July 12, 2019

Dear Friend of Valara Capital,

For the second quarter and six months ended June 28, 2019, Valara Partners, LP produced total returns, net of fees, of 1.07% and 11.01%, respectively, versus corresponding total returns for the S&P 500 of 4.30% and 18.54%. Clearly it continues to be a challenging environment for us. However, in the last few months the internals of the market have shifted in ways that may portend better performance ahead.

During the second quarter the bloom really came off any expectation that there would be a neat and clean resolution of Washington's and Beijing's trade dispute, with the oratory getting heated and personal. The market was caught off guard with how abruptly this emerged and sold off accordingly. Offsetting this were the central banks of Europe, Asia and America all tilting toward interest rate cuts and accommodation. Global economic data came in weaker than expected, particularly in China, and inflation moderated slightly. Contributing to the softer inflation numbers were a sell-off in oil prices precipitated by somewhat weaker demand and swelling supply out of the US shale basins. The weakness in oil prices was relatively short lived, albeit devastating to the energy stocks, as the Iranian situation heated up with an attack on two oil tankers in the Gulf of Oman and the downing of a US drone. Quietly at first, then more noticeably as the quarter progressed, gold moved strongly to the upside. Most of this move can be attributed to political tensions and the fact that global central banks find themselves preparing to ease with interest rates and unemployment at extremely low levels. Something seems amiss and the Federal Reserve's "medicine" of low interest rates and leverage is prominent on the list of possible explanations.

In spite of all of these uncertainties, global stocks adopted the glass as half full view emphasizing the likelihood that the global central banks would support stocks. The strongest markets in the quarter were Russia, Brazil and Germany, with China, Korea and Mexico bringing up the rear. The S&P 500 was solidly in the middle of the pack. Interest rates peaked in early March and continued lower straight through June. The ten year Treasury bond gave up 27% of its yield during that four month stretch of time. With the hope that the Federal Reserve would soon be cutting the Federal Funds rate, credit spreads tightened, further easing corporate borrowing costs. It is interesting to note that the Treasury yield curve officially inverted at the end of May which according to the Federal Reserve Bank of San Francisco is the most reliable predictor of a recession of all the various term spreads.

PERFORMANCE COMMENTARY

At the outset of this letter, I noted that the internals of the market had shifted somewhat. Among the biggest surprises is that if gold stocks were a sector (they are an industry in the Materials sector) they would have been the top performer in the period. The top three sectors were Financials, Technology and Materials. The weakest three were Energy, Transportation and REITS. Growth continued to lead value but by a reduced margin. Interestingly, the new technology/social media stocks lagged the old technology stocks with Amazon, Apple, Google, Twitter and Netflix being held back by increased regulatory or competitive concerns. Microsoft, Qualcomm, PayPal, Visa and Mastercard were important leaders.

Energy was the weakest sector by a noticeable margin and the largest detractor from our performance. I have continued to review our assumptions for the sector and the stocks that we hold. While I fully expect that fossil fuels will lose share to alternatives I think this will be a much longer process than implied in

the consensus expectation and valuations. Ensco was the fund's biggest detractor followed by Transocean, National Oilwell and Murphy. GAP was also a notable underperformer, being one of many retailers to post disappointing Q2 results. The strength of gold mining stocks in general was a great help and our leading positions were: Agnico Eagle, Barrick, Kinross and Newmont Mining. AIG and Met Life were contributors within the strong Financial Services sector with AIG up 24% on positive Q2 earnings.

Our trading picked up in the second quarter. We added four new positions to the portfolio: Quest Diagnostics, Carnival Cruise Lines, Mohawk Industries and State Street Corp. We trimmed our position in Newmont Mining after the acquisition of Gold Corp (another of our holdings), moved the proceeds into Pan American Silver and Barrick Gold and made several other minor opportunistic adjustments. In the period we shifted over 5% from the SPY into specific stock investments.

OUTLOOK

The Fed and other global Central Banks have now made it clear that they see the slowdown that the yield curve and leading sectors have been fretting about for over a year. As such, it is the overwhelming consensus expectation that the Fed will cut interest rates at their July 31st meeting. The question du jour is whether they will succeed in reenergizing and extending the cycle or not. Speculation abounds as to how much more influence the Fed can wield starting this process with rates and unemployment already so low. More concerning is that while the economy is sluggish, inflation is not as convincingly so. With trade skirmishes all over the world (import prices), unrest in the Middle East (oil), epic flooding of Midwestern farm land (food, especially corn), it's not impossible that that inflation picks up just as the Fed is easing. That would be incrementally damaging to the Fed's credibility and would largely tie their hands from taking further action. My guess is that markets would not like that much. If inflation, in fact, rises, it is likely to be buffered somewhat by the current record high corporate profit margins but that would suggest future earnings disappointments – also not a happy outcome for markets. Buttressing this concern, in the build up to the now commencing Q2 earnings reporting season there have been a higher than usual number of negative preannouncements. In sum, the obstacles are building at the same time the market is breaking to new highs. As you all know, our strategy is to methodically invest in companies that are trading significantly below their relative fair value without trying to time the market. We have stayed true to our discipline while being conscious of the issues above and I believe we are well positioned to outperform regardless of what comes next. Thank you for your continued faith and patience. Please feel free to call or email with any questions.

Sincerely,

Robert W Simmons, CFA
Principal