Spring Ocean Capital Newsletter 4Q 2016

Portfolio Performance

Our portfolio performance for the year were:

	S&P500	Spring Ocean Composite*
2016 1Q	1.4%	8.6%
2016 2Q	2.5%	8.9%
2016 3Q	3.9%	3.7%
2016 4Q	3.8%	3.5%
2016	11.95%	26.8%

** We use the Interactive Broker's portfolio analytic data output. It includes all managed accounts. For detailed monthly return data, please see the other report (IB portfolio performance report). Performance data are not audited.*

The following table shows our five best and worst performing stocks for the full year. It also shows their mark-to-market Profit and Loss (PnL) as a percentage of consolidated Net Asset Value (NAV) at end of 4Q 2016. (*For simplification, we use end of 4Q NAV as denominator for PnL percentage calculation here. Because we have significant asset increase during the 3rd quarter, the PnL% shown here is smaller than time-weighted return calculation.*)

	Profit%	Loss%
PCI (PIMCO Dynamic Credit Income)	3.7%	
APEI (American Public Education, Inc.)	2.1%	
OUTR (Outwall Inc.)	2.0%	
EMC (EMC Corp)	1.6%	
PFN (Pimco Income Strategy Fund II)	1.6%	
MCD H6 (Canadian Dollar Future)		-0.1%
ES H6 (S&P 500 future)		- 0.8%
GILD (Gild Science Inc.）		-0.9%
BKE (Buckle Inc.)		- 1.1%
MDY (SPDR S&P MIDCAP 400 ETF TRST)		-1.6%
Total：	11%	-4.4%

The top 5 best performing stocks had a total PnL of 11%. The bottom five had a total PnL of -4.4%.

In the 4th quarter, the top 5 best stocks had two new members. APEI and PFN replaced CJR.B and ORV. Their position changes were mostly due to market movements. In the 4th quarter, Trump's surprise election victory and his proposed tax cut lifted lots of middle and small capital US based stocks. Our profit in APEI probably was benefited from the Trump rally.

PCI and PFN were our two largest positions. As we discussed before, they offered some of the highest yields and was managed by one of the best fixed-income management company (PIMCO) in the world. When we started these positions a year ago, their market value had a large discount compared to their net asset value (NAV). The market concerned that the Fed would increase rate and the long bond bull market would end. Both funds had limited duration about 3. We reasoned that as long as the Fed did not increase the interest rate too quickly, we could still make money. We had been correct so far and the market had responded by closing the discount gap, and these two positions contributed nicely to our profit in 2016.

Among the 5 biggest losses, GILD was a new position we initiated recently. We put about 10% position in this stock, the recent mark-to-market loss was mostly likely due to market fluctuation. We are confident this position will bring us profit in the future.

All other 4 positions in the biggest losses were from previous allocations. As we discussed for almost a year, BKE (Buckle Inc.) had experienced lots of head winds. The fundamental of this stock had deteriorated, though it was still profitable. However, I still believe BKE offers value and a committed management team. We will keep a close eye on this position.

MDY, ES H6, and MCD H6 were our hedging positions. We sold short MDY and ES H6(S&P 500 index future) to hedge some of the market risk. For the year, the market went up, and we incurred loss in the MDY as well as the ES H6 future position. MCD H6 was a hedging position on some of our Canadian dollar exposure. Since they were hedging positions, their loss were usually cancelled out by the other positions that made money.

In the 4th quarter, our portfolio were underweighted compared to the market, and as the market kept going up, our 4th quarter results slightly lagged behind the market. For the whole year, our performance was significantly better than the market. We were happy with the results.

Major positions at the end of 2016

Our major 5 positions at the end of 2016 were:

	Sep. 2016	Dec 2016
Index ETFs	-21%	-20.7%
PCI (PIMCO Dynamic Credit Income Fund)	18.6%	18.1%
PFN(PIMCO Income Strategy Fund II)	9.7%	11.3%
ABC(AmerisourceBergen Corp.)	0%	10.3%
GILD(Gilead Sciences)	9.2%	9.8%

The one major change in the top 5 positions was the replacement of PDI by ABC. ABC was a pharmaceutical distribution company. The United States pharmaceutical distribution market was majorly controlled by 3 companies, and ABC was one of the undervalued and most competitive among the big three.

PDI was one of our major holdings for PIMCO fixed-income closed end funds. However, over the year, PDI's market price relative to its net-asset-value increased from a discount of -7% to premium of about 8%. We were also a little bit worried about the coming interest rate increase in 2017, which is generally bad for fixed-income products. Therefore, we trimmed our position in it.

Also, for presentation purpose, we changed the short position from "MDY" to "Index ETFs" for our top 1 position. We sometimes shorted a couple different index ETFs for tax or other considerations. These index ETFs had high correlation, and they all shared one purpose as a hedging to our portfolio. We believe it made more sense to group them together as one position here.

Our positions by asset class at the end of the year were:

	Sep 2016	Dec 2016
Equity	58.6%	61.6%
Equity Index Hedge	-21.9%	-20.7%
Fixed-income fund	44%	34.8%
Arbitrage	-0.7%	-0.9%(9.8%/-10.7%)*
Cash/cash equivalent	20%	25%

**The arbitrage position consist of 9.8% long and 10.7% short position, net of -0.9%.*

We trimmed some of our fixed-income fund position. We also increased some equity position due to the recent position in ABC and GILD. We still havd a large portion of cash on hand. Going forward, we will cautiously deploy the cash.

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