Mark's Musings

Whitmore Capital Management Quarterly Newsletter

Q4, 2013 March 31, 2014

"There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose."

- John Maynard Keynes

4Q 2013 — The Ride Got Bumpier

Whitmore Capital L.P. returned 6.2%, net of all fees, in the fourth quarter of 2013. This more than offsets the rather poor 3Q 2013 for the fund, where it was down almost 3.5%. Since inception, the Fund has outperformed the Credit Suisse Hedge Fund Index by more than 45% through the fourth quarter of 2013.

Note: In the period between the end of 4Q 2013 and the publication of this letter, the Fund has received finalized performance figures for January and February, 2014. The investment results for these months are –2.81% and –5.01%, respectively.[1,2]

Redacted as proprietary to Whitmore Capital L.P. investors.

Performance Drivers

Some of the positions that helped create solid 4Q 2013 returns included:

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The last quarter of 2013 saw a relatively isolated (and, since 2009 at least, exceedingly rare) outbreak of risk-aversion among investors in emerging markets. Investors and money managers around the world finally began taking note of many of the things I have been concerned about for quite some time. Namely, the virtually uninterrupted bull market that is now almost five-years old (and perhaps long in the

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[2] About the Credit Suisse Hedge Fund Index. This index is compiled by Credit Suisse Hedge Index LLC. It is an asset-weighted hedge fund index and includes only funds, as opposed to separate accounts. The index uses the Credit Suisse Hedge Fund Database, which tracks approximately 9,000 funds and consists only of funds with a minimum of US$50 million under management, a 12-month track record, and audited financial statements. The index is calculated and rebalanced on a monthly basis, and reflects performance net of all hedge fund component performance fees and expenses. The particular funds that comprise the index may have rates of return that are significantly different and/or more volatile than those of the index. Finally, while individuals may invest in a particular fund included in the index, they may not invest in the index itself.

tooth?) has lifted a lot of boats. What tends to happen in periods of investor ebullience/ complacency is that assets which perform most spectacularly are those which are further out on the risk curve. Recall the graph of returns I included in the last report, showing mid-cap stocks, small-cap stocks and the NASDAQ outperforming the Dow Jones Industrial Index by 5%, 8% and 9% respectively in 3Q of 2013.

Similar circumstances were present in foreign exchange markets prior to 4Q 2013, with riskier currencies (particularly those with chronic external imbalances in their current accounts, such as the Turkish lire) rising oftentimes far in excess of what I would deem to be their fair value. Investors in all asset classes tend to invest by looking in the rear-view mirror, and the good times enjoyed by investors making big profits in riskier assets gets projected far into the future.

So the "speed bump" we saw in the fall of some of the riskier currencies during 4Q 2013 is an interesting development. Time will tell whether this is a portent of things to come for broader asset markets in the developed world or an ephemeral respite in the ongoing ascendency of assets deemed to be further out on the risk curve. I for one would error on the side of caution.

An Interlude for a Brief Tirade

As is my mantra, I find very little significance in short-term returns such as those contained in a quarterly report. Interestingly, behavioral economists have found that investor performance is generally compromised when people become fixated upon short-term changes in the values of one's portfolio. Awareness of short-term losses, especially those of significant magnitude, will induce many, if not most, retail investors to panic. Similarly, closely following rapidly ascending assets tends to encourage investors to chase performance. This leads to people buying high (when they have seen an asset rise significantly over time) and selling low (throwing in the towel and capitulating when asset markets are offering fire sales such as in early 2009). I am convinced one of the reasons why the housing market collapse was generally not as precipitous as what we saw in the equity markets is due to the fact that, crude Zillow estimates aside, there is no ticker symbol one can pull up at work to find one's home value marked to market on a daily basis. Had people been aware of how low the actual transactional value of their homes had fallen during the financial crisis nadir, as was the case in the equity markets, I am certain we would have seen a greater cavalcade of selling by timorous home owners.

My point is that much to our collective financial detriment, we live in a world where, at least as it concerns asset markets, the urgent ("how did we do this month?") takes the place of the important ("what will my ten, twenty or thirty-year returns look like?"). Of course, broadcast financial journalism (which is actually much more about entertainment than illumination; one only needs to watch Jim Cramer for a few minutes to appreciate this) is utterly fixated upon nonsense such as what moved the market a fraction of a percentage point before the closing bell. *So I would like to emphasize the importance of looking beyond monthly, quarterly or even yearly reports and not lose sight of the insignificance of these relatively fugacious changes to the value of investor portfolios in light of the overarching goal of accumulating wealth over the long-term.* Having said that, let me briefly recap 2013.

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2013 — The Case for Diversification Gets Stronger

"… US equity investors may be getting lulled into expectations of returns that close to ninety years of market history shows will be unobtainable going forward."

The first full year of returns for Whitmore Capital has passed, and I am pleased with the results. Net of all fees, the fund was up 15.3% for 2013.[1] As always, context is important when assessing results. Coming off of seven-month returns of nearly 40% from the fund's inception point through the end of 2012, I tried to make sure every investor knew that those returns were aberrational. The danger was not just that 2013 would come nowhere close to the returns of 2012 (that was all but certain). Rather, one of the most important concepts in all of investing is reversion to the mean. As we have all seen, when any investment increases in value a few magnitudes above its expected rate of return, significant negative returns often follow in the short-term. Of course for those investors who presciently see value and opportunity, this can lead to excellent medium-to-long-term results, which is certainly what Whitmore Capital L.P. seeks to do in the realm of currencies. But the point is, what could have been a flat, or even negative, year for the fund, turned out to be very solid.

Interestingly, when establishing the fund, my *goal* was to provide annualized returns of 15% net of fees over the life of the fund, making 2013 right on target. Please keep in mind that this is **not** a representation of predicted future returns, as nothing in life, much less investing, is certain or guaranteed. It is just aspirational based upon my experience investing in currencies for over a decade now. As should also be obvious, if there are periods of extreme outperformance such as the last seven month of 2012, it is also likely there will be not just quarters, but years, where the fund will underperform and almost certainly obtain negative returns.

Our 2013 results compare quite favorably to the Credit Suisse Hedge Fund Index, which was up slightly less than 10% for 2013.[2] However, were we to use a benchmark truly representative of the niche Whitmore Capital L.P. occupies within the hedge fund world, 2013's outperformance becomes even more dramatic. BarclayHedge's Currency Traders Index (BCTI) was up a fractional 0.87% for all of 2013. This continues a *very* long period of poor aggregate performance for currency-based funds, with annualized ten-year returns for the BCTI coming in at less than 2%.[3] These returns failed to even keep up with inflation over the last decade.

As I have mentioned, context for returns are very important. And depending upon the asset class with which one compares the fund's results, it was either an exceptionally excellent year or very underwhelming. On one hand, bond investors in 2013 would have been thrilled with a 15% rate of

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[3] About the BarclayHedge Currency Traders Index. This index is an equal weighted composite of managed programs that trade currency futures and/or cash forwards in the inter bank market. The particular funds that comprise the index may have rates of return that are significantly different and/or more volatile than those of the index. Finally, while individuals may invest in a particular fund included in the index, they may not invest in the index itself.

return, as this was a very poor year for the asset class deemed by most investors to be the safest. Barclays US Aggregate Bond Index was down slightly more than 2%, disappointing many investors who were willing to accept the absurdly low yield offered by most bonds in today's zero-interest rate environment with the understanding that their principal was generally secure. And while a 2% loss is far from devastating, it does highlight the challenges to investors (particularly retirees) looking to obtain a safe yield. They have the Larry, Moe and Curly of US Fed Chairs, namely Alan Greenspan, Ben Bernanke and, in the very near future, Janet Yellen, to thank for that. How I wish Ms. Yellen permed her hair to make that comparison perfect!

Similarly, investors in gold (which includes me) would have also been thrilled with a 15% rate of return. The "barbaric metal" collapsed a massive 28% over 2013, basically closing the year at its 40-month lows. This monumental decline has led many (including a money manager friend of mine) to boldly predict that gold would plummet to below $900/oz. in the near future. This would represent more than a 50% decline from its peak fewer than three years ago. While such a decline cannot be ruled out as a possibility, I for one am not prepared to write off the potential appreciation in gold from depressed levels. This is especially the case in light of a battalion of central bankers around the world prepared to run the proverbial printing presses night and day to inject fiat money into the world economy should we hit a global economic air pocket.

However, investors in US stocks (of which I have very little exposure) would likely scoff at 15% returns for 2013. The S&P 500 had its best year in more than fifteen years, achieving almost a 30% rate of return. Now one might fairly ask the question, "Why should I invest in a complicated and relatively expensive hedge fund if I can reasonably expect to achieve twice the rate of return by holding a cheap, passively managed, index fund?" Well, quite frankly, one should not.

Let me clarify. If one has a **reasonable** expectation that the S&P 500, or quite frankly *any* relatively broad-based index fund were going to achieve 30% returns over the next decade, there would be little or no role for Whitmore Capital L.P. in one's portfolio. My point (which I flesh out in an attached essay) is that US equity investors may be getting lulled into expectations of returns that close to ninety years of market history shows will be unobtainable going forward.

In sum, rather than looking at the great disparity of returns across various assets as an endorsement of the attractiveness of US stocks, I would reiterate the point I made in the 2Q 2013 report: In light of the possibility of extreme and unpredictable volatility in asset markets going forward (due to the combination of a still unwinding credit bubble juxtaposed against the prospect of an excessively accommodative monetary backdrop), one may be well served by having eggs in a number of different baskets.

A brief aside: As anyone who reads my reports and essays know, while I am somewhat cautious about the prospect of global equity returns in general going forward, I am particularly pessimistic about the US market. For those investors who share these concerns but are befuddled as to what vehicle they might consider for the equity exposure in their portfolio, let me offer Armor Capital as an alternative. I have gotten to know one of its principals, Boris Zhilin, as a result of his participation as an investor in Whitmore Capital L.P. In our conversations and correspondence, I have been struck by his thoughtfulness and humility, two qualities that are absolute prerequisites in my book for picking a fund manager. While the first quality is an obvious attribute, the latter should not be undervalued. I have no doubt that there is a direct correlation between the brashness of money managers and the propensity for the funds they run to blow up. Armor's long-term track record is extremely impressive (particularly in light of the poor returns most equity investors have obtained in the last fourteen years), and I think the investing approach employed by Boris and his co-founder is both sound and disciplined. Interested accredited investors can obtain more information by contacting: info@armorcapital.com. By way of full disclosure, while I am not presently an investor, I expect that may change in the coming months.

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About Whitmore Capital Management, LLC

Whitmore Capital Management, LLC was formed in 2012 to offer investors access to a proprietary foreign exchange investing program (the Fund, Whitmore Capital LP). This program focuses on cash currencies but may also include futures, forwards and currency options. The objective of the Fund is to achieve long-term returns superior to the Credit Suisse Hedge Fund Index.

At the very core of the investing program is a mathematical model developed by Mark Whitmore. This proprietary calculus for determining the "fair value" of exchange rates aims to identify long-term opportunities to profit from temporary currency market mispricing. The outcome of these quantitative analyses are supplemented by qualitative analyses of the circumstances surrounding each currency to determine the configuration of the portfolio itself. Finally, sentiment indicators are reviewed as an additional analytical overlay. Currencies traded for the Partnership's account may include, but are not limited to, pairs of the following currencies: AUD, CAD, CHF, CNH, CZK, DKK, EUR, GBP, HKD, HUF, ILS, JPY, MXN, NOK, NZD, PLN, RUB, SEK, SGD, TRY, USD, ZAR.

Contact: mark@whitmorecapitalmanagement.com

Website: www.whitmorecapitalmanagement.com

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