Valara
Capital Management, LLC

October 12, 2017

Dear Friend of Valara Capital,

The Partnership's third quarter results were a solid step in the right direction. For the three months ended September 29, 2017, Valara Partners, LP generated a total return, net of fees, of 5.79%. This compared to a total return of 4.48% for the S&P 500 index. For the nine months ended September 30, 2017, the Partnership produced returns of 5.13%, net of fees, versus 14.24% for the S&P 500.

Equity markets worldwide remained on the rise for the quarter despite an abundance of geopolitical, financial and natural disaster background noise. The only stock market of note that is not at or near five year highs is China and even the Shanghai market rallied in the quarter. The global economy continued to grow modestly with a hint of acceleration over the last three months. The US economic environment mirrored the global trend with data generally coming in positively. After a substantial build-up of anxiety about the potential for a Federal debt ceiling fight in September a deal was quietly cut and the issue tabled until December. Global central banks continue to be the epicenter of the markets' focus. The Fed's message remains tilted toward tightening monetary conditions gradually over the coming months but the yield curve is not convinced. Short rates have risen but the ten year yield has remained anchored within a narrow band. Auto sales, decelerating bank loan growth, the flattening of the yield curve and the stagnation of federal government tax receipts continue to hint that the economic cycle is maturing.

Happily, there was a slight shift in the markets dedication to growth stocks in the quarter. Growth still strongly outperformed value but there were pockets of value that rallied impressively. Technology stocks, semiconductors and biotech were the strongest groups but they were followed by energy, materials and financials, in that order. There were wide differences in the performance within the energy and materials space with the offshore drillers and other extremely depressed stocks rallying vigorously – in a handful of cases in excess of 30%. Large cap and small cap indices both outperformed mid-cap which was also evident in the equal weighted S&P lagging the market cap weighted index once again. The significant outperformance of a relatively small group of very large-cap market darlings with high valuations will always make it difficult for active value managers to keep up. Fortunately, if we are correct in our valuation assessments (on average), when this narrow market ends it will help our performance greatly. The weakest sectors in the market were either consumer focused and/or defensive in nature – Staples, REITS, Consumer Discretionary, Health Care and Utilities.

PERFORMANCE COMMENTARY

Valara's outperformance in the quarter was primarily driven by our exposures to oil and secondarily to other materials. It would appear that the oil price is finding a base in the $40 to $55 price band. In that range, a wide swath of the industry, both on shore and off, breaks even. There are specific projects in the onshore shale that claim to make a healthy return at $50 oil. That said, I do not see any companies putting up much in the way of profits and the oil price has been in the $45 - $50 band (West Texas Intermediate) for a while now. I continue to believe that the future supply of oil is gradually shrinking due to underinvestment and that when supply tightens sufficiently prices will push above $55 and then $60. I can't say exactly when to expect that outcome but I remain confident the process is under way. Our best performing stocks were Alcoa, Diamond Offshore, Transocean and Noble Corp – all of which were up over 25%. Other important contributors were Weatherford, Newmont Mining, Ensco, Gilead and Citigroup.

The weakest stocks in the portfolio were General Electric, Fluor, IBM and Mosaic. Each of these stocks underperformed for company specific reasons. The market lost patience with GE's ongoing restructuring and nominal progress in profitability and cash flow. The frustration has led to shareholder activism and management change. The shareholder activism confronting GE at the moment is not unique in today's environment. P&G is going through the same thing right now and so are Honeywell and DuPont. AIG went through it last year as did Pepsi and Arconic. GE has a great franchise with leading industrial businesses and at current prices it appears significantly undervalued. Fluor, IBM and Mosaic all reported Q2 earnings or outlook disappointments, none of which derailed our respective investment theses.

Early in the quarter, with good timing in hindsight, we added to Diamond Offshore, Ensco, Transocean, Weatherford, National Oilwell Varco and Marathon Oil. At about the same time, we added slightly to Barrick Gold, Kinross, Wheaton Precious Metals and Gilead. These trades were funded by reductions of Citigroup and Microsoft (which had been very strong performers and had greatly reduced upside in our work) and cash. We made an incremental trim of BankAmerica and we eliminated our positions in Quest Diagnostics and Alcoa, both of which reached our target prices.

OUTLOOK

The outlook remains largely the same as it was in early July. Our baseline expectation is for modest economic and earnings growth – nothing spectacular but good enough to satisfy markets that are still well supported by liquidity. We remain watchful for impacts on economic growth as the Fed progresses with its tightening campaign. As mentioned last quarter, we openly wonder how much tightening our leveraged system will absorb before slowing. That said, we don't think the Fed misses the point and we expect it will continue to be very gentle with its pace and responsive to market conditions. As a general reminder, our strategy is focused on compounding wealth over cycles. We buy stocks with a longer term perspective, the same way we would buy entire businesses. We do this with a very specific and disciplined process. Whether it's a high growth biotech or a low growth manufacturer we look for opportunities to pay less than the business is worth (thereby generating excess returns) and we are willing to be patient and vigilant as each investment works out whatever issues or misconceptions created the discounted price. We remain excited about our portfolio holdings and their future return potential. As always, we appreciate your continued confidence and support.

Robert W. Simmons
Principal