OPEN SQUARE CAPITAL

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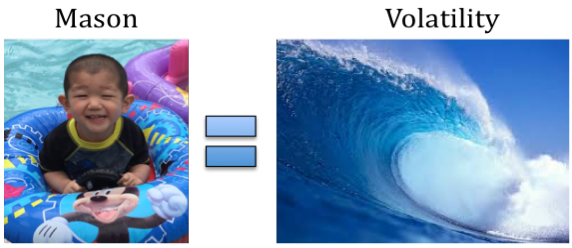
April 1, 2016

Dear Limited Partners,

When I sit down to write these letters something usually sparks the topic. This quarter's letter is courtesy of Mason, my two year old who has lately developed the habit of wriggling around in the swimming pool so he can squeal with delight at making waves. As a budding investor most of his babbling market commentary is subject to interpretation, but at the risk of being reductive he said "Dada, listen . . . ."



A Potato Nobody Wants

The world's a funny place these days as central bankers act like teenagers on a road trip to Growthville, everyone's trying to call shotgun. The central banks in most countries are usually tasked with controlling the money supply and promoting stable growth. This often boils down to a Goldilocks dilemma where you want just enough growth to avoid deflation, but not too much growth as to create inflation. Lately economic growth has been hard to come by in the industrialized world. The European Union, U.S. and Japan are all experiencing low or no growth, and China's growth is decelerating. With so little organic growth, central bankers have turned to "adjusting" the money supply to spur demand (i.e., currency devaluation).

Devaluation is a powerful tool. For instance if the European Central Bank devalues the Euro in half, what was a $1 to 1 Euro exchange rate becomes a $1 to 2 Euro exchange rate. This extra Euro gives customers the opportunity to buy twice as much European goods and services, stoking the EU economy. Two bankers can play this game, and if a second banker does it, so can a third, then a fourth, and soon every central banker is forced to devalue their currency because if you don't customers will simply buy more goods and services from the cheaper countries and your economy could slow and possibly contract. Thus, devaluing your currency passes the economic slowdown to your neighbor like a hot potato. It's not a difficult game to learn and when every central banker plays it, our world, our swimming pool starts to fill up with money.

Mason's Waves and Volatility

So the world today has become awash with capital. Unlike water though, capital doesn't just pool into calm lakes. Investors abhor idle capital and like my Mason, love making waves.

Bigger and Faster

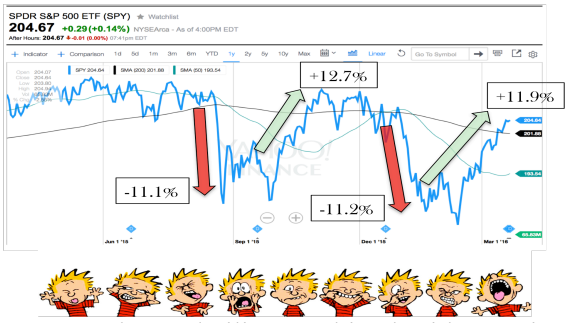
Investors will push and pull capital in an attempt to maximize risk-adjusted returns. They direct it to asset classes that exhibit stronger growth, which usually translates to higher demand, increasing prices and healthier returns. So when so much capital flows from one asset class to another chasing returns, it builds momentum like a wave.

Those buying in the beginning are usually buying for fundamental reasons, trading security and liquidity for a satisfactory return. This is temporary as the game quickly shifts to speculation. Buying begets more buying as momentum investors (investors who buy what has gone up and sell what has gone down) pile in and a flood overtakes the initial trickle of capital. Market timers, ranging from short-term algorithmic computers, day traders and hedge funds can add to the rush of capital and exaggerate the momentum.

When there's too much capital the waves often get bigger and faster. Expensive things become more expensive, and small ripples become tsunamis as capital rushes from one industry to another, one company to another, often before the financials reveal the underlying truth.

The fundamental way of thinking (i.e., being careful as to the price paid) becomes stodgy when price action dominates. P/E multiples, which basically measures an investor's desire for owning a stock, expands quickly, as the flow of capital means the "P" (price) increases much faster than the "E" (corporate earnings). It's not the price you pay that matters anymore, it's the price the next guy pays that matters. Decoupled from fundamentals, the market starts to run on emotions, and fear and greed create the biggest types of waves.

Here's a simple example. In August 2015, the companies within the S&P 500 (an index tracking the largest 500 U.S. companies by market capitalization) were worth about $19 trillion combined. Since then, the market in its wisdom decided every 6 weeks or so that these 500 companies were collectively worth $2 trillion less, then more, then less, then more. The volatility simply reflected the swings in investor sentiment because nothing fundamentally changed for these companies to have collectively added or detracted that much value in so short a time. Calvin from the Calvin & Hobbes comic strip kindly illustrates the real underlying reasons for the volatility.



Volatility in of itself isn't dangerous, but volatility combined with emotion is. The market myopically focuses on "investor sentiment", which is amorphous and driven largely by human psychology, animal

spirits and in extreme cases our fight/flight central nervous system. Although we like to pride ourselves on how evolved we are, people today are still as irrational and prone to emotional extremes as those who participated in the 17th century Dutch tulip bulb mania. During that mania, the price of a single pot of tulips reached the equivalent of $1M today. The difference today is that when the world is flooded with so much money, everything becomes a tulip.

So keep this in mind when you see prices swing high and low. Keep in mind that when money is on the line emotions will often trump intellect. Remember that fundamentals do matter in the long run and that fundamentals can help us avoid being foolish and foolhardy. So really the best thing to do in our little world full of wave making Masons is to stay rational and avoid the noise, and that's what we'll try to do.

Our Quarter

As you've seen from the chart above, the year began tumultuously. The market pretty much headed straight down as we began the new year. By February, the S&P 500 was down by approximately 12% on concerns that the global economy was going into a recession, with China's lagging economy leading the way. Our fund was also disproportionately affected as oil prices fell from a year-end price of $40 to $26 per barrel. Given our concentration in the energy space, January and February saw a downdraft in our performance. As the world realized that the economy wasn't all that bad, the waves went the other direction and the S&P 500 recovered, and so did our fund.

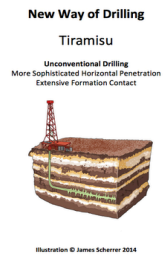
Date	Open Square Fund I Performance YTD*	S&P 500 Performance YTD*	Outperformance / (Underperformance)
January 1 – March 31	3.17%	1.33%	1.84%

* Prior to fees. S&P 500 is using ETF: SPY, per Yahoo Finance

We'll provide an update on our core energy positions in the next quarterly letter as we're waiting on a few developments by OPEC in the weeks ahead. The declines in February did allow us to initiate three new positions. We sold some of our Apple stock to take advantage of what we think may be good opportunities. While we still own significant shares of Apple, and still believe in the prosperity of the company, we saw some great bargains. Our theme for this quarter? Natural gas, seven refrigerators, and one burrito.

Natural Gas

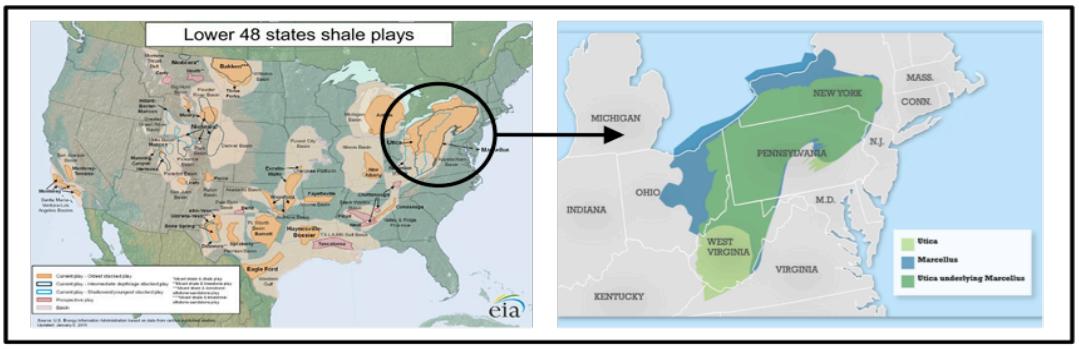
In most of our energy discussions so far we've written primarily about oil. This is because in late 2015, oil was a dominant position in our portfolio (it still is), but as we began 2016, we increased our natural gas bets as we think there are some attractive bargains. The US currently has an overabundance of natural gas thanks to fracking. As discussed in our previous letter, this is the tiramisu of drilling. Here's the picture again for reference.



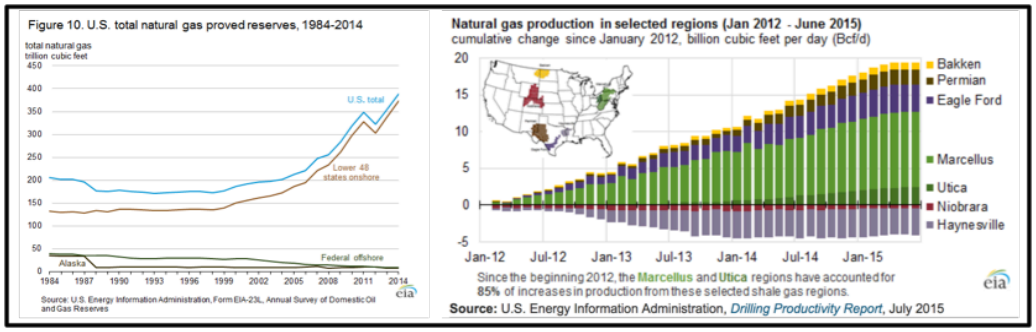
Insert drill, hydraulically fracture the layers of the rock that trap the oil and gas, and extract. Whenever a company drills via hydraulic fracturing, three things usually come out, oil, natural gas, and natural gas liquids (i.e., butane, propane and methane). The amount of each depends on where and what type of rock formations you drill.

Natural gas is colorless, odorless, and tasteless so refiners add mercaptan for safety to give natural gas its rotten eggs odor. Natural gas is primarily used in electricity generation, heating homes and commercial properties and industrial applications (e.g., making plastics and other chemicals).

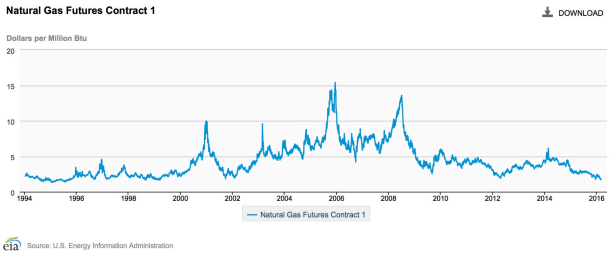
Unlike oil, the natural gas market is highly inelastic and sensitive to regional supply and demand. It's greatly affected by changes in the weather and demand is greatest in extreme weather. Think cold winters and hot summers as catalysts for peak energy demand. Demand is also seasonal as inventories build in the fall/spring and decline in the winter/summer. Some of the most prolific natural gas reserves are in the East Coast, specifically the Marcellus and Utica shale.



Our companies, Antero Resources Corporation, Cabot Oil and Gas, and Range Resources control significant reserves in these areas (i.e., amounts of natural gas that are economically recoverable). Economic recoverability, however, is a fine line dependent on natural gas prices. As cheap money flooded the world, shale exploration and production ("E&P") companies borrowed heavily to finance increased drilling and production. Unsurprisingly shale gas reserves and production exploded, resulting in overproduction.



Just as night follows day, lower prices followed overproduction. Natural gas in storage currently sits at a five year high, and prices have fallen by almost half to $1.52 mmbtu from a year ago. This price represents a 17 year low.



Just stepping back a bit, you'd think that highly paid executives at energy companies would know this. A commodity product whose demand is regional "may" be prone to falling prices if you overproduce it. Again the stock market likes growth and CEOs like to be liked by the market. Besides, Donald Trump said . . . "You have to think anyway, so why not think big." Apparently, the first part of that sentence doesn't even need to be true.

Our Variant Perspective

So why do we think natural gas prices will rise?

1. Weather

This winter was unseasonably warm thanks to El Niño, a macro-scale weather pattern that brings warmer and wetter than average winters. This led to lower natural gas demand for heating, inventory build-up, and lower prices. El Niño winters, however, are typically followed by La Niña winters.

La Niña brings about cooler temperatures, which increases the demand for natural gas. Weather is tricky though, but even if a cold La Niña fails to appear, an average winter would elevate demand and deplete natural gas supplies. So really, Game of Thrones is right . . . "Winter is Coming", and there's a good chance 2017 will be a much colder winter.

Using Pixar's Inside Out's Joy and Sadness, I've explained our position to Mason this way:

2. Weakness of Competition

Two of the largest natural gas producers, Chesapeake Energy and Southwestern, are heavily indebted and approaching bankruptcy. Although the companies have relied on asset sales of non-core assets to generate cash, these are one-time events. If these companies do enter bankruptcy, their production will be severely impacted as creditors take over and conserve cash. Alternatively, if the companies were to survive, their heavily indebted balance sheets and depressed stock prices will hamper their ability to finance production growth. The natural gas drilling business is capital intensive, and the inability to raise money by taking on debt or selling stocks prevents companies from surviving or growing. Whatever the outcome, our stronger companies will likely have future opportunities to buy cheap distressed assets, take market share, or both.

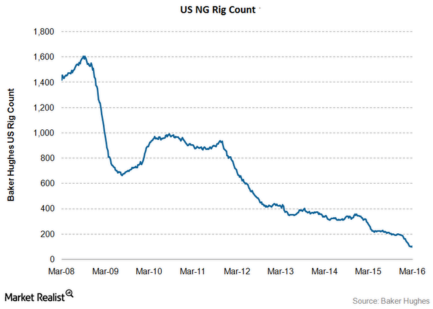
3. Increased Demand

Natural gas is primarily used in electricity generation, heating and industrial applications, and demand for the gas has increased as prices have declined. In 2016, natural gas is expected to exceed coal in electricity generation (33% vs. 32% for coal). We anticipate this trend to accelerate because of concerns over global warming. In December 2015, 195 countries at the Paris climate conference ("COP21") agreed to the first legally binding agreement to limit greenhouse gas emissions. This bodes well for natural gas as many see it as a bridge from coal and fossil fuels to more sustainable renewable energy.

Demand for natural gas is also rising in the manufacturing sector. The hydrocarbon serves as an ingredient in antifreeze, plastics, fertilizer, chemicals, pharmaceuticals and fabrics (as heat or as a raw material). As a heat source, it is used to melt, bake, dry, or glaze products such as bricks, cement, ceramics, tile, food products and other commodities. Given the abundance and cheapness of the resource, manufacturers have begun situating manufacturing plants next to large reserves, driving additional demand.

4. Supply

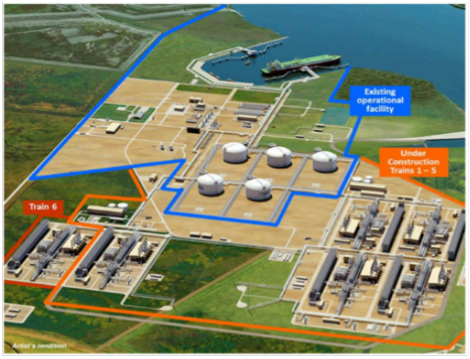
Finally, given the glut and low prices many companies have reduced their capital expenditures. Rig counts (i.e., the machines that drill wells) have in turn plummeted. Even accounting for increased drilling efficiencies the number of operating rigs has fallen 60% from last year, to an all time low of 88 as of last week. This will dramatically reduce the number of wells drilled, thereby slowing natural gas production.



Curtailing supply coupled with an increasing demand will result in supply/demand rebalancing. We don't need natural gas prices to shoot-up dramatically from these low levels to make money. The risk/reward is asymmetrical at this point, so we'll be patient and see how this plays out. We're big cheerleaders of natural gas and it's better for the environment. So you see? Save the cheerleader, save the world.

Our New Refrigerators

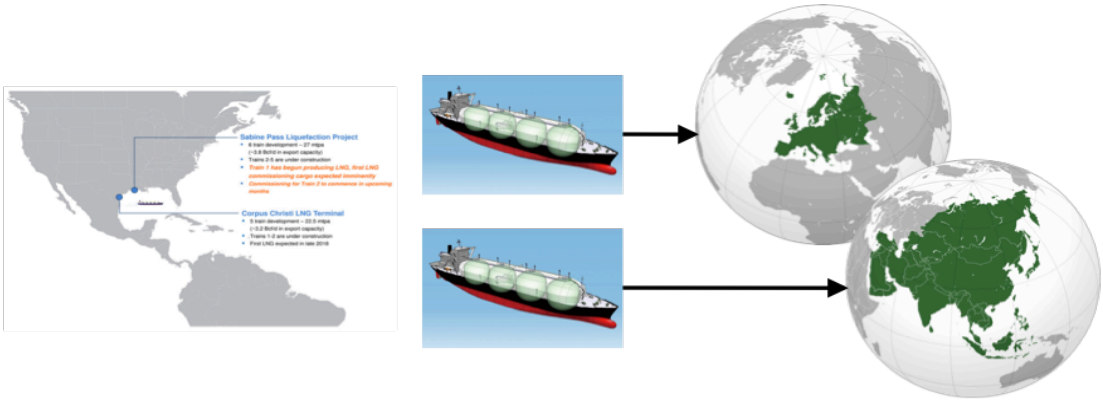
In addition to natural gas stocks, we also bought some refrigerators, seven to be exact. Our refrigerators are owned by Cheniere Energy, a Houston, TX based company engaged in the liquid natural gas ("LNG") related business. Cheniere is currently constructing two facilities, one in Sabine Pass, Louisiana and the second in Corpus Christi, Texas. Here's an artist rendering of what the completed facilities will look like:



Sabine Pass, Louisiana

Corpus Christi, Texas

The LNG business is all about arbitrage. Although natural gas is abundant in the U.S., it is still a regional product. So freeze it, ship it, and sell it to other parts of the world where natural gas commands a higher price. Cheniere "simply" procures the natural gas, turns it into LNG, and arranges transportation.



Why freeze it? Well if you cool natural gas to negative 260F degrees it becomes a noncorrosive and nontoxic liquid that occupies a volume that's approximately 1/600th of its gaseous state. This liquefaction allows LNG to be transported economically. Upon arrival the LNG is then heated and turned back into natural gas for customer delivery.

Cheniere's Contracts

Our seven refrigerators (i.e., known as "trains" in the LNG world) are expensive. These behemoths spanning acres will cost Cheniere close to $40B when finished. Since the company is paid only when it produces the product, almost the entire cost of the plant is funded by debt. This is the ultimate field of dreams . . . if you build it, you really hope they'll come. However, before you can borrow, you need something to convince bondholders that they will indeed come.

Cheniere has an interesting history. Before the shale fracking boom, Cheniere built regassification facilities anticipating that the US would need to import natural gas. This turned out to be disastrously wrong, and Cheniere and its previous CEO Charif Sarouki changed strategies to become the first U.S. company to build liquefaction export facilities. From 2012 through 2015, Cheniere also signed 13 customers to long-term 20-year take-or-pay LNG Sales and Purchase Agreements ("SPAs") for both the Sabine Pass and Corpus Christi LNG facilities. SPAs are the cornerstones of Cheniere's future revenue stream and means that Cheniere has effectively sold more than 87% of their LNG production for the next 20 years.

Too Much of A Good Thing

These agreements, however, were signed nearly 4-5 years ago, when LNG prices in Europe and Asia were significantly higher. LNG prices have since plummeted for a few reasons. In Asia, Japan had closed all of its nuclear power plants in the wake of its 2011 earthquake and the Fukushima nuclear plant disaster. Consequently, natural gas demand and imports soared to meet Japan's energy needs. Japan has begun restarting its nuclear facilities, which dampens future demand. Secondly, LNG prices are indexed to oil, and as oil plummeted so has LNG prices. Third, LNG supply is forecasted to dramatically increase as new LNG plants currently planned or in construction come online (e.g., 11 in the US and 7 in Australia). The spike in LNG supplies will only further weaken LNG prices.

Although it only costs Cheniere about $2 mmbtu today to obtain natural gas, energy companies would need to sell LNG for more than $7 mmbtu after paying Cheniere to freeze and transport it. Take a look at the price of LNG these past few years, if you pay $7 mmbtu and sell it for $5 mmbtu, that's not a great business model:

	December 2013	December 2014	December 2015	February 2016
Europe	$11	$10	$6	**$5**
Asia	$16	$16	$8	**$7**

As such, the concern recently has been that Cheniere's customers will cancel these SPAs. To some extent this makes sense, why would customers pay for LNG that they could not profitably resell? Wouldn't they simply cancel or renegotiate these contracts?

Our Variant Perspective

1. The Contracts

We've analyzed the SPAs and have concluded that there are no provisions that would allow a customer to unilaterally cancel or amend the contracts for economic reasons. The SPAs can be terminated only in very limited circumstances (e.g., if a counterparty files for bankruptcy) and Cheniere's customers have agreed to pay a fixed fee regardless of whether or not they take delivery of the LNG.

The majority of Cheniere's customers are also publically traded companies with investment grade ratings making willful breaches unlikely. An arbitrator (as required under the contract) would almost certainly find in favor of Cheniere, which would likely impact the market capitalization of the energy company. We have considered the possibility that if the counter-party is a government-backed entity they could use the political clout of the government to force Cheniere to renegotiate or cancel the contracts. Fortunately, only a few of the 13 counterparties are government-backed entities, mitigating the risk.

2. Energy Security

Energy conglomerates entering into long-term contracts seek dependable supplies of energy, and this security trumps temporary economic losses. The major LNG suppliers in the future will be Canada, US, Australia, Qatar, Iran and Russia. Who would you rather depend on for your energy needs, the first three

or Qatar, Iran and Russia? We think most energy companies will continue to hedge their risks by sticking with a US supplier like Cheniere.

3. LNG Price

We believe the market, as it is apt to do, is taking a short-term view on LNG prices. Yes, some counterparties will be forced to pay Cheniere's fixed fee and simply refuse LNG delivery if European and Asia prices are unprofitable (saving on transportation costs). This would likely be temporary, however, as European and Asia prices are indexed to the price of oil. We're pretty sure oil prices will fluctuate in the next 20 years. The cure for low oil prices has always been low oil prices. When oil prices inevitably increase, the once uneconomic LNG trade will become economical again as LNG prices rise.

4. LNG Oversupply

There is an argument that Cheniere faces an LNG supply glut in the future when new LNG liquefaction facilities come online in North America and Australia. We agree with that assessment, however, with a major caveat. We believe most of the projects that have not signed long-term sales agreements will likely never be built as there'd be nothing to borrow against. We're beginning to see this play out with recent cancellations of Canadian and US LNG plants. In fact, the US Federal Energy Regulatory Commission also recently denied an application for an LNG plant because the sponsor couldn't demonstrate a commercial need for the product (i.e., no customer agreements had been signed).

In addition, remember that Cheniere has already pre-sold 87% of its LNG production for the next 20 years. Therefore, even if there is an oversupply of LNG, price weakness will only affect the remaining 13% of LNG to be sold at the spot price (i.e., LNG ordered for the next quarter). We don't need Cheniere to hit a home run on the unsold inventory for the stock to climb higher. Our estimates are based primarily on the 87% already sold, and if Cheniere is able to generate any additional profits on unsold LNG, the stock price will climb higher from where we think it should be.

A Burrito

After buying a refrigerator we decided some food was in order, so let's welcome our third new position.

Chipotle is a Denver based fast-casual fresh Mexican food restaurants with over 2,010 restaurants worldwide at year-end. Recently, the company hit a rough patch with a rash of food safety issues. The company's sales plunged over 30% in December following an outbreak of E. coli in multiple states, salmonella in Minnesota and norovirus in Boston and California. The outbreaks led to a Center for Disease Control investigation and media and customer backlash.

For any restaurant, food safety is paramount, let alone one that prides itself on serving safe and healthy food with the motto "Food With Integrity". Chipotle compounded its problems by reacting defensively when investigators came knocking. We think though that the executive team has finally found religion. On February 8, Chipotle shut down all 1,900 restaurants in the U.S. for a few hours to update its employees on its new food handling procedures and policies.

Perception is Reality, Until Reality is Reality

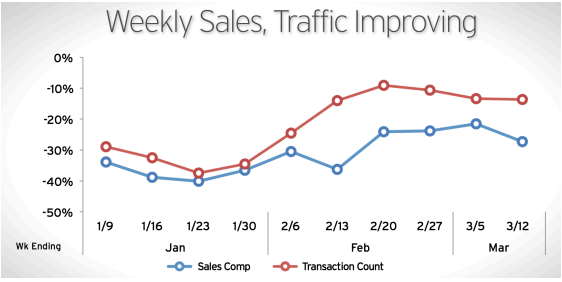
We know historically that these types of food crises fade if the company does not reoffend. Whether it's Jack in the Box in 1993 (where four children died from E. coli contaminated hamburgers) or Taco Bell in 2006 (E. coli contaminated tacos), customers do eventually return and the stocks recovered after a year.

We acquired Chipotle stock in the last week of January 2016 anticipating that the CDC would eventually conclude its investigation. The CDC did just that on February 1, and the clouds looked like they were beginning to part. A new marketing push in February that included free burrito giveaways also increased visits to the stores. The strategy was designed to encourage customer visits. The company was betting that customers would eventually return if they left satisfied and healthy after the free offer. Other than E. coli nothing stirs the stomach like free food. Jack Hartung, the company's Chief Financial Officer, said

> *It was kind of eerie – and we'd hear this from customers. They would walk by a restaurant and see, god that was always busy, and now there's no line whatsoever . . . .*

The giveaways help combat this negative perception. Potential customers like to see customers. It's a bit monkey see, monkey do, and with time, we think Chipotle's will be a place where Yogi Berra's quote applies "nobody goes there anymore. It's too crowded."

Chipotle's own weekly data seems to indicate things are improving, as weekly sales began climbing from mid-February into March.



You'll notice that there's a dip in the very last week. Unfortunately the company had another setback in the first week of March when a store in Massachusetts reported a norovirus outbreak among its employees. Fortunately, no customers were harmed in the making of the burritos, but the negative media coverage was unhelpful. Food safety is an evolving process though, and as the company moves forward and refocuses these cases will hopefully not reoccur.

If Chipotle can manage to say out of the media spotlight, customers will eventually come back. Same store sales fell by over 26.1% in February, and Chipotle warned that it would post its first quarterly loss as a public company for Q1 2016. While sales may recover in the longer-term, margins may not. The new safety protocols will likely reduce Chipotle's industry leading profit margins by 2%. The margin compression could be mitigated by reductions in labor costs depending on how sales recover, but at this stage it's a bit early to tell. This is something we'll keep an eye on. We think that as the company moves past the food safety issues it can refocus on maximizing profitability and continued growth. Even with the recent turmoil, the company plans to add 220 to 250 additional stores to its existing 2,010 stores in 2016 resulting in top and bottom line accretion. Baby steps for now with better days ahead.

One last interesting factoid (to me at least). Chipotle just hired James Marsden, father of actor James Marsden as its new Executive Director of Food Safety. He's a former Kansas State University meat-science professor and renowned food safety expert. His son was Cyclops' in the X-Men movies . . . so very cool. So we salute you Mr. Marsden for joining the Chipotle team.

Parting Thoughts

So there it is, our first Q1 under our belt. We're looking forward to Q2 and with some luck and rational thinking it will hopefully prove to be successful and prosperous. As always thank you for investing and please let us know if we can explain any of our ideas above in more detail.

Sincerely,

Nelson Wu
Managing Director