Mark's Musings

Whitmore Capital Management Quarterly Newsletter

Q4, 2014 March 31, 2015

2014 Year in Review — AKA Annus Horribilis

2014 was obviously a year of not just severe underperformance, but serious capital impairment. The approach that Whitmore Capital LP takes regarding capital markets in general and currency investing in particular does not lend itself to smooth returns. After all, our approach is largely predicated on identifying instances where the market has it wrong, where currencies are either significantly overvalued or undervalued based upon what fundamental analysis tells us is their fair value. This often entails "leaning into the wind." Where trend followers are simply seeing price action and chasing it for as long as it lasts, Whitmore Capital LP tries to take the long view. We believe there is more money to be made, with a higher expected probability of making it, by being strategic in our approach. We actually *need* those market timers whose actions in the market help drive prices to unsustainable levels. We do not really care whether those prices are either too high or too low, or even which of our investible currencies are driven outside the range of fair value. While their actions might cause Whitmore Capital LP to lose money in the short term, they are actually creating opportunity for us in the long run to make more money. By taking this macro approach to the markets, we are willing to absorb shorter term losses if, and only if, our expected longer-term return is higher. I recently read an excellent description of this approach as being, "early, chunky and explosive."

Yet while the fund was designed to absorb short-term losses of significant magnitude, 2014 represented a level of capital losses for investors that exceeded anything we anticipated as being remotely possible. As such, we think a frank assessment of what happened, what specifically went wrong, and how we have taken steps to insure that something like this will not happen again is in order.

Going into the last quarter of 2014, while we were disappointed with returns for the year, the fund was still averaging cumulative annualized net returns in excess of 20% since inception. As of the end of September we had returned 3.75% for the year, which was certainly well below what Whitmore Capital LP hopes to achieve in an average nine month period.

Nevertheless, in many ways we were thrilled with the results. After all, as I had articulated in my quarterly newsletter at the end of 2013, I believed that 2014 represented more risks than potential rewards in terms of asset markets, particularly for the US stock market. Accordingly, our macroeconomic overlay had us overweighting defensive currencies, or currencies that would likely appreciate in times of dislocation in asset markets. As no such dislocation took place, our defensive posture proved to be a drag on returns. Moreover, one of our largest holdings, the Russian ruble, had already lost more than 11% of its value as concerns mounted over its activities in Ukraine and what had been softening oil prices during 2014. Oil had peaked earlier in the year at around $105 per barrel and by the end of September was trading at around $90 per barrel. Weak oil in turn

"A man must be big enough to admit his mistakes, smart enough to profit from them, and strong enough to correct them."

- John C. Maxwell

was also hurting the Norwegian krone, one of those defensive currencies the fund had overweighted and which is also a currency quite sensitive to the price of crude oil.

In light of all of those developments, I would have generally expected the fund to be *down* 3.75% or more for the year, not up. However, several of our investment theses proved to be working quite well.

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Exhibit 1.

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Exhibit 2.

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I can understand, however, that discussing the positives of the first three quarters of 2014 is similar to saying that for the first three days, the Titanic's maiden voyage was really quite pleasant. As such, the real import of 2014 for Whitmore Capital LP investors is what took place in the fourth quarter. Much of that is discussed in detail above. We will focus here on the larger backdrop against which the catastrophic losses of the end of the year occurred, as well as highlighting the "lessons learned."

Up until late November, the fund had experienced some mild losses for the quarter, but nothing serious. Oil was continuing to weaken (it was around $75 per barrel) and there were reports that Russia was directly intervening in Ukraine. This was causing ongoing weakness in the ruble and to a lesser extent the Norwegian krone.

However, the day before Thanksgiving started a three week period in which the fund saw extremely steep losses, culminating in the events of December 16th in which the fund was forced to liquidate its entire ruble holdings. The spark for this period was a decision by the Saudis to refrain from limiting crude oil production in spite of dramatically lower oil prices and concerns of a worldwide supply glut. This caught oil experts, money managers and pundits by surprise (myself included). The conventional wisdom was that Saudi and other members of OPEC would do what they had always done in the face of flagging oil prices – temporarily, and in concert with each other, trim oil production so as to limit further oil price declines.

While it was widely understood that Saudi had the least need to cut production since it has the lowest cost of producing oil in the world and would still make solid profits with oil even under $50 per barrel, they had nevertheless typically acted in concert with other OPEC members, who did not have the luxury of such low costs, to limit supply. In retrospect it appears that the Saudis were willing to throw other OPEC members under the bus in order to 1) drive out the low-cost shale producers in North America that from the Saudi's perspective were threatening to flood the world markets with cheap oil for years; and 2) try to economically cripple some of their nemeses such as Iran, Russia and Syria whose economies largely relied upon the sale of oil and whose production costs were significantly higher.

In light of this surprise development, the oil market, and in turn the ruble and, to a lesser extent the Norwegian krone, went into a free-fall. This culminated in the fund's "Black Tuesday," in which we were directed to sell all ruble holdings within ninety minutes at prices that were well below any daily closing level for the ruble since the fund has existed. But this is well chronicled above. What I imagine most investors want to know is what lessons were learned from the debacle, and how confident are we that something like that will not happen again.

"We actually need those market timers whose actions in the market help drive prices to unsustainable levels … While their actions might cause Whitmore Capital LP to lose money in the short term, they are actually creating opportunity for us in the long run…"

A Conviction Reinforced and Lessons Learned

Those unfamiliar with the basis of my investment strategy (and maybe some who are) might assume lesson number one would be the importance of liquidating a position such

"Financial history is littered with examples of huge profit opportunities for those with the dispassionate resolve and willingness to take advantage of bargains where others see just folly."

as the ruble that is turning dramatically against me. They would be wrong. More than a dozen years of full-time investing experience (and even longer thinking about and studying investing) has consistently demonstrated that the best profit opportunities have come where the market has driven prices dramatically in the opposite direction of where fundamentals inform me they should be heading. Financial history is littered with examples of huge profit opportunities for those with the dispassionate resolve and willingness to take advantage of bargains where others see just folly.

Warren Buffet's investment in Goldman Sachs comes to mind to illustrate this point. In September 2008 Goldman Sachs had seen its stock plunge almost 50% in the last year as concerns over the sub-prime mortgage crisis were beginning to expand into concern about a far more generalized credit crisis. Buffet agreed to buy preferred shares and warrants in the company at a break-even price of $115 per share. Less than a year later the stock would be up over 50% and Buffet made more than $3 billion on the investment when he sold it five years later. What a lot of people forget was that for three months the investment looked absolutely foolish based upon what the market was doing. By December, Goldman stock had dropped in excess of another 50%, and was trading at a mere $53 a share. Buffet's investment was vastly underwater. Did this induce Buffet to try to unload what appeared to be a very poor investment? Of course not. Buffet was confident that at $115 a share Goldman stock was a bargain in light of its intrinsic value and given what he expected to happen in the economy (and specifically the herculean endeavors he knew the government and the Fed would undertake to prop up the banking system). Just because the market three months later was saying he overpaid for his investment by more than 100% did not mean he would not ultimately be proven right.

At Whitmore Capital LP, we have never prevaricated one bit about the fact that we will "lean into the wind" against the market, and at times that will cause capital losses. In the past we have characterized unrealized capital losses in which we have a reasoned belief that we will ultimately profit to be "good losses" in that they allow the fund to dollar cost average into positions at even more favorable prices. However, this entire strategy is premised upon one very critical assumption – that we will be able to maintain (and potentially add onto) those positions so as to ultimately profit when the market "comes to its senses." As noted above, were that the case, while December would not have been a good month for the fund, losses would have been in the range of 15%, and not reached the level of capital impairment that we ultimately faced. Most regrettably the fact that we were forced to liquidate all of our ruble holdings at the worst possible moment will not just serve as a drag on fund returns for 4Q 2014. As I write this the ruble is up more than 22% from the level we were forced to exit our positions, yet by the time the fund could re-enter those positions and do so gradually, we are up only 3% from our average cost-basis, which will serve as a huge drag on cumulative fund returns going forward. Finally, due to the level of capital impairment we suffered, the number of ruble positions is only about 2/3rds of those we had, thus further hindering our ability to profit from the resurgence in the ruble. Our 1Q 2015 returns (which look to be exceptionally strong) would thus be dramatically higher had we had our full portfolio of rubles from mid-December. Accordingly, as stressed above, we strongly believe that the catastrophe that was December should be seen almost exclusively as the result of an institutional risk as opposed to representing a flaw in the fund's strategy. We would add that, as our fund's strategy targets longer-term profit opportunities, the success of our strategy is best judged over a similar, multi-year period and not in the immediate aftermath of short-term movements (even movements as severe as what we experienced in the fourth quarter).

But all of this is not to say that there were not valuable (if quite expensive) lessons to be learned from Whitmore Capital LP's bruising 4Q 2014. Three specific things come to mind.

First, and most important, is the critical importance of having a secondary broker. Prior to the events of the fourth quarter, we viewed this as a luxury that would serve as a drag on returns, and one that was unnecessary in light of the fact that we were dealing with the largest retail foreign exchange broker in the country that had weathered the Global Financial Crisis (GFC) without a hiccup in its currency offerings. A secondary broker would have hindered returns for investors because FXCM had granted us "institutional pricing" on overnight carry rates, despite the fact that we did not meet the assets under management (AUM) requirement. We were granted this privilege due to my ten-year relationship with them prior to launching the fund, as based upon my individual track record they felt confident in our ability to grow AUM rather quickly to get to the institutional AUM threshold. Since Whitmore Capital LP holds currency positions for significant lengths of time and uses leverage to do so, even small differences in overnight carry rates can make rather large differences in returns. For instance, if the average difference in overnight interest rates between institutional and non-institutional pricing was only 0.6%, that would equate to a reduction in overall returns of 5% per year for investors assuming fund leverage of slightly more than eight-to-one. Had we moved money out of FXCM to fund another account (for which we would also not be eligible for institutional pricing), FXCM would have certainly terminated out access to favorable roll rates. I must admit that I made an erroneous assumption concerning FXCM. Since I had a greater than twelve-year relationship with FXCM during which time I had never been forced to liquidate any position, and that these included times in which most other financial institutions had experienced major counterparty losses and other catastrophic events which impacted their clients, I did not think there was a reasonable possibility that the fund's ruble positions would be subject to forced liquidation. Indeed, there had never been an instance of which I am aware where a currency broker took such action. And most frustratingly, FXCM was the only broker to take such action, and only with the ruble, in December. I simply did not see the risk of this unprecedented action, which is my failure.

As investors already know, we have two brokers, and will always have at least two brokers going forward to limit the possibility that we would ever face such circumstances again. Although I would not be surprised if in my remaining years on earth I never see another instance of a broker forcing liquidation of currency holdings, particularly with ninety minutes notice.

Second, volatility in global financial markets, and particularly currency markets, has reached such levels that reducing fund leverage is warranted. I am aware that even before December, investors in Whitmore Capital LP have been taken on a rather bumpy ride in terms of monthly swings. December of course took volatility to a whole new extreme. I choose a target leverage of 7.5 to 9 for the fund based upon my ten years of currency investing as an individual prior to launching the fund. Historically monthly moves (particularly to the downside) of greater than 5%, while not rare, were at least uncommon. However, it is clear that a phenomenon that I have predicted and discussed in my writings has actually come to pass with even greater force than I had anticipated. I previously noted that because we live in an era of "monetary disorder" whereby central banks have collectively pumped the equivalent of trillions of dollars into the global economy in a desperate (and in my opinion, ultimately futile) attempt to counteract the necessary macroeconomic adjustments brought about by the GFC, it would be likely that this extraordinary liquidity sloshing around in the markets would exacerbate volatility. This phenomenon is made even more acute in conjunction with zero (and even negative, as in the cases of Switzerland, Denmark and Sweden) interest rates, as the cost of capital is so low, speculators have little restraint in using huge leverage on already massive available liquidity to chase asset bubbles. This exacerbates

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The magnitude of moves I have witnessed in the currency markets in the last year have been greater than I have ever seen in light of the relatively benign economic backdrop (for now). This has lead me to conclude that it is prudent to reduce fund leverage to the range of 5 to 7.5 unless or until overall exacerbated volatility in financial markets abates. While this may not be welcome news to the most aggressive of fund investors who can stomach huge portfolio swings in the short-term in hopes of making bigger gains in the long-term, I still believe that even with reduced leverage that there is solid opportunities for significant capital appreciation, as 1Q 2015 results will prove. Moreover, this may allow some fund investors to sleep better at night.

Third, we need to do a better job of factoring in exogenous, sector-specific risks to our currency portfolio. As part of our macroeconomic overlay, we devote a great deal of thoughtful analysis and consideration to risk factors to the overall global economy, and make sure that our portfolio is not filled with currencies that would move in the same direction should the global economy unexpectedly break hard in one direction or the other. For instance, if we think it even somewhat possible for the world economy to unwind, we make sure our portfolio is not exclusively long "risk-on" currencies like the British pound, Turkish lire and Polish zloty that typically perform best during a salutary global economic backdrop, but languish when asset markets and/or economies become dislocated.

However, as we witnessed in 2014, a big enough move in a commodity (in this case crude oil) can do tremendous damage to a currency portfolio that is not sufficiently diversified between currencies that are hurt versus helped by a sharp move in a particular commodity or sets of commodities. In this case we were overweight currencies that would be significantly hurt by a huge drop in oil (the ruble and Norwegian krone). This is not to say that we were not monitoring the oil market with appropriate perspicacity, or that we did not appreciate the likely impact declining oil would have upon these currencies. Rather, because we do not fancy ourselves to have a significant comparative advantage to the larger financial community in commodity analysis (unlike currencies), we need to do a better job of contingency planning should unexpected moves in certain commodities occur. This is not just true for oil. For instance, there are several currencies in which we take positions such as the Canadian and Australian dollars, as well as the South African rand which are quite sensitive to the price of precious metals.

In sum, while we are most relieved to put 2014 in the rear-view mirror, it is critical that we soberly reflect upon what we can do differently to both insure that no setback of this magnitude ever happens again to the fund and in order to do things better so as to enhance future returns even more than would otherwise be the case had the December debacle never occurred.

Q4 2014 Performance Summary

As our investors are aware, Whitmore Capital, LP suffered through an abysmal fourth quarter. While the other sections in this letter spend time expanding on the events leading to the extreme underperformance for the quarter, and how the fund responded and is positioned for the future, in this section we will deal strictly with the summary numbers.

The fund's total return, net of all fees, for the fourth quarter of 2014 was -43.00%. (Note: In the period between the end of 4Q 2014 and the publication of this letter, the Fund has received finalized performance figures for January and February, 2015. The investment results for these months are 5.10% and 10.50%, respectively.)[1] For comparison, our narrow benchmark, the BarclayHedge Currency Traders Index, returned 2.88% and our broad benchmark, the Credit Suisse Hedge Fund Index, returned 0.70% over this period.[2,3]

While there was no respite during the quarter, as the fund generated negative returns in each of the three months, the vast majority of negative performance is due to December returns of -34.02%. And the vast majority of this performance is attributable to the fund's positions in the Russian ruble (see the following essays for in-depth discussions on the ruble). Falling global crude oil prices throughout the fourth quarter contributed to the ruble's sharp decline as well as to the decline in the Norwegian krone, which as shown in Exhibit 1, was the fund's second worst performing currency over the fourth quarter. Energy production is a significant driver of both the Russian and Norwegian economies and the currencies of both countries were thus, heavily exposed to steep declines in global oil prices.

Analysis of 4Q Performance Drivers

This content is available exclusively to Whitmore Capital, LP investors.

*Exhibit 1. Worst Performing Positions**

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*Exhibit 2. Best Performing Positions**

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2014 Performance

The fourth quarter results more than reversed the fund's strong third quarter, which had brought fund year-to-date returns into positive territory. All told, the fund's annual performance in 2014 is an extremely disappointing -40.87%. This compares to 2014 returns for the BarclayHedge Curren-

[1] Past results are not necessarily indicative of future results. You should carefully consider whether your financial condition permits you to participate in a commodity pool. In so doing, you should be aware that commodity interest trading can quickly lead to large losses as well as gains. Such trading losses can sharply reduce the net asset value of the pool and consequently the value of your interest in the pool.

[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.

[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. In 2015 there are 82 currency programs included in the index. 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.

cy Traders Index and the Credit Suisse Hedge Fund Index of 3.30% and 4.13%, respectively. The fund's since inception returns from June 2012 fell from 66.38% at the end of the third quarter 2014 to -5.17% at the end of the fourth quarter 2014.

Ever since the fund's inception, we have not shied away from the fact that our performance is likely to be bumpy over the near-term. Our strategy is predicated on the ability to identify substantial deviations from fair value and invest fund assets accordingly. This approach often entails absorbing significant losses, and at times judiciously dollar-cost-averaging-into those losses, as the market deviates further from our perception of fair value in an attempt to secure greater long-term profit opportunities. As such, we have consistently stated that we measure ourselves on long-term returns and put relatively little weight on short-term results both positive and negative. All that being said, the severity of December's negative performance is clearly well outside the range of expected monthly returns and, thus, requires a frank discussion on what exactly caused the extreme underperformance and capital impairment, and how the fund is positioned going forward – both strategically and operationally – to guard against future significant downside risk. The other pieces in this quarterly letter will address these issues.

“Our strategy is predicated on the ability to identify substantial deviations from fair value and invest fund assets accordingly. This approach often entails absorbing significant losses … in an attempt to secure greater long-term profit opportunities.”

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Understanding the Ruble Debacle

What Exactly Happened? A Review of Fourth Quarter Events

In the 3Q 2014 letter to investors we stated that the best time to invest is when there is "blood in the streets" and noted that while medium-to-long-term prospects for the ruble appear quite bright, in the short term the ruble may face further depreciation, particularly against the US dollar. Unfortunately, the second half of our assertion was borne out and then some over the fourth quarter, and in December in particular.

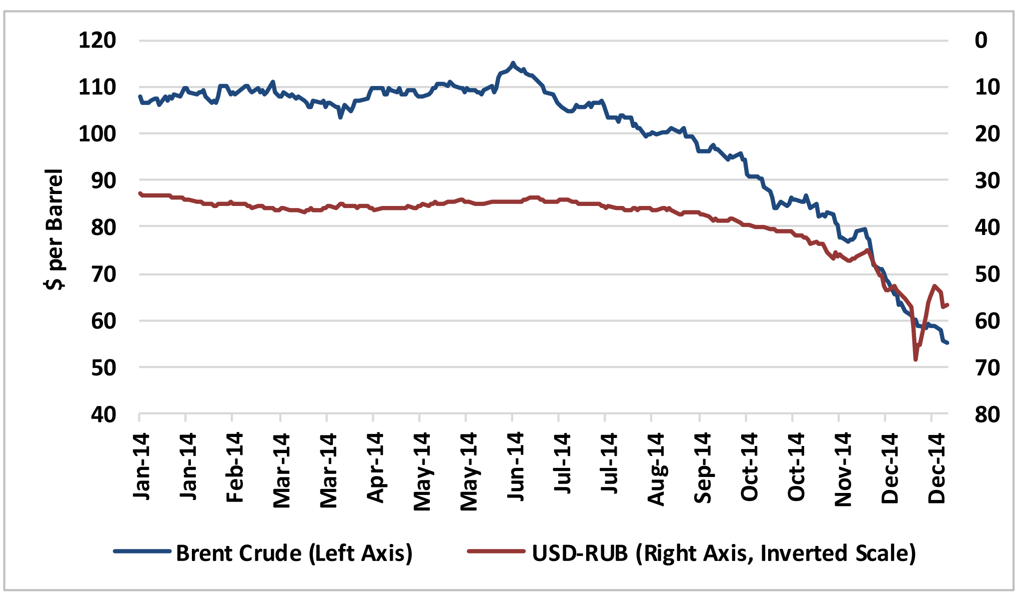
The ruble had been soft for much of 2014 up through the third quarter as growing uncertainty surrounding Russia's role in the Ukraine conflict and the international sanctions levied against Russia weighed on the ruble. Over the fourth quarter, however, the ruble's decline accelerated, and toward the end of November through the middle of December, the bottom appeared to fall out of the ruble.

At the beginning of the fourth quarter the US dollar – Russian ruble exchange rate was approximately 39.5 rubles to the dollar. At the end of December the ruble was trading at over 56 rubles to the US dollar. However, even this understates the extent of the ruble's precipitous fall. At its nadir, the ruble reached an intra-day low of 79 rubles to the US dollar – a 50% depreciation against the US dollar from the start of the fourth quarter.

The trigger for the ruble's steep fall was the accelerated decline in global oil prices. The price per barrel of Brent crude fell by more than 41% over the fourth quarter (see Exhibit 1). Oil's decline led to extreme negative sentiment surrounding the ruble and swelling numbers of momentum traders pilling into the short-ruble trade. Increasingly, the ruble traded in concert with oil and as oil fell further, so did the ruble. The correlation coefficient between the USD/RUB exchange rate and Brent crude prices rose from 0.70 over the first three quarters of 2014 to 0.958 for the fourth quarter.

"… it was not just the extent to which a major currency declined in this period that was unprecedented but also the volatility exhibited by the ruble during its decline."

Exhibit 1. The ruble's 4Q 2014 decline mirrors the fall in crude oil prices



Sources: OANDA; US Energy Information Administration

> ***"As deleterious as the ruble's precipitous and volatile decline was for our fund, this alone would have been much less dire as the resulting losses would have been unrealized."***

The ruble's fall from the end of November through mid-December is by far the sharpest decline over such a short duration in a currency of a large nation (Russia's economy is the 8th largest in the world) we have ever witnessed. However, it was not just the extent to which a major currency declined in this period that was unprecedented but also the volatility exhibited by the ruble during its decline. At one point on December 15th the ruble had declined by 12% – a single-day move the size of which we have never seen. This proved to be only the beginning. The next day the ruble fell more than 25% in just a 5-hour window. Going back to 1971 when Nixon closed the gold window and ushered in the current era of fiat currencies, we are unaware of any 5-hour time period, which saw a non-crisis currency move 10% let alone 25%+.

As deleterious as the ruble's precipitous and volatile decline was for our fund, this alone would have been much less dire as the resulting losses would have been *unrealized*. Through a combination of judicious leverage management and the trimming of non-core positions, the fund was able to weather the ruble's fall without having to exit our ruble positions due to liquidity issues and, therefore, would have been able to fully profit from the subsequent (and we anticipate long-term) rebound in the ruble. Unfortunately, the ruble's decline was merely the precursor to the truly bad news. On December 15th, on the heals of the ruble's 12% intraday decline, our broker, FXCM, informed us that it would be suspending all trades in the ruble on December 17th. All ruble positions at FXCM were to be liquidated as of this date. To our knowledge, and according to FXCM personnel, FXCM had never pulled trading in a major currency before this announcement.

Upon hearing this, we immediately began contacting other foreign exchange brokers to determine whether we could gain access to the ruble through another entity. We also appealed directly to FXCM senior personnel to reconsider pulling ruble trading, or at least allow our fund to maintain existing positions or transfer them to another broker. That evening, Russia's central bank hiked interest rates by 6.5 percentage points (to 17%) in an effort to stem the ruble's slide. Despite this action, near-term volatility in the ruble only became more extreme. After rallying 6% on the news of the central bank's interest rate hike, the ruble proceeded to decline more than 25% overnight to a low of 79 rubles to the US dollar.

In the aftermath of this overnight move, FXCM, which had been planning on maintaining access to the ruble had it stabilized after the central bank's dramatic interest rate hike, decided to not only suspend ruble trading, but to do so a full 24 hours earlier than previously stated. On the morning of the 16th we received notice that we had 90 minutes to sell all of our ruble positions. Apparently three more liquidity providers had simply stopped offering the ruble to foreign exchange prime brokers, and there was a real concern on the part of FXCM that there would simply be no liquidity (and hence no way to unwind positions at any reasonable price).

As such, through no choice of our own, we were forced to exit all of our ruble positions. The only bit of good news is that we were able to exercise as much discipline and patience as permitted within the circumstances of the 90-minute window and were able to exit in the aggregate at about a 3% better price than had we simply liquidated all positions in one block upon first notification of the 90-minute window. This was also a better price by 10% than where the ruble sat at the lows of the night, which would have been the exit point had the fund either voluntarily sold out of panic or involuntarily sold due to poor risk-management causing margin calls at the bottom. Nevertheless, these were without question the most painful trades we have ever executed.

We were able to expedite the establishment of an account with an alternative broker that continued to offer uninterrupted access to the ruble. However, in the intervening period between our forced liquidation and the establishment of the new account, the ruble snapped back from its lows to the high 50's range. This meant that the average entry price of the new positions we established in the ruble was almost 20% higher than the average exit price of our forced liquidation, significantly impairing the fund from realizing profits from the ruble's massive appreciation since December 16th.

How Could this Happen and Where Was the Failure?

Let us preface everything that follows by making it clear that we accept full responsibility as manager of this fund for the losses investors in Whitmore Capital LP have endured. Nothing that follows is in any way intended to be self-exculpatory. Nevertheless, in attempting to, as rationally and dispassionately as possible, assess the reasons for the fund being forced to liquidate rubles at most dramatic losses, the simple answer is largely an extrinsic one: unprecedented institutional risk that was in turn brought about by unprecedented volatility.

Stepping back for a minute, it is worthwhile to reiterate that our investment strategy is predicated on a willingness to endure short-term losses – as currencies deviate further from our analysis of their underlying fair values – in order to capture greater long-term capital appreciation. We liken currency markets to a rubber band initially stretched horizontally. If one pulls up or down at the midpoint of the rubber band, the resistance builds the further one continues to pull, taking more force to keep moving in the same direction. The rubber band directs more and more force to returning to the horizontal plane. Now think of the fundamentally derived intrinsic value of a currency as being that horizontal plane. The further a currency deviates up or down, the greater the natural economic forces exert themselves to push that currency back to equilibrium. Indeed, the most recent academic studies have found that, using some of the same fundamental indicators of a currency's fair value that we use at Whitmore Capital LP, the further that a currency drifts from fair value, the faster it will revert, and with greater magnitude, to fair value.

In the case of the ruble during its dramatic decline, the key question thus became: is the market and the ruble overshooting to the downside? Our answer to this question was, and remains, a strong "yes" and consequently we maintained our ruble positions seeking to capture the expected "snap-back" of the ruble rubber band. Adding to our decision was the fact that due to the large interest rate differential between Russia and the United States, we received a significant positive carry rate on our long ruble positions. In effect we were being paid, quite well, to wait for what we expected to be a strong reversal in the ruble.

To understand our assessment of the ruble it is necessary to distinguish between currencies that are objectively in crisis and those that are simply seeing declines in their value. The hallmarks of an actual currency crisis are nations plagued by one or more of the following: 1) hyperinflation; 2) crippling and imminently unserviceable sovereign debts; 3) massive money printing; 4) chronic and massive current account balances and/or 5) quickly evaporating foreign exchange reserves. Russia had none of these problems and therefore we determined that the ruble's dramatic decline did not reflect the reality of its fundamentals but rather the activity of momentum traders piling on one side of a trade.

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As such, in keeping with our value-based investment strategy of targeting currencies that are over or undervalued relative to their fundamentals and mid-to-long-term prospects, we continued to maintain our positions in the ruble. Indeed we even added modestly to our position in the ruble as it traded into the 50's and low 60's. To be clear, the decision to add, incrementally, to our position was the result of reasoned analysis of quantitative and qualitative factors impacting the ruble and not the result of some blind devotion to a mechanistic, dollar-cost averaging strategy. We believed (and still do) that the ruble was significantly undervalued at these levels – even with the headwinds from falling oil prices and sanc-

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tions – and offered a truly compelling long-term return opportunity.

While we no doubt underestimated the level of volatility and the extent of the ruble's short-term decline, even at its depths in the middle of December the fund would have been in a position to capture greater long-term capital appreciation from its ruble positions had it not been forced to liquidate by FXCM. Had we not been forced to unwind our ruble positions, the fund, while still facing large losses, would have faired significantly better. While issues such as daily carry rate fluctuations limit our ability to construct an exact hypothetical portfolio performance, our forced exit imposed approximately \$1.3 million of realized losses on the fund (both in terms of foregone appreciation in the ruble and foregone interest earned on our ruble positions) that would have been avoided had we been able to continue to hold our ruble positions through the end of 2014.

In this scenario, our portfolio would have been down approximately **-15%** (instead of -30.42%) for the month of December and down approximately **-27%** for the fourth quarter (instead of -43.00%). Likewise, since inception returns through 4Q 2014 would have been in excess of **20%** (instead of -5.17%). Unfortunately, the foregone benefit of this "avoided loss" will only become more pronounced in the event of further ruble appreciation as the fund will be hampered by both less capital with which to invest in the ruble while maintaining appropriate portfolio diversification and less attractive entry points for its ruble positions compared to the exit price at which we were forced to liquidate.

In short, **it was the unforeseen institutional risk event of FXCM pulling ruble trading that transformed significant but manageable unrealized losses into permanent capital impairment.** And it is this, and not a flaw in fund investment strategy, that we see as the key failure – and our failure – that led to the severity of the fourth quarter's results.

*** Past results are not necessarily indicative of future results. You should carefully consider whether your financial condition permits you to participate in a commodity pool. In so doing, you should be aware that commodity interest trading can quickly lead to large losses as well as gains. Such trading losses can sharply reduce the net asset value of the pool and consequently the value of your interest in the pool. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.**

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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.

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