $80 billion. Some of the purest-play broadcast stocks that could participate the most in this windfall compared to their current enterprise values trade at very reasonable valuations in terms of FCF-to-EV yield and have strong growth potential. Furthermore, TV ad revenues are likely to get a cyclical boost over the next year with the U.S. elections, making these timely short-term if not long-term investments.

Spectrum Incentive Auction Likely Winners							
TV Broadcast Company	Enterprise Value ($ Billions)	EV to # of TV Stations in Top 25 Markets	EV to Total # of Stations	Incentive Auction Potential Windfall to EV Rank	Core Business Rank	FCF to Current EV Yield	Projected 3-yr FCFPS Growth Rate
EW Scripps (SSP)	2.2	0.31	0.07	100	40	7.2%	10.1%
Tribune Media (TRCO)	8.2	0.46	0.19	89	28	4.3%	5.0%
Sinclair Broadcast (SBGI)	6.5	0.59	0.05	78	91	7.1%	26.4%
TEGNA (TGNA)	12.9	0.68	0.29	67	40	4.6%	7.0%
Media General (MEG)	4.4	0.88	0.06	56	36	8.6%	11.4%
Nexstar Broadcasting (NXST)	3.2	1.07	0.04	45	97	8.1%	24.2%
CBS Corp. (CBS)	34.6	2.16	2.16	33	84	6.3%	13.6%
Twenty-First Century Fox (FOX)	78.5	3.27	2.80	22	67	4.9%	6.9%
Comcast (CMCSA)	196.2	10.33	7.27	11	87	5.1%	15.4%
Walt Disney Co. (DIS)	198.7	28.4	24.8	0	51	4.3%	11.0%

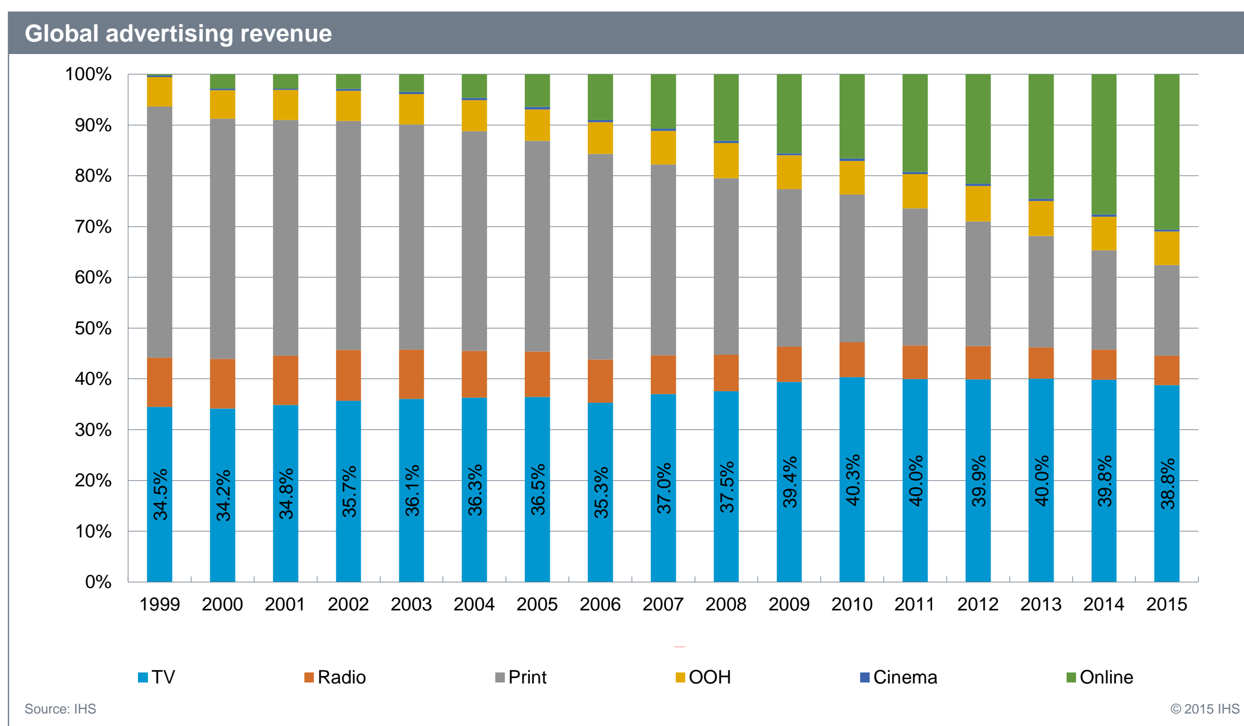
Source: Crescat estimates and Crescat models. Ranks are based on a zero to 100 Scale with 100 being the best.

The potential cash windfall from the Incentive Auction is not yet priced into many of these stocks and could be more than 50% of EV for some of them. EW Scripps, Tribune, Sinclair, and TEGNA are the four stocks with the most cash windfall potential relative to their current EV based on our broadcast auction model, which is driven by the number of TV stations owned in the largest cities as well as the overall number of stations owned. Also, the TV broadcast stocks with the strongest core businesses according to Crescat's discounted-FCF fundamental equity model are Nexstar, Sinclair, Comcast, and CBS. In our hedge funds, based on our new Broadcast Auction macro theme, we own a mix these seven with an overweight position in Sinclair, the one that overlaps both groups.

The reason that the cash windfall is not priced into many of these stocks is that cable and TV industry stocks have been under selling pressure due to the threat of a longer-term profit squeeze from over-the-top (OTT) internet and mobile video streaming led by technology companies such as Netflix (NFLX), Amazon (AMZN), and Google (GOOG). Netflix is the chief disruptor with its large-scale, low-fee, business model. While Netflix's current business model is devoid of free cash flow, consumers love it, and surprisingly so do investors. Reed Hastings, Netflix's CEO has promised its customers that there will be no ads. But that means there will no advertising revenues for its investors either. How will Netflix achieve FCF profitability and will its investors ever hold it accountable for such? FCF has been negative for three out of the last four years.

In the media monetization battle, traditional media and cable companies are already beneficiaries of digitization. They sit on valuable programming content and, ironically, infrastructure assets necessary for broadband wireless video delivery. They already have strong free cash flow in their core businesses driven by both rising retransmission fees and stable market share of traditional TV advertising. The media executives who run these companies are smart business people who know how to run profitable businesses. They are experts in capitalizing on advertising spending and content distribution in particular. Their content is already retransmitted and streamed digitally where they are participating in online and mobile advertising revenues.

Broadcast and Cable TV's Share of Advertising Revenues Remains Steady
And They Are Also Participating in Online Ad Revenues



The Incentive Auction will give the TV broadcasters a chance to monetize their underutilized spectrum. They will receive a cash infusion courtesy of the FCC and the wireless carriers. The cash will likely be returned to shareholders through dividends and/or stock buybacks because these companies generate plenty of free cash flow on their own already. They don't need it.

Sincerely,

Kevin C. Smith, CFA
Chief Investment Officer

Tavi Costa
Emerging Markets Analyst

Nils Jenson
Energy and Materials Analyst

Only accredited investors and qualified clients will be admitted as limited partners to a Crescat fund. For natural persons, investors must meet SEC requirements including minimum annual income or net worth thresholds. Crescat funds are being offered in reliance on an exemption from the registration requirements of the Securities Act of 1933 and are not required to comply with specific disclosure requirements that apply to registration under the Securities Act. The SEC has not passed upon the merits of or given its approval to the Crescat funds, the terms of the offering, or the accuracy or completeness of any offering materials. A registration statement has not been filed for any Crescat fund with the SEC. Limited partner interests in the Crescat funds are subject to legal restrictions on transfer and resale. Investors should not assume they will be able to resell their securities. Investing in securities involves risk. Investors should be able to bear the loss of their investment. Investments in the Crescat funds are not subject to the protections of the Investment Company Act of 1940. Performance data represents past performance, and past performance does not guarantee future results. Performance data is subject to revision following each monthly reconciliation and annual audit. Current performance may be lower or higher than the performance data presented. Crescat is not required by law to follow any standard methodology when calculating and representing performance data. The performance of Crescat funds may not be directly comparable to the performance of other private or registered funds. Investors may obtain the most current performance data and private offering memorandum for a Crescat fund by contacting Linda Smith at (303) 271-9997 or by sending a request via email to lsmith@crescat.net. See the private offering memorandum for each Crescat fund for complete information and risk factors.