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2020 Third Quarter Investor Letter

October 8, 2020

Dear Investors,

We would like to begin by thanking our clients for their continued support and unwavering confidence in our investment strategies through these unprecedented times for the financial markets and our country. Additionally, we would like to welcome our many new investors to the Pelican Bay Family. We appreciate the opportunity you have bestowed upon us to realize your financial objectives with integrity and discipline.

Pelican Bay Capital Management will be celebrating our second-year anniversary on October 31st. Despite the challenges presented by COVID in the spring, the firm has flourished with assets under advisement growing seven-fold since the start of the year.

In August, Pelican Bay launched a new portfolio strategy that we are calling Inflation Plus. This new strategy represents our fourth portfolio offering. We believe it is a unique product that expands on our experience with the Dynamic Income Allocation Portfolio. We will discuss the strategy and portfolio construction in more detail in the pages below.

Most importantly, we are extremely excited to share our third quarter investing results as our portfolios delivered outstanding risk-adjusted returns. We continue to overcome the challenges presented by our portfolio positioning during the initial economic shock from the COVID crisis.

The Concentrated Value and Phoenix Portfolios both outpaced the stock market in the third quarter, despite the former having 20% in cash, and the latter having a large short-hedge position. Like last quarter, the Dynamic Income Allocation Portfolio delivered on its mandate to produce elevated levels of income with amazingly little volatility. The results for each portfolio for the third quarter and year-to-date are in the table below.

Portfolio	Q3 Return	YTD Return
Concentrated Value	10.6%	-29.2%
Dynamic Income Allocation	3.1%	-12.2%
Phoenix Fund	14.7%	-26.2%

The layout of this quarter's letter will start with a general market commentary, followed by individual reviews and analysis of each of our portfolios including Concentrated Value, Dynamic Income Allocation, and the Phoenix Fund. Lastly, we will discuss our Inflation Plus portfolio strategy.

As always, if after finishing this letter you have any questions or would like to discuss any topics in greater detail, please don't hesitate to call 239-738-0384 or send an e-mail to tyler@pelicanbaycap.com. We welcome your feedback and look forward to your correspondence. Additionally, we encourage you to share this letter with as many friends and colleagues as you like.

Market Commentary

The rebound in equities from the March market low continued into the third quarter with a persistent outperformance of growth stocks, led once again by the FAANG names and other companies that are believed to be beneficiaries of shift to "work from home" (WFH). Amazingly, Apple's market capitalization at one point exceeded $2 trillion, a figure that is greater than the national GDP of all but seven countries in the world.

Consequently, the tech heavy Nasdaq 100 Index returned 12.42% for the quarter, lifting its year-to-date performance to 27%. With its greater exposure to tech stocks, the Nasdaq is widely outpacing other equity indices. In absence of any other information about the markets or COVID Pandemic, an investor waking up from a New Year's Eve induced coma might observe the Nasdaq's impressive year-to-date performance and assume the economy has been booming in 2020.

As we discussed in our second quarter letter, we thought the odds of a market pullback had become elevated following strong gains in stocks this spring. Our view was that the $3 trillion of liquidity injected into financial markets by the Federal Reserve, which many investors attributed as the primary cause of the sharp rebound in Q2 equities, came to an abrupt halt in the middle of June. In fact, over the summer liquidity was withdrawn from the markets as the Treasury issued new debt to pay for Congress' $3 trillion stimulus package. Additionally, we thought the sharp rebound in assets prices combined with the consensus expectation of a V-shaped economic recovery, reduced the likelihood of another trillion-dollar stimulus program at the expiration of benefits in July.

As we progressed through the third quarter, we were surprised to observe the markets relentlessly march higher. As the Fed's balance sheet and the M2 money supply both shrank in July, stocks moved higher. As the PPP program and extra $600 unemployment benefits came to an end in August, stocks continued to climb. The gains seemed to come every day as if stocks could only go one direction, irrespective of any fundamental headwinds with utter disregard for valuation.

In September, the market finally took a breather with the S&P 500 falling 3.9%, its first down month since the sell-off in March. At one point the Nasdaq reached correction territory after falling more than 10% from its newly established all-time high. Volatility has started to rise again and economically sensitive sectors like banks and energy companies have continued to sell off. Even credit spreads began to widen for the first time since March.

We think markets are starting to correctly incorporate the shrinking probabilities of another large stimulus package in the near future. Without another rescue package, it appears reasonable to us that the economic recovery could reverse course in the fourth quarter (more on this topic below). The impact of 11 million people no longer receiving their extra $600 weekly unemployment benefits combined with 4 million workers who have abandoned jobs to care for children in at-home virtual classrooms should have negative reverberations for consumer spending, the economy, and ultimately stock prices.

Additionally, as we move closer to November, uncertainty around the election will become a larger influence on asset prices. Political preferences aside, the Biden Campaign is running on a platform of higher corporate taxes and higher capital gains taxes. If Mr. Biden's platform wins the day and becomes law, S&P 500 Earnings would shrink by 10%, and we have to believe the equity risk premium would increase as the government allows investors to keep a smaller portion of their equity returns. Both should reduce stock prices.

At the very least, the potential for capital gains tax increases in 2021 could inspire investors to realize their large gains in the final months of 2020 before higher tax rates kick in 2021. This could result in higher tax-selling activity, putting downward pressure on stocks. In 1969, 1976, and 2009, capital gains taxes were increased materially, and markets underperformed in anticipation of the higher future tax rates.

Moreover, this year's election brings an added level of uncertainty for investors as the odds of an uncontested election are high. Several swing states including Wisconsin, Michigan, and Pennsylvania have recently had court rulings that allow an extra 8-15 days for mail-in ballots to be received. If polls are correct and the election is close in these states, we won't know who won the election for several weeks after election day on November 3rd. We would suggest this is not a good outcome for investor sentiment. For historical context, the S&P 500 fell 12% as the Bush-Gore election remained unsettled over who won Florida.

Considering today's elevated asset prices and increasing odds of negative catalysts materializing, we continue to believe that stock markets could experience increasing volatility and potentially another correction in the fourth quarter. We are continuing to maintain a defensive position across our portfolios, and we are prepared to pounce on opportunities should they emerge.

Let's Party Like its 1999

In July and August, market volatility declined, and equity markets rose on strong momentum to new all-time highs in what could be reasonably characterized as a "blow-off top." The S&P 500 jumped 14% in these months on high volumes, which is normally a seasonal weak period for markets as summer trading enters its lull period as investors head for their holidays. As you can see in the chart below, the S&P advanced from 3,100 to 3,500 in almost a straight line with only seven days displaying negative momentum.

The daily market activity seemed to enter a period of frothiness that for us at least was very reminiscent of our memories of the culmination of the tech boom in late 1999 early 2000.

Many of the hallmarks of investor exuberance that are typically associated with stock market bubbles became evident during this period. For example, "story stocks" like Tesla, Nikola, and Zoom appeared to increase beyond any rational valuation metrics. The valuations of FANG stocks moved from a justifiable (but expensive) 30x earnings multiple up to 40x, often in the absence of any company headlines.

In the case of FANG member Facebook, their stock jumped 8.2% on August 26th even though they announced that morning that Apple's new iOS's update for their iPhones would dramatically hurt Facebook's ad revenues.

Separately, Apple itself saw its stock price jump 10% the day they announced a stock split. As a reminder, stock splits have no impact on valuation. It is as if a shop keeper was asked by a customer if they could break a $10 bill and the shop keeper was so excited about the opportunity, they handed over eleven singles in exchange.

Like the dot-com craze, we also witnessed an uptick in companies with negative earnings rushing to the market in an IPO frenzy. In most cases these companies had large pops in their stock prices on the first day of trading. Year to date there have been 127 IPOs on US markets that have averaged a first-day pop of 38%. According to Bloomberg, only 9% of these IPOs were companies with profits. This activity was capped by the IPO of Snowflake in September.

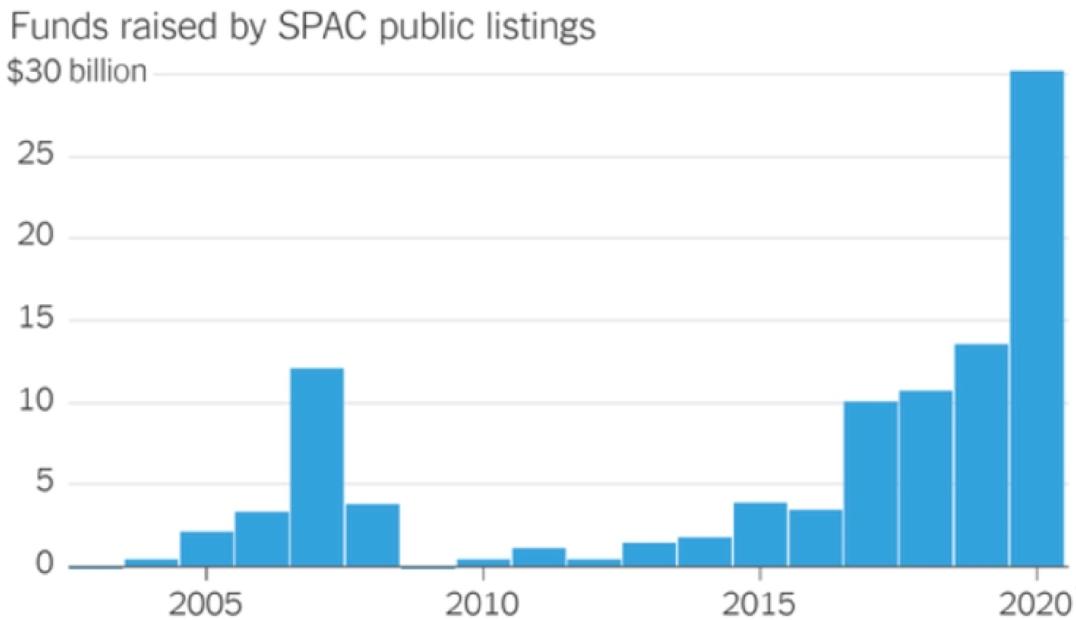
When Snowflake filed their IPO prospectus, they had indicated shares would price between $75-$85 per share. As the IPO date neared, they raised the range to $100-$110 per share, and the final listing price the morning of the IPO was ultimately $120. This price alone was already a significant upward revision from their original expectations.

Incredibly, as the stock began to trade, it opened initial trading at $245 per share, more than 100% above the up-sized IPO price. The first day's trading saw Snowflake shares spike as high as $319 before settling at $254. This represented a $70 billion valuation on a company that is expected to generate revenue of just $575 million this year. This represents a price-to-sales multiple of 122x, which in our estimate is impossible to justify.

Another distinct sign of speculative excess in equity markets is the boom in capital raised for Special Purpose Acquisition Vehicles, also known as SPACs or "blank-check companies." SPACs are companies with no operating business that raise money from retail investors through an IPO and use those proceeds to acquire another private company. At the time of the IPO investors must sign up without knowing what company they will ultimately own. They are essentially betting on the sponsor of the SPAC to find a great investment. SPACs are extremely speculative because they allow "story-stocks" to go public without the usual scrutiny of investors and the SEC that is typically afforded during the normal IPO process.

As of October 1st, there was 115 new SPACs announced this year. The total capital raised is estimated to be $43 billion so far in 2020. The year is not even over, and this record haul for SPACs is four times greater than any other year in history.

The chart on the following page displays SPAC funds raised annually since 2003. The figure for 2020 only includes funds raised through August. The last time investor appetite for SPACs was so strong was in 2007. If you recall, stock markets did not do so well in the immediate future.



Source: NYSE and NASDAQ

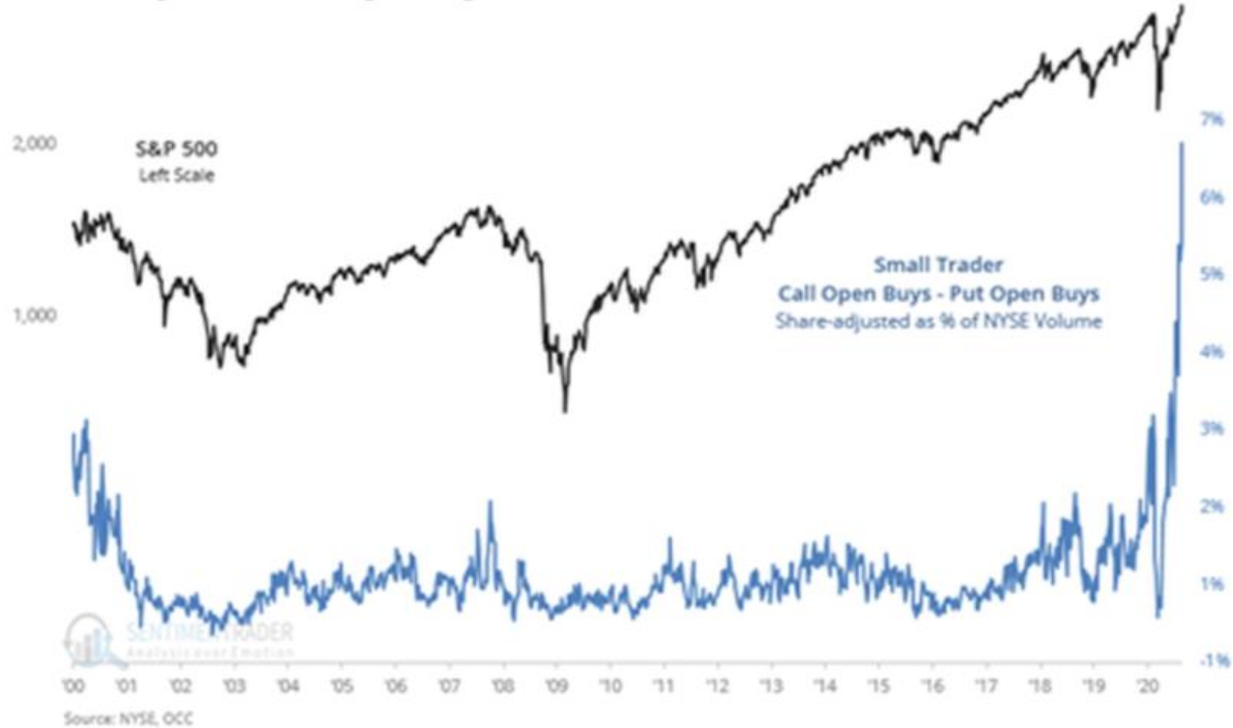
Finally, one of the principal hallmarks of a market bubble is broad participation from retail investors. We saw the same excitement from retail investors in 1999. Over the course of this secular bull market which started in 2009, the lack of retail investor enthusiasm has been a key missing ingredient of a true investment frenzy.

Determining the presence of a retail investor frenzy is mostly subjective. Some examples include investors receiving stock tips from their Uber drivers, day-traders quitting their day-jobs, and waiting room TV's tuned to CNBC. Today we believe there are some clear signs that retail enthusiasm for stock investing is at elevated levels. Citadel reported that retail investors were accounting for 20% of equity market volumes in the early summer, far above normal levels. The number of retail accounts on the Robinhood platform (known for zero commissions) doubled between March and May this year. Robinhood now boasts 30 million accounts in the US. That translates into one in every seven adults in the country.

We believe the best evidence of speculative froth on the behalf of retail investors is the volume of equity calls from small traders on single stocks. Call options by their nature are very speculative. They are essentially levered bets that stocks will go up, often with spectacular payouts if the underlying stock jumps.

Call options by retail investors have always increased at market tops. However, the call volumes written by small traders have gone parabolic over the summer, crushing previous highs. The chart below displays Small Trader Call-open buys less Put-open buys as a percentage of NYSE volumes. This ratio also spiked in 2000 and 2007. But the jump in volumes this summer is breathtaking. Some of the difference can be explained away by lower commissions, but it none the less is a clear indication that retail investors are speculating on stocks with abandon.

Massive surge in risk trading among smallest of traders



Sky-high tech valuations; record IPO issuance; SPAC frenzies; and clear signs of excessive speculation in the stock market by retail investors. These market characteristics typically do not materialize in the middle or earlier stages of bull markets. They develop in the final stages of a bull market and periods of strong economic expansion.

The fact that we are witnessing these signs of excess in a period where the economy is being turned upside down by a global pandemic is perplexing. Moreover, it reinforces our view that investors would be wise to tread cautiously moving forward. In fact, their presence should suggest investor caution even if the economy was booming.

No one can call the top, and markets could get frothier. But the signs of exuberance are all around us and at some point, the punch bowl runs dry or is yanked away. The market rally may be in the 8^{th} or 9^{th} inning, but there is always a chance that we could go into extra innings.

In a few years, when we look back at some of the things going on in the markets today, it will look really silly.

Are the Work from Home Productivity Gains Sustainable?

One of the major surprises of the pandemic has been the success with which many white-collar jobs were transitioned to a home office environment. While we may quarrel with Zoom Video's equity valuation, its technology saved the day. It is easy to imagine how much worse the quarantine-economy would be if recent advances in technology didn't exist.

Many executives saw productivity increase as their employees no longer had to spend time commuting, sat through less meetings, and wasted less time hanging by the preverbal water cooler. Some management teams have expressed to us that employee productivity and success of shifting the workforce out of the office was so good that they may abandon the office setting permanently. Some large companies have already told employees than can continue to work remotely through all of 2021. Obviously, this kind of sentiment is not good for office landlords in Manhattan or other major cities.

We believe the productivity jump provided by the shift to work from home may fade faster than many people think. Most importantly, we do not think it is surprising that productivity jumped initially.

The existing workers already knew how to do their jobs. They understood the workflow and had pre-existing relationships with the co-workers. However, as the economy recovers and companies hire new employees, none of these factors will be present. The new employees won't have any clue about the workflow or company culture. We would argue that new-worker productivity will be much worse than the recent experience of productivity gains from existing employees who started their employment in the office setting.

Additionally, many of these workers were watching the news and undoubtedly worried their job could be furloughed or even terminated as the economy was closed down in March. They likely put in extra effort to prove their worth to the company. We saw the same phenomenon in 2008 as employees shouldered the workload of colleagues who were let go. But that productivity boost faded as the job markets improved. These workers either got burnt out or jumped ship for a less demanding job. The more confident these employees get with the security of their job working from home, the higher the likelihood that they take more liberties within their personal confines.

Lastly, we are firm believers in new innovative ideas springing from chance encounters employees have when they are away from their desks. Prior to the pandemic, this was the central theme in office design. Private offices were being replaced by open-floored concepts that emphasized communal working spaces. Companies spent lavishly on cafeterias, meeting spaces, and public areas with the intent to encourage more employee interaction and the odds of a random encounter among co-workers. The technology companies were the biggest proponents of these changes. In a complete 180-degree shift, now these same businesses are leading the charge to work from home.

Overcoming the obstacles of operating a company during a pandemic is challenging and all encompassing. However, as management teams eventually move beyond the current crisis, they will shift their efforts back to innovation and will probably find the work from home environment seriously holding back their efforts.

For investors, buying stocks in companies that have benefited from the work from home transition has been a massive winning bet this year. However, if you agree with the rational laid out above, and also that scientists will eventually discover a viable vaccine and/or treatment for

COVID, isn't it conceivable that the stocks that gained from the work from home transition will presumably struggle as this trend reverses?

Many of these work from home companies have been richly rewarded by investors with elevated valuation multiples for their ability to grow during the pandemic. As a vaccine gets closer, investors should consider taking their chips off the table. We believe it is highly likely that these companies will have significant downside risk and pricing in pandemic-induced elevated growth rates into perpetuity is foolish.

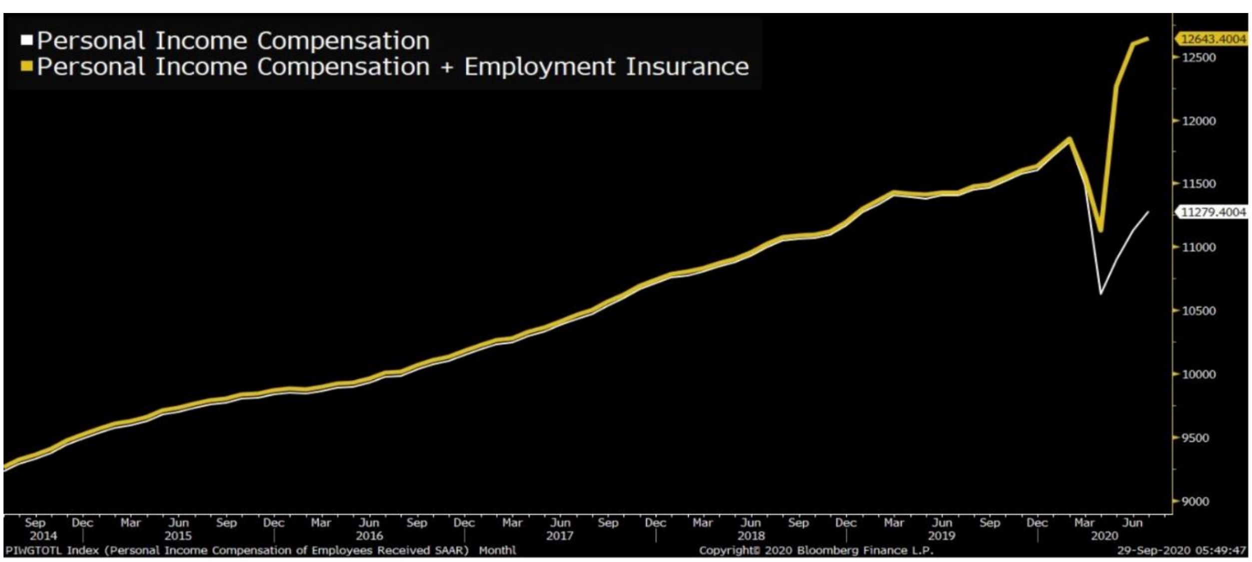
What if We Haven't Seen the Real Recession Yet?

The economic blow wrought by the COVID pandemic is often compared to the economic collapse associated with the Great Depression. Second quarter GDP in the US fell at an annualized rate of negative -31.4%. This was an unprecedented collapse of economic activity. Even the normally slow-moving National Bureau of Economic Research (NBER) who is charged with identifying the official start and end of recessions was remarkedly swift in labeling the current malaise as a new recession.

As summer unfolded some economic activity began to return to normal. According to the Atlanta Fed's GDPNow forecast, the economy is expected to grow 34.6%. While this rebound is impressive it means the economy is still down 7.7% from the first quarter. The math of percentages becomes complicated as the percentage changes get larger.

None the less, there is a decent number of economists and market commenters that believe the recession is now over. We would like to propose an alternative thesis: we haven't even seen the real negative impact of this recession yet.

Considering the GDP data just presented, we recognize that this notion might strike many as preposterous. However, a review of other important economic data beyond headline GDP figures tells a much different tale. Both personal income and retail sales actually rose in the second quarter. Of course, this is a highly unusual contradiction in economic data points.



In our opinion, the chart above is the most important piece of this economic puzzle. The government stimulus provided by the CARES act drove personal income above its natural trend line by $650 billion dollars or 5%. Without the stimulus, personal income would have fallen more than $700 billion or 6% short of its trajectory.

It is natural for personal income to fall in a recession. Frankly, it is a recession's defining feature. Consumers lose jobs and their income falls. They spend less money, and their spending is another person's income, which is now lower too. The Government stimulus essentially short-circuited this natural recessionary progression, at least for the time being.

As of August, the stimulus support from the government has largely run out. There is no longer a $600 weekly supplement to unemployment insurance, and PPP dollars supporting employee salaries is running out. The economy is still well short of a full recovery and personal income is finally set to fall. We think there is a low probability of further government stimulus until 2021 and the normal decline in consumer spending could materialize.

Concentrated Value

The concentrated value portfolio continued its outperformance in the third quarter. The portfolio generated a total return of 10.6%. We once again widely outperformed the Russell Large Cap Value Index which returned 3.7% in the quarter. Importantly, we achieved our results with much lower risk than the market, as the portfolio held an average cash position representing approximately 25% of our holdings.

Our cash position declined throughout the quarter as we deployed money into new investment ideas that we will discuss in more detail below. The current cash position has fallen to 19% of the portfolio composition. We would expect the cash level to return to a more normal 1-7% range by the end of the year. We believe it is likely that equity markets experience increased volatility in the next several months. If this outcome materializes, we have dry powder to act quickly and initiate new positions in companies on our target purchase list.

Our strong results were driven by many of the same top-performing companies as last quarter. The price momentum that drove strong result for Toll Brothers, Kinross Gold, and Royal Caribbean continued through the third quarter. All three companies landed on our list of top five contributors for the second quarter in a row. Below is a table of our top and bottom five contributors to the portfolio return for this quarter.

Toll Brothers has been a surprising beneficiary of the pandemic as workers were forced to work from home. Without the need to commute, workers are leaving cities for lower cost suburbs. At the same time, apartment and condo owners found their quarantine confines a little too cozy, and they are taking advantage of record low interest rates to upgrade to a house with more room.

Demand for homes was already rebounding before COVID as years of under-building and growing population created a situation where there was a housing shortage. The ultra-low rates (complements of the Federal Reserve) was just gasoline on the fire. We believe the positive home-building trend will persist as there is a need for millions of new homes to close the housing deficit, and inventories of existing for-sale homes will remain subdued.

Toll Brothers is well positioned to benefit from these trends, despite the recession, as their volumes are primarily in the luxury home market. Their clients are typically wealthy retirees and high-income professionals that are capable of making sizable down payments and no problems securing mortgage financing.

Top 5 Contributors

Name	Absolute Return	Contribution to Portfolio
Toll Brothers	49.54%	2.47%
UPS	50.88%	1.99%
Royal Caribbean	28.69%	1.29%
Kinross Gold	22.16%	1.27%
Nutrien	22.96%	1.00%

Bottom 5 Contributors

Name	Absolute Return	Contribution to Portfolio
Phillips 66	-18.88%	-1.01%
CVS	-9.23%	-0.57%
Fleetcor Technologies	-3.09%	-0.19%

As you can see from the list above, we only had three stocks lose money in the third quarter. The largest detractor from performance was Phillips 66 (PSX), a refinery and chemical company. PSX is a new addition to the portfolio in the third quarter.

As is often the case, our biggest detractors in the Concentrated Value Portfolio are newly initiated positions. It is normal for these stocks to be under pressure and can often experience continued negative momentum after we establish a position. This is simply because it is impossible to time the bottom. We don't hesitate to buy when high quality companies fall well below our estimates of intrinsic value. Continued near term weakness is price of admission for a value strategy.

PSX is an integrated energy company that is comprised of US refineries, a feedstock advantaged global chemical business, midstream operations, and a network of gas stations in the US and Europe. What makes PSX most attractive as an investment is the strong management team and their shareholder friendly capital allocation execution. PSX operates in capital intensive industries, and their management team has been able to successfully deploy significant amounts of growth capital at abnormally high returns on investment. Their annual capital spend has been between \$2-\$3 billion annually and they have generated a 12% return on these investments. There are few other companies in the world with similar opportunities to compound large amounts of capital at such attractive rates. The company also returns every dollar of excess cash back to shareholders through a substantial dividend and opportunistic share buybacks.

PSX easily meets all the characteristics we look for when making an investment in the Concentrated Value Portfolio. It is a growing business that should generate abnormal profits well into the future. PSX has a solid balance sheet with smartly termed low-interest rate debt. Most importantly, the management team operates the companies in the best interest of shareholders.

Shares of PSX currently trade at a significant discount to our estimate of their intrinsic value. We believe normal earnings per share are between $7-10. We think the appropriate valuation multiple for this high-quality company is 11-14x earnings. This represents a valuation range of $77-$140 per share. Prior to the emergence of COVID, PSX regularly traded within this range. But now the stock is trading hands at just $54. Gasoline demand in the US will rebound, and the company has a long list of high-return capital investments over the next several years. PSX represents an amazing opportunity for capital appreciation. Additionally, we will be receiving 6.7% dividend yield as we wait for the stock to reflect its higher intrinsic value.

Our newest position is Portland General Electric Company (POR). POR is a regulated electric utility in the state of Oregon. Shares tumbled from more than $50 in the spring as social unrest surged in Portland and wildfires spread across the state. Shares had fallen to $34 in September representing a price to earnings multiple of just 13x. This is well below their regulated utility peers that trade for 18-21x earnings. We believe this discount is unjustifiable as POR enjoys a constructive regulatory regime in Oregon and a rate base that will grow mid-single digits, in line with other public utilities.

We believe the current stock price is reflecting investors' mistakenly incorporating large wildfire-related labiates at POR. Similar large wildfires in California had driven that state's largest utility into bankruptcy. However, California is a different state and a unique situation where they had a law called "inverse condemnation." This misguided legislation resulted in utilities being entirely responsible for all cost of any wildfires that initially ignited because of their equipment. This ultra-strict liability was irrespective of any outside contributing factors to the fire's spread, even if the company had acted negligent or not.

Conversely, the law of inverse condemnation is not applicable law in Oregon. Even, if POR's equipment is found to have started these fires, insurance companies would need to prove that POR acted grossly negligent and was solely responsible for all damage. This is an extradentary unlikely outcome that should not be reflected in the company's stock price.

POR is the first utility we have owned in this portfolio. The opportunity to own utilities at steep discounts to their intrinsic value is a rare occurrence. We believe it is highly likely that POR closes its current valuation gap relative to their peers as concerns around wildfire liability diminish. Considering its stable business fundamentals afforded as a regulated utility, POR may have the best risk-adjusted return potential in our entire portfolio.

We sold or positions in Amazon and Moody's on success during the third quarter. We acquired shares of these two companies in the depths of the downturn in March. Both stocks nearly doubled and reached all-time new highs this summer. It was difficult to sell our stakes in these high-quality compounders, but valuations had stretched well ahead of our most optimistic calculations of their intrinsic values. Should either company stumble we would jump at the opportunity to own them again.

Lastly, we wanted to revisit the Investment Philosophy of the Concentrated Value Portfolio. We utilize a value investment strategy that seeks out companies for investment which the Portfolio Manager deems to be high quality companies. Quality is defined by possessing business operations with durable competitive advantages, allowing for high returns and growing cash flows streams. We want these high-quality companies to also have solid balance sheets, preferably with a net cash position. We also prefer that their management teams make decisions with an emphasis on maximizing shareholder returns.

Once we find these high-quality companies, we generally only invest in their stock if they trade at a steep discount to our estimate of their intrinsic value. This is necessary to provide our investors the opportunity to generate an above market return and protect capital. This discipline creates a wide margin of safety if an undesirable scenario plays out in the future. Pelican Bay Capital Management believes that identifying a significant difference between the daily market value of a security and the intrinsic value of that security is what defines an investment opportunity.

Dynamic Income Allocation

It was an incredibly quiet summer for most asset classes apart from large-cap US stocks. Interest rates, major currencies, and international equities were remarkably stable throughout the quarter. The third quarter was a 180-degree departure from the wild swings in valuations experienced in the first half of 2020. In particular, bond prices barely budged as benchmark US Treasury yields and comparative corporate bond spreads both traded within a very narrow band of just 20 basis points.

In this environment the DIAP performed very well and easily delivered on its mandate of generating the highest possible return with little volatility. The portfolio generating a 3.1% total return in the quarter. Amazingly, the volatility of daily returns was just 0.34%, less than a third of the volatility recorded in the S&P 500.

Much of our quarterly gains were attributable to the continued shrinking of the discount between the preferred stock index and the actual value of its underlying securities. We expected this to happen and still believe this trend could continue into the fourth quarter as preferred stock prices remain attractive relative to bonds. Furthermore, the yield on preferred shares is 5.2%. We believe this is incredibly attractive relative to similarly long duration investment grade corporate bonds that yield just 3.0%. We would not be surprised to see this spread contract leading to further gains for preferred shares.

We also believe that utilities remain attractively priced as they still trade approximately 15% below their pre-COVID prices. For the first time in several years, utility valuation multiples trade at a discount to the market multiple. We would expect this discount to reverse as utilities' steady business models and mid-single digit earnings growth have proven resilient during the pandemic. Moreover, if interest rates stay depressed, the yield on utilities looks ever more attractive as investors hunt for yield. Our utilities allocation is currently at its maximum allowable portfolio weight of 10%.

Ticker	Name	Contribution to Portfolio	Absolute Return	Target Weight
PFF	ISHARES US PREFERRED STOCK	1.27%	6.68%	20.0%
VCLT	VANGUARD LONG-TERM CORPORATE	0.28%	1.33%	20.0%
VCIT	VANGUARD INT-TERM CORPORATE	0.21%	1.32%	15.0%
VYM	VANGUARD HIGH DVD YIELD ETF	0.35%	3.65%	10.0%
EFAV	ISHARES EDGE MSCI MIN VOL	0.31%	3.13%	10.0%
VPU	VANGUARD UTILITIES ETF	0.48%	5.11%	10.0%
MBB	ISHARES MORTGAGE SECURITIES	0.03%	0.24%	10.0%
HYG	ISHARES IBOXX HIGH YIELD	0.19%	4.06%	5.0%

Throughout the quarter we maintained our portfolio in the "Max Protect" position with only a 30% exposure to equities. We were hoping for the market to demonstrate increasing volatility in the quarter. This outcome would give us an opportunity to transition the portfolio to a more aggressive posture, but this scenario hasn't unfolded as of yet. We believe the probability is high that markets see increased volatility in the fourth quarter. Futures on the volatility index (VIX) for the months of October, November and December are pricing in elevated activity.

The current yield on the DIAP fell marginally to 3.5% on October 1st from 3.9% at the beginning of last quarter. This small decline is primarily associated with increasing valuations in the equity portion of the portfolio and shrinking bond spreads for corporate bonds. We do not anticipate there is much room for yields to decline further. While we are just a few training days into the fourth quarter, interest rates have begun to move higher thus far in October. None the less, the existing dividend yield for the DIAP remains at a substantial premium to US treasuries which are currently yielding just 0.6%, representing a 2.9% spread.

Ticker	Current yield	Portfolio Yield
PFF	5.18%	1.04%
HYG	5.11%	0.26%
VYM	3.49%	0.35%
EFAV	3.98%	0.40%
VPU	2.75%	0.28%
VCLT	3.04%	0.61%
MBB	2.08%	0.21%
VCIT	2.44%	0.37%
Total Portfolio		**3.50%**

Additionally, the portfolio yield will also increase when we feel it is appropriate to shift the DIAP to a more aggressive posture and move away from our "Max Protect" positioning. As we reallocate the portfolio, investors can expect to see us divest our mortgage back securities (MBB) position first. We will also likely trim our long-term corporate bond in favor of high-yield bonds, especially if junk bond spreads widen in a down market. We will also increase our allocation into high dividend US (VYM) and International (EFAV) stocks if equity prices continue to decline.

Lastly, it is important to reiterate the investment philosophy of the Dynamic Income Allocation Portfolio. The DIAP is designed to function as the core foundation of an investor's portfolio by operating with the dual mandate of generating the highest current income possible while preserving capital.

Pelican Bay Capital Management attempts to achieve this dual mandate by only investing in asset classes that by themselves offer a current dividend yield that is greater than either the dividend yield of the S&P 500 or 10-year U.S. Treasury. In our view, elevated income can add stability to a portfolio and maximize the benefits of compounding through reinvestment.

We then construct a portfolio of these high-yielding asset classes with an emphasis on minimizing correlation of the overall portfolio and maximizing its diversification beyond the typical 60/40 stock/bond portfolio. We finally add a valuation overlay that we utilize across all our portfolios. We allocate a larger position weighting to the most undervalued and attractive investment opportunities, while avoiding owning overpriced assets.

Phoenix Fund

Please note: The Phoenix Portfolio is only available to "Qualified Clients" pursuant to section 205(e) of the Investment Advisors Act of 1940 and section 418 of the Dodd-Frank Act.

The performance of the Phoenix Fund this quarter was exceptional. As the calendar turned to July, we began to place more weight on the probability that a reversal of Fed liquidity and the premature expiration of stimulus could cause a draw down in stocks, or at least a flight to quality. Our distressed equity strategy can come under extra strain during these unique risk-off environments. We wanted to protect our strong rebound in Q2 and moved to place hedges on the portfolio in case markets turned down. At one point in late August the portfolio was net short for a brief period.

Our total return was 14.7% for the third quarter, easily outpacing the S&P 500's gain of 8.9%. The elevated volatility we expected never emerged, and our position of long bets performed so strongly that they resulted in the portfolio outperforming the S&P 500 in every month of the quarter, despite the drag from our large hedge position in July and August. Our hedge caused a drag of 4.7% in the quarter but helped our returns in September as markets fell.

The strong outperformance was a result of our investment thesis playing out in our larger Tier 1 portfolio names at the top of the portfolio. Our largest investment entering the quarter was ADT. The stock rocketed 81% in the quarter on the news of a new investment from Google. That morning, the stock doubled from $8 to $16, above our estimate of fair value and we quickly exited our position. Shares have since retraced back to $8.40. Do not be surprised if we reinitiate a position in ADT during the 4th quarter.

We also exited our position in Evolent Health on success. The stock jumped 86% this quarter to our target price of $13. The company's Medicare business recovered more quickly than anticipated as a result of COVID. They also divested their stake in an ill-conceived venture in the health insurance business that had initially put pressure on the stock. This is what had originally creating our opportunity to establish a position last year.

Top 5 Contributors

Name	Absolute Return	Contribution to Portfolio
ADT	80.82%	6.14%
Evolent Health	85.97%	3.45%
Hovnanian	38.33%	2.93%
FreightCar America	83.87%	2.78%
Kinross Gold	22.16%	1.58%

Bottom 5 Contributors

Name	Absolute Return	Contribution to Portfolio
S&P 500 3X Short	-20.89%	-4.74%
Francescas	-29.83%	-1.23%
Gran Tierra	-32.90%	-0.87%
Eagle Bulk Shipping	-4.76%	-0.47%
Comstock Resources	-9.81%	-0.42%

We were also successful in our trading bucket with notable wins from Community Healthcare (CYH) and Restoration Hardware (RH). Both contributed 1.6% to our total return. Our trading bucket had no loses this quarter. Additionally, we didn't participate in any merger arbitrage opportunities in the third quarter.

We had three stocks produce negative returns in the quarter, Francesca's, Gran Tierra Energy, and Eagle Bulk shipping. The drop in Francescas was particularly painful as the company is making progress despite the enormous challenges posed to apparel retails from COVID closures. We like the new CEO and believe he is making appropriate strides to refresh the brand, drive ecommerce sales, and renegotiate lower rents for the brick and mortar stores. The stores that were open this summer saw much better than expected same-store sales. Francesca's popularity with millennials and teenagers has improved this year.

Francesca's enterprise value of just $20 million is absurdly cheap and implies a real risk of an immediate bankruptcy. To put this valuation in perspective, it represents an enterprise value of just $28,000 per store. Their stores have average sales of $300,000-$400,000 per unit. We continue to believe shares are worth as much as $20-$30 versus just $3 today.

We re-entered our position in Comstock Resources at the very end of the quarter as the stock came under pressure. It continued to fall the last few days leading to an initial negative mark. However, we generally aren't concerned with price swings in the first week of owning a company.

Comstock is a natural gas shale producer with an operating territory in the Haynesville-Bossier trend in Louisiana. Comstock has industry leading cash operating cost of just $0.60 per mcf. The average cost of peers is $1.23 per mcf. The company also has an advantageous geographical position as their territory in eastern Louisiana is located next door to the gulf cost refiners and LNG export terminals. There is plenty of pipeline capacity to ship Comstock's expanding production volumes to the market. Comparatively, their peers in the Marcellus Shale Play in West Virginia and Pennsylvania are struggling with too few pipelines and higher transportation costs to gulf coast markets.

Our investors may remember Comstock from our positive experience in the second quarter. We had acquired shares near $5 in April and sold most of our position around $7. Hopefully, our second bite of the Comstock apple will be similarly successful. This time we acquired our position at $4.82 per share.

We continue to believe Comstock is worth $7-9 per share and could see another rapid recovery to fair value as natural gas prices are poised to benefit from many near-term catalysts. Seasonally, we are moving into winter when heating demand increases, and gas prices typically jump. Gas prices are also being supported by the curtailment in drilling activity by shale producers this year which has finally curbed production growth. Additionally, over the summer, liquified natural gas (LNG) exports increased on the back of higher gas prices in Europe and

Asia. Higher LNG exports put added pressures on domestic demand and aids market prices. Our valuation is predicated on natural gas prices of $2.50-$3.00 per mcf, which is not an aggressive assumption.

Our largest new position in the third quarter is PG&E Corp (PCG), a regulated electric and gas utility in Northern California. PG&E is one of the best opportunities we have come across in the last two years of analyzing investments for the Phoenix Fund. This company gives us a unique risk-return profile that we normally cannot attain within our distressed equity mandate. Frankly, we did not anticipate that we would ever have an opportunity to own a regulated utility with a low-risk 50-100% return potential.

PG&E recently emerged from bankruptcy after being inundated by insurance claims associated with devastating wildfires in 2017 and 2018. As we mentioned above in our investment case for POR, California used to have a law called “inverse condemnation” which burdened their utilities with unlimited losses from wildfires with no recourse. We believe this law made it impossible to invest in any California utility.

The legislators finally reached a similar conclusion, and PG&E will no longer have to operate under constant threat posed by this potential death sentence. Under new rules called A.B. 1054, inverse condemnation has been scrapped and a more reasonable prudence standard has been implemented. The state also set up a new $21 billion wildfire fund and limited subrogation claims to 40%. Most importantly, A.B. 1054 limits exposure to 20% of the utilities Transmission and Distribution (T&D) equity rate base only if they were proven to be negligent. This caps the liability for PG&E at a reasonable $2.4 billion. Moreover, the utility is taking large steps to insure they can’t be found negligent including, extra spending on tree-pruning, hardening of major transmission lines, and pre-emptively cutting off power to areas should the conditions for wildfires increase.

Upon its exit from bankruptcy, PG&E refinanced their debt, issued shares to wildfire claimants, and funded their portion of the $21 billion wildfire fund. The company also finalized their new share count and issued new earnings guidance of $1.00-$1.10 per share.

We acquired our shares in PG&E at a price of approximately $9.50 per share. We believe it could quickly fetch a 13-16x earnings multiple as the utility returns to growth and investors get more comfortable with the new wildfire liability rules. This would translate into an intrinsic value of $13-17 for PG&E shares. This valuation range still represents a large discount to their peer utilities that benefit from 18-21x price-to-earnings multiples. But the 9x we paid was simply too cheap.

We believe PG&E’s stock price was depressed for several factors. Immediately after emerging from bankruptcy PG&E issued a significant amount common stock to former debtholders and wildfire claimants as compensation. These entities ultimately want their money and have been unloaded into the market. Additionally, there appears to still be a great deal of confusion around the protection from wildfire lawsuits afforded under A.B. 1054. We are confident these factors are transitionary, and patient investors will benefit.

Finally, we wanted to revisit the investment philosophy of the Phoenix Fund. The portfolio takes advantage of structural biases against institutional ownership of financially levered companies with low-stock prices. We seek companies that have had their stock prices fall 70% or more in the last two years and are priced below $10 dollars per share. This outcome typically leads to forced selling from their institutional shareholders, creating the opportunity to make outstanding investments for less constrained investors.

Generally, these companies are under distress from poor performance caused by what we believe are temporary factors. These companies typically have elevated levels of debt, and any prolonged period of business stress could cause stockholders to endure substantial losses. The Phoenix Fund is a high-risk, high-return investment strategy. Please see the Risk of Loss Section of Part 2A of Form ADV referenced below.

Inflation Plus

We are pleased to announce a new portfolio strategy available for individual investors. In a climate of low interest rates, the Inflation Plus portfolio strives to deliver a current income above the rate of inflation and prevailing rates offered by money market funds and savings accounts. The interest rates afforded to investors parking their money in bank certificates of deposit, money market funds, and US Treasury notes are unacceptably low.

The Inflation Plus portfolio is designed to generate higher levels of income by allowing moderate portfolio volatility. This portfolio uses low-cost ETFs and the volatility dampening portfolio construction techniques we developed for our Dynamic Income Allocation Portfolio.

We believe that the Inflation Plus portfolio can earn higher levels of current income compared to money markets and savings accounts in exchange for an acceptable level of higher risk. For example, the current income for the Inflation Plus portfolio is 2.52% versus the sub-1% yields in risk-free assets.

The portfolio can achieve this outcome due to our thoughtfully designed allocation that is constructed around a core holding of short-duration lower-risk fixed income asset classes that have historically demonstrated little daily volatility. These core asset classes include short-term corporate bonds, treasury bills, and mortgage-backed securities. This core grouping of assets will generally account for more than half of the assets in the portfolio.

This core holding will be supplemented with small positions in other higher income-producing asset classes that have demonstrated low correlation to the core holdings but carry higher risk and volatility. Through the risk reducing benefits of owning uncorrelated assets, we believe that adding small slices of riskier high-income assets to a core position of short-duration stable assets will boost income without a commensurate increase in portfolio volatility.

We encourage you to reach out to us if you would like to learn more details about the Inflation Plus Portfolio and its low fees.

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On the operational front, Pelican Bay Capital Management has brought on John Geppert as an Equity Research Intern for the Fall of 2020. John is currently a Junior at the University of Maryland in College Park pursuing a major in Finance. John is also a member of the Men's Division One Lacrosse Team, an elite program that regularly competes for the National Championship. Despite the demands of being a student athlete, John has also excelled academically. This fall, John will be tasked with researching publicly traded companies in the retail industry for potential investment.

In closing, we would like to thank our investors for their continued support. We also want to extend a warm welcome to our new investors. We are looking forward to the future and achieving your investing goals with integrity and discipline.

We are excited about the potential future returns for each portfolio. We believe we have positioned our portfolios to continue to deliver strong performance as they meet the challenges of the next several months and take advantage of the recovery that will ultimately materialize.

Warm regards,

Tyler Hardt, CFA

For more information please see Part 2A of our Form ADV available on the SEC's website at www.adviserinfo.sec.gov. You may also request a copy from Pelican Bay Capital Management by e-mailing us at info@pelicanbaycap.com.

Additional information about Pelican Bay Capital Management, LLC also is available on the SEC's website at www.adviserinfo.sec.gov.