Valara
Capital Management, LLC

July 14, 2017

Dear Friend of Valara Capital,

The Partnership's second quarter results were distinctly disappointing. For the three months ended June 30, 2017, Valara Partners, LP generated a total return, net of fees, of -4.53%. This compared to a total return of 3.09% for the S&P 500 index.

Global markets generally continued to fare well in the second quarter with some narrowing in leadership. One of the primary shifts, that will be discussed below, is the sell-off of oil in the period which tended to negatively impact those markets that are heavily exposed: Russia, Brazil and Canada, most notably. China, Spain and Australia were softer markets as well, on idiosyncratic issues. The macro backdrop continued to see modest global economic growth with a great deal of focus on the policies of the key central banks. In the United States the Federal Reserve continues to tighten and has additionally introduced the reduction of its balance sheet to its talking points. Interest rates in the period vacillated notably suggesting continued uncertainty about the ultimate impact of Fed action on the US/global economy and markets. There is increasing speculation that the European and Japanese central banks may follow the Fed and begin moving in the direction of reigning in their securities purchases.

All of the primary US market trends seen in Q1 continued and in some cases strengthened in Q2. There was a clear preference for growth stocks with a leaning towards the largest companies. The groups that led the market were health care (particularly biotech), technology and the beneficiaries of lower oil prices – namely transportation. Financials and industrials were also outperformers with the former benefitting from continued hopes for regulatory reform, tax relief and higher interest rates. By far the weakest group was energy with all subsectors under pressure but led by exploration and production companies and offshore drillers. Gold stocks also underperformed, but in comparison to energy they were a lesser detractor and our stock selection within the group was somewhat of an offset. Retail, staples, REITs, consumer discretionary and utilities rounded out the underperforming sector list.

**PERFORMANCE COMMENTARY**

For Valara LP the second quarter underperformance was substantially about the weakness in oil and its impact on the stock prices of our holdings. The immediate concerns for oil relate to OPEC ineffectiveness, inventories remaining stubbornly high and the boom in drilling that has occurred in the US shale oil basins – primarily the Permian. We have no better or worse forecast of what the oil price will be in six months' time than anyone else. Note Goldman's recent flailing as evidence of the difficulty of short term commodity price forecasting. If the stock prices are to be believed, the market today is very worried that the WTI price is going lower and it may. Our thesis has a longer term perspective. The primary capital that is entering the market, boosting supply, is in the US shale – very little capital is being invested anywhere else. Shale today is less than 10% of total production and it is not profitable at $45 per barrel. Over time industry profitability must improve, through higher prices and/or lower costs, or supply will contract due to underinvestment – which itself will balance the market. This dynamic is already quietly at work. We have positioned the portfolio in industry participants that are significantly undervalued and will benefit from a recovery that we ultimately believe is coming.

The biggest individual detractors from performance in the quarter were Weatherford International and our handful of deep water drilling stocks – Transocean, Diamond Offshore, Ensco and Noble. As noted above, gold was not a particular help in the period with the Fed raising interest rates. Goldcorp was our worst performer in the sector. Of note is the fact that both Kinross Gold and Agnico Eagle Mines were solid outperformers. Additional positive portfolio contributions were made by Citigroup, which was our largest financial position, and by Microsoft, Met Life and Quest Diagnostics.

The quarter was another quiet one from a trading perspective.  Despite the sell-off in oil we only added slightly to our energy positions.  We did move some money within the group from Chevron and Noble to Diamond, Ensco and National Oilwell Varco, picking up leverage to the commodity price.  Outside of Energy we continued to reduce our position in Quest Diagnostics, sold Johnson and Johnson completely and added a new position in Gilead Sciences – all on valuation.  We also modestly trimmed our position in BankAmerica.

**OUTLOOK**

Not much has changed with respect to our outlook for the remainder of 2017.  Our base case is for continued modest growth and solid earnings which should be supportive of markets.  The prospects for near term tax reform or regulatory relief have certainly faded with the political disorder in DC.  That said the market so far does not seem to care.  We continue to be watchful for late cycle signs and will be paying close attention to the Fed's tightening and balance sheet actions.  Weak auto sales remain one of the only economic variables that are bucking the modest growth trend – with job growth, confidence indicators and housing continuing to be favorable.  We continue to find the greatest degree of misvaluation in energy and basic materials but we do see individual company opportunities, like Gilead, on the list and will continue to pursue them within our discipline.  As always, we appreciate your continued support and confidence.

Robert Simmons
Principal