Mark's Musings

Whitmore Capital Management Quarterly Newsletter

Q2, 2015 **October 9, 2015**

"In the short run, the market is a voting machine but in the long run, it is a weighing machine."

- Benjamin Graham

The Five-Level Pyramid of Investing Success

As a self-identifying neo-Luddite, I have a love/mostly hate relationship with technology. This is a huge source of amusement among many of my younger friends, a significant number of whom actually run tech companies. One of my closest friends likes to joke that he is worried about sending me a text with a picture attachment, as it might "blow up" my circa 1995 cell phone. I have recently succumbed to pressure from everyone (most importantly my wife) and purchased an iPhone. And, other than the very cool voice to text feature that allows me to bypass using my clumsy thumbs, I must say that I would just as soon have back my old flip phone from ten years ago.

Indeed, I avoided getting a cell phone for as long as possible back in the late 90's. A topic that is beyond the scope of this piece is the degree to which the level of 24/7 connectivity has actually undermined our quality of life, productivity and even our ability to think at deeper levels. My fear about getting a cell phone was that as an attorney, I was already working long hours catering to client demands, and that a cell phone would simply facilitate making those hours even longer. Sure enough, right before I left law, I purchased a cell phone and the separation from work and home, already tenuous at best, began to deteriorate further.

More recently, during the last vacation I took with friends, I was struck by the fact that in a beautiful tropical destination, had you replaced flip-flops and swim trunks with business casual attire, our villa might as well have been a remote office facility. At any given time there were between two and five mobile electronic devices getting heavy use as emails, reports, markets and news had to be monitored. I must admit I was as much of a guilty party as any. But it certainly did not enhance our vacation experience.

I raise this topic because fourteen years ago was the last time I took a vacation in which I was absolutely cut off from the exigencies and distractions of our post-post-modern lives. And in the midst of my "disconnected" state, a very funny thing happened – I began to think. Now do not get me wrong, I do not mean to imply that this is an unusual phenomenon. But this kind of thinking was different from what I was used to experiencing. Most of my time is consumed with focused, directional thinking. Namely (and I presume this is true for most other people), I am confronted with a plethora of specific problems that must be solved and/or topics to process and analyze. I see this phenomenon as a corollary to Parkinson's Law that "work expands so as to fill the time allocated for its completion." In a world where we are inundated and thoroughly saturated with data and correspondence related to work, our conscious thought is forced to expand the time with which to deal with such data and correspondence. Hence it can crowd out thought that might be otherwise directed to deeper matters.

So here I am back in 2001 on a small island in the Caribbean with no access to the internet(!) and with lots of spare time to relax. I guess we all have our own forms of relaxation. Being a finance geek by nature, my mind began to drift away from the world of currencies, stocks, bonds and commodities that had so pre-occupied it since I had left law just a year earlier. I began to think about the more generalized nature of investing success, or lack thereof. By the time I left for the US I had a somewhat detailed outline for a potential book on the topic. Here, in ascending order of desirability, are what I deem to be the five levels of investing success.

I. Running with the Lemmings

This is the very bottom of the pyramid of investing success, and that which I implore people to avoid at all costs. What do I mean by "running with the lemmings?" Most individual investors left to their own devices invest by looking in the rearview mirror. While they may occasionally look ahead, it is generally to see all the market participants who have profited greatly from a particular investment already (all of whom got in at better prices). Their field of view is so crowded with such success stories of friends, neighbors and colleagues they do not see the cliff rapidly approaching.

A relatively new, and I think extremely exciting (if that is not too oxymoronic for most readers), branch of financial thought is behavioral economics, which I have touched on in passing before. Economists within this school of thought have done a very good job of identifying the ways in which we tend to fall into predictable patterns of behavior that lead to sub-optimal economic decision-making.[1] One of the biggest traps they have identified that leads to very poor investment results is making financial decisions based up "recency bias." We have a cognitive tendency to place greater weight upon results going back a few years at best (and usually not that far), often ignoring longer-term, and hence more reliable, data.

Recency bias leads to two mistakes. First, and by far the most dangerous, is that investors are prone to invest in extremely inflated assets. In the eighteen years I have been a serious investor, we have already seen two massive asset bubbles burst, leaving literally trillions of dollars of investor losses in their wake. I vividly remember the animal spirits and greed unleashed by the tech bubble. Otherwise financially conservative friends of mine in some instances had over 50% of their liquid net worth tied up in a *single* tech company that had appreciated many fold. Most were *adding* to their positions going into 2000, despite valuation levels that were literally unprecedented. Many saw losses in individual stocks in excess of 95%, and a few saw their companies go to zero. What I find both so fascinating and so discouraging is that several of the very same people were, just several years later, investing in second, third or fourth homes (usually on an extremely leveraged basis), despite the fact that the housing market was then providing unprecedented returns.

The second mistake, while less pernicious, nevertheless serves as a serious financial detriment to investors. It is either selling "dogs" before they have had their day, or avoiding them altogether. I must say this ties into a very natural human tendency: we want to associate ourselves with "winners." Hence, when a stock, sector or entire asset class provides poor returns for any meaningful period of time, our proclivity is to dump it. I remember at the same time internet stocks were all the rage in the late nineties, Asian stocks had completely cratered in the wake of the East Asian Financial Crisis of 1997-98. Entire national stock markets had lost 50-75% of their values from top to bottom. Retail investors and money managers alike dumped Asian stocks *en masse*. Like is so often the case, this proved to be a fire sale, as many markets rebounded in the solid triple digit range. As we saw from the depths of market lows in late Winter 2009, the same thing was certainly the case here in the US.

Astute readers may already note that, taken together, these two mistakes cause most retail investors to reverse the most basic

"We have a cognitive tendency to place greater weight upon [recent] results … ignoring longer-term, and hence more reliable, data."

[1] One excellent book laying out the lessons of behavioral economics for individuals and geared to the non-economist is *Why Smart People Make Big Money Mistakes and How to Correct Them* by Gary Belsky and Thomas Gilovich.

maxim of investing. Namely, lemmings "buy high and sell low." Just how bad are individual investors at plying their skills in the market? Judging by their results, pretty dismal. According to the 2014 release of Dalbar's Quantitative Analysis of Investor Behavior (QAIB), investors' inflation-adjusted annualized returns for the preceding ten year time period was an incredibly awful **0.2%!** Had an investor simply held a market weighted global equity index fund and an aggregate bond index fund in equal parts during the same time, their after-inflation returns would have been over *15 times* greater.

Please do not be a lemming!

II. Getting Eaten by the Well-Fed Parasites

Slightly higher up the pyramid lies the level where most people exist. As anyone who has read much of my writing knows, I am a ruthless critic of the financial services industry. According to the Commerce Department, the financial services industry comprises an incredible $1.3 trillion worth of America's GDP (almost 10% of our total economy). Yet, on a net basis, I would argue that it has the dubious distinction of being the only sector of the economy that fails to add any net value to its customers.[2] As I always must qualify, there are many talented individuals within the industry who do provide real value to their clients. I am fortunate enough to know more than a handful of such people. But rest assured, these individuals are the exception and not the rule.

Study after study has demonstrated that, in the aggregate, financial advisors and money managers fail to deliver *any* positive returns compared to broad indexes once their fees are taken into consideration. However, the financial services industry has done a masterful job of packaging itself. The vast majority of financial advisors and wealth managers are not investing strategists themselves. Rather they are focused on relationship development and maintenance with their clients. When I have had detailed discussions with friends about the financial professionals in their lives a typical refrain is, "While he may not have kept up with his benchmarks, I really like him." That is exactly how they want you to feel because if most were employed only on their ability to beat benchmarks, there would be a whole new army of Uber drivers on America's streets.

I encourage everyone who uses such individuals to conduct at least bi-annual reviews that include asking your advisor to provide you with relevant benchmarks against which the investment portfolio he has constructed should be measured.[3] If there is underperformance compared to benchmarks, it is appropriate to ask for an explanation.

"One significant problem with the majority of advisors and wealth managers is their poor track record at avoiding catastrophe."

One significant problem with the majority of advisors and wealth managers is their poor track record at avoiding catastrophe. It would be one thing if investors would be getting slightly inferior returns most of the time if the fraction of the time when the sky falls (for instance 2000-02 and 2008-09), financial services professionals had positioned their portfolios so as to avoid the carnage. But both anecdotally and empirically I have not found this to be the case. Going into both market debacles we have seen over the last fifteen years, money managers had less cash and more money deployed in overvalued markets than average. A litmus question I would have for advisors and wealth managers is what their client returns were like in 2008-09. While few profited during that time, many managed to escape with less losses than the market as a whole. At the very minimum, if the person in question got mauled by the

[2] For an excellent book on the failings of the financial services industry as a whole, and money managers in particular, I would recommend *Bogle on Mutual Funds* by John Bogle. As a money manager myself, while I may not agree with all of his assertions, I believe Bogle makes a very compelling case as to why paying people to manage your money is generally a losing proposition.

[3] I would actually insist that such benchmarks be part of their normal reporting if that is not already the case.

market, they must be able to articulate what aspect of their strategy caused this and how they have modified that strategy to ensure it will not happen again.

I should emphasize what I am *not* saying. I do not mean to imply that any advisor/ manager who goes through serious capital losses is not worth using. Particularly after the Fund's 4Q 2014 performance, that would be extremely hypocritical. As I have said on many occasions, short-term returns may not be a fair benchmark due to the vagaries of markets during such a short period of time. But advisors/managers with longer-term returns should be able to justify those returns against benchmarks, either through solid results or explanation of why their strategy will succeed going forward.

Finally, please understand that if you are one of those investors who, left to your own devices, know you cannot resist the urge to chase "hot stocks" like the lemmings, it is better to use a well-fed parasite.

III. Falling into the "Buy-and-Hold" Trance

Now we are getting to investing approaches that, while I would argue are not optimal, at least give investors a fair chance of earning a decent net return over time. Buy-and-hold investing first became popularized by Burton Malkiel in his outstanding book, *A Random Walk Down Wall Street.* First published in 1973 and now in its 10th edition, this was the first book on investing I ever read back in 1986 and I was an adherent of this approach up through 1999. The aforementioned John Bogle is its other prominent apologist. In essence both Malkiel and Bogle argue that predicting the direction of markets is a losing game. Instead, one is best served by simply buying a broad index fund and holding it through thick and thin. One of the intellectual underpinnings of this approach is that market pricing is always "correct." This means that the price of any given asset at any time fairly reflects the asset's intrinsic worth as measured by the aggregate opinion of market participants. This became known as "efficient markets theory" since proponents argue that major asset markets quickly and "efficiently" incorporated all relevant information into the price of any given investment, making it impossible to consistently make money by betting any given investment would go either up or down in price in the future. Any future price moves would be based upon new, unknown events or circumstances that by definition were not predictable.

First, the pros of simply buying and holding. To begin with, it can be done in a remarkably cost-effective manner. In the equity realm, Vanguard offers some of its index funds for investors who deploy $10,000 or more at a yearly cost of 0.05%, or a measly five basis points. You will not beat that cost when it comes to owning equities, period. Another benefit is that it takes individual discretion out of the equation. As we saw when discussing the lemmings, most people will actually buy high and sell low. By simply buying the market and forgetting about it, people put their portfolio on auto-pilot and thus capture almost the entire gains enjoyed by the market as a whole (which will beat the vast majority of other individuals and even professional money managers).

The main downside to buy-and-hold investing is the flip side of removing individual discretion, and the main reason why I abandoned this investing approach in 1999. At the time, I observed two asset pricing phenomena I could not square with anything remotely rational. On one hand, you had US internet stocks, with no earnings, few of which had any sales and whose proponents were advocating such nonsense as "eyeballs" as a basis for valuation, trading for hundreds of billions of dollars in terms of their collective market cap. On the other hand, you had hundreds of companies in Asia, with real revenues and earnings even during their worst financial crisis in decades as well as dividend yields that in many cases approached double digits, trading at a fraction of their levels from just a couple of years earlier. Now efficient market theorists argued that both price levels were based upon all the relevant information about both broad assets and factored in the prospects

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"… buy-and-hold investing … ignores the fundamental reality that the single greatest determinant of long-term investing returns is the valuation level at which one purchases an asset."

for both. This simply did not square with reality as I understood it. Internet stocks seemed to be one of a long series of bubbles that an examination of economic history will reveal occur with some regularity, while Asian stocks appeared to be the kind of despised asset that financial history also shows represented a screaming deal (as Baron Rothschild said over 200 years ago, "buy when there is blood in the street").

Most people are completely unaware of the risks associated with buy and hold investing. Financial history clearly and convincingly demonstrates that when one invests, or even maintains their existing investments instead of selling them, when stocks or any other assets are richly priced, even long-term returns are disappointing. Imagine that a 25 year-old man back in 1929 has a very wealthy aunt who passes away and leaves him a vast inheritance. Being ahead of his time he decides to employ a "buy-and-hold" investment approach and invests the entire amount in a diversified portfolio of US stocks at the peak of the bubble prior to the Great Depression. Within years he sees his portfolio absolutely annihilated, but he remains steadfast in his belief that holding stocks, no matter what their valuation level is the prudent thing to do. When I ask people how long it would have taken that person to see stocks get back to the level at which he bought them *once inflation is factored in*, I have never had anyone get even close. Most guess between 10-20 years, and a few 30 years. The real answer, contained in Robert Shiller's excellent book, *Irrational Exuberance*, is actually **fifty-five years**! Our young man would be an octogenarian before stock prices would get back to comparable inflation-adjusted levels. The deficiency with simple buy-and-hold investing is that it presumes assets are equally attractive at all times, thus this approach fails to take into account valuation levels. Indeed, most buy-and-hold advocates would have argued at the peak of the stock market manias in 1929, 2000 and 2007 that stock prices represented all of the relevant information and rational prospects, and thus no imminent decline could have been predicted.

I should note that there are many wealth managers and advisors that offer to charge relatively modest (at least by financial industry standards) fees for managing one's portfolio in a manner consistent with a buy-and-hold approach. While I think these services are likely to outperform those offered by most other financial services professionals, investors should be cautious of two things. First, how, if at all, will the advisor/wealth manager avoid a 2000/2007 scenario in which stocks are drastically overvalued and ripe for poor performance over a ten-year period or even longer? Most buy-and-hold strategies do not have a way to escape this danger. Second, I am very wary of approaches which treat future stock returns like an actuarial table. Often these strategies are touted by pointing to long-term (75+ years) figures showing average equity returns approaching double digits. But these figures hide the fact that **when** one invests, and specifically the valuation level of markets when one invests, almost entirely drive whether ten-year+ returns will be robust or disappointing. For instance, US markets hit their peak valuation levels in 2000. Is it any surprise that fifteen years later, average annual gains in the S&P 500 index have been an anemic **1.6**%, not even keeping pace with inflation? Alternatively, if one has the courage to invest when markets are trading at cheap valuation levels, one tends to be richly rewarded. Had an investor purchased US stocks in 1980, shortly after Businessweek published a cover story boldly proclaiming the "Death of Equities," one would have had annualized returns (including dividends) of approximately **17% for the next twenty years**.

In short, the reason why buy-and-hold investing, while doing better than most investment strategies, is ultimately a vastly deficient strategy is that it ignores the fundamental reality that the single greatest determinant of longer-term investing returns is **the valuation level** at which one purchases an asset.

IV. Rebalancing for a Better Tomorrow

As we approach the apex of the pyramid, truly sound strategies finally emerge. About ten years ago, I read an excellent book on investing entitled (rather boldly) *The Only Guide to a Winning Investment Strategy You Will Ever Need*. In it, Larry Swedroe makes several very cogent arguments concerning, among other things, the importance of using low-cost index funds and what real diversification should look like in a portfolio. Also included was the first lengthy treatment I found about something I had always thought was a critically important investment strategy that everyone should employ: regular portfolio rebalancing.

Portfolio rebalancing is a vastly superior approach to the "buy and forget about it" strategy advocated by many efficient market theorists. The reason why this is such a powerful and successful strategy is that it naturally and automatically forces investors to "buy low, sell high," which is after all what every investor aspires to do, but at which so few are successful. Let's use an overly simplified example in which a hypothetical investor back at the beginning of 1997 had a portfolio of two equally weighted assets – US stocks and gold, with $10,000 in each asset. At the end of the year, gold had fallen about 20%. On the other hand US stocks appreciated a robust 33%. This would leave his investments in gold and US stocks at $8000 and $13,300 respectively. In order to keep the 50-50 weighting of these assets our hypothetical investor would have had to have sold $2,650 of his US stock portfolio and bought gold with it, thus adding to his investment in gold by a full one-third. The following year US stocks have another banner year, delivering almost 29% returns, while gold was flat. The same rebalancing process would have the investor sell another $1,500 worth of his US stock portfolio and buy gold, increasing his stake in the precious metal another fourteen percent. Our investor who started with not quite 28 ounces of gold at the beginning of 1997 now has almost 42 ounces. 1999 saw a final amazing year for US stocks, as the S&P 500 returned in excess (just barely this time) of 20% for the **fifth** consecutive year (yet somehow most market analysts, money managers and talking heads on CNBC did not find any reason to be concerned about a bubble!) Gold remained utterly unloved, staying flat for the second straight year. To rebalance, our intrepid investor would have had to sell another $1300 worth of US stocks to buy another 4 ½ ounces of gold. Note that the gold we started with now has gone from 27 ½ ounces to 46 ounces, with the final 18 ½ ounces acquired at a *20% discount*.

Now having chatted with many people during the late nineties about investing, let me assure you that had our hero divulged his investment strategy to any of his friends, they would have likely tried to institutionalize him. Selling US stocks, at the time deemed to be the bluest of blue chip investments, to buy gold?!? Gold had endured a nearly 20-year bear market, having fallen more than 65% off its peak. Yet Mr. Market was about to assert his inevitable hand, leveling the formerly mighty and elevating the theretofore downtrodden. The $5,450 in proceeds from selling overpriced US stocks between 1997-99 and buying gold would turn into more than $12,000 over the next six years as gold went up 120%. Meanwhile stocks lost approximately 50% of their value from the bubble peak and did not surpass those levels until just a few years ago.

The beauty of regularly rebalancing a diversified portfolio is that one does not even need to possess an understanding of which assets are overvalued versus which are a screaming buy. Because investors employing this strategy will be trimming position in "winners" while dollar cost averaging into "losers," intrinsic to the process of portfolio rebalancing is, "buy low and sell high."

"… intrinsic to the process of portfolio rebalancing is 'buy low and sell high.' "

V. Putting it All Together — Only Buy or Hold Attractively Priced Assets

In order to explain what I believe is the optimal investing strategy that lies at the top of my investing pyramid, it may be helpful to take a step back to assess why individual

"… dollar-cost averaging into assets trading at historically cheap valuations will likely lead to vastly superior investment returns."

investors tend to obtain such abysmal results, which substantially lag even simple aggregate market returns.[4] To summarize how not to invest, in essence there are two extreme approaches into which investors tend to fall.

On one end of the spectrum are those that tend to be hyperkinetic. These are individuals always on the prowl for the next big move in a stock or asset class. Many of these investors use a variety of indicators (charts, "tips" from financial journalists or talking heads on CNBC, what their colleague who just bought a new car is doing with her investments, etc.) to make decisions. These people are particularly prone to "lemmingitis," and never want to be left out of the next "Big Thing" when it comes to investing. These investors have the deck stacked against them. Oftentimes by the point at which an investment is getting press and attention for being a high-flier, most of the money has been made by those on the ground floor. Furthermore, the investor is prone to suffer large trading costs and any money invested in stock will generally bee subject to less advantageous short-term capital gains treatment. As a whole, these investors substantially underperform the markets.

On the opposite end of the spectrum are those that have a fixed asset allocation that never changes (other than perhaps trimming stocks and adding more income producing assets as one gets older). As noted above, these are the tried and true "buy-and-hold" crowd, along with a substantial percentage of investors who may simply choose an allocation for their 401(k) or brokerage account and never think about it again. While this will ensure near-market returns so long as one is choosing low-cost index funds, it leaves investors utterly unprepared when market crashes occur. Just in the last fifteen years we have seen two such crashes that left US stock investors sitting on 50% or greater losses in each instance!

As detailed above, portfolio rebalancing can mitigate the damage of such financial storms by forcing investors to mechanically sell assets that have risen in value (and the more they have risen, the greater percentage one sells), while using the proceeds to buy more reasonably priced assets. That is very good.

But there is yet another approach that is even better – **simply avoid purchasing or holding expensive assets.** Conversely, **aggressively dollar-cost averaging into assets trading at historically cheap valuations will likely lead to vastly superior investment returns**. Anyone who claims that ten-to-twenty year stock returns are not in any way predictable due to the efficiency of the market should carefully consider the chart on the next page) from Hussman Funds. It measures the market cap of nonfinancial stocks against the level of productivity and income generation from the nonfinancial sector of the US economy. To somewhat oversimplify, it is like an aggregate price-to-sales ratio for the nonfinancial portion of the US economy.[5] In other words, the higher the ratio, the more expensive nonfinancial stocks are. (Note: we could also use other valuation metrics for the market e.g., P/E ratios, dividend yields, price-to-book ratios, and get similar results.)

While this chart "only" goes back 68 years, I can assure you that if it went back another thirty-years it would demonstrate that **when stocks are cheap in terms of valuation metrics, ten-to-twenty-year returns are superior and when they are expensive, ten-to-twenty-year returns are poor.** Moreover, **the great-**

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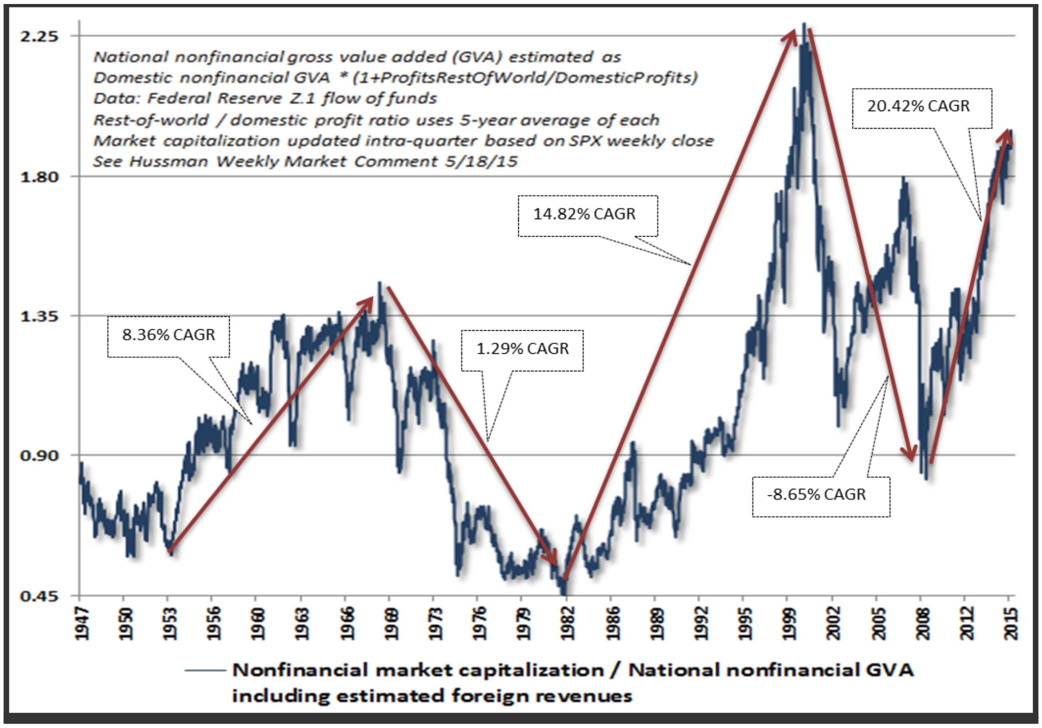
[4] I should note that because advisors and money managers cater to the masses, the financial services industry as a whole tends to use the following extreme strategies as well, which I believe helps lead to the disappointing returns for the industry as a whole. As I have cited in the past, Keynes' quote on what "worldly wisdom" teaches us about reputation is a particularly perspicacious observation in relation to financial service professionals: "Better . . . to fail conventionally than succeed unconventionally."

[5] The financial sector of the economy is excluded due to the vastly different accounting methods used to calculate valuation metrics.

Exhibit 1. Current Valuation Levels Drive Long-Term Returns



Sources: Hussman Funds, US Federal Reserve, Whitmore Capital Management, LLC
CAGR = Compound Annual Growth Rate. CAGR figures for the select periods are calculated by Whitmore Capital Management, LLC based on S&P 500 Index returns. Data through 5-18-15.

er the gap between average valuations and the valuation level at any given time, the more extreme future under-performance/outperformance going forward will be. And while the chart only deals with US equities, the same principle applies to all asset classes and individual investments. The chart clearly shows that periods of more pronounced variations from an average valuation level lead to more significant reversions to the mean (and usually overshoot beyond mean valuation levels in the opposite direction).

As you can see from the chart, US stocks hit a historic peak in valuation levels right around the turn of the millennium. Sure enough, the last fifteen years have seen some of the worst equity returns since the Great Depression. As already noted, and borne out by the chart, buying stocks around 1980 and holding them for fifteen-to-eighteen years (until valuation levels became absurd) would have led to the best equity returns investors have had since at least the 1920's.

One of the great things about this approach is that it does not rely on any semblance of precise timing to obtain returns significantly superior to the vast majority of hyperkinetic traders or buy and hold investors. Back in late 1998, when I first opened a brokerage account, I made a decision that US stocks looked absurdly expensive. Other than some natural resource stocks, I owned nothing in the US until the first quarter of 2009. Now it is true that in the eighteen months that followed my decision to stay out of the US market I looked like an idiot; the market went up more than 50%! But during those 10 ½ years I sat out of US markets, the S&P 500 eventually went down more than 30% from the level it was at in the Fall of 1998. The same is true for buying cheap assets. One did not have to buy gold

"… periods of more pronounced variations from an average valuation level lead to more significant reversions to the mean."

at its nadir of $260 more than a decade ago to have profited handsomely from its more than 300% gains since (even after its brutal bear market over the last three years).

I hope this has been some good food for thought. Successful investing is one of the most challenging endeavors I can imagine. It requires discipline, patience and even the willingness to look foolish during (hopefully short) periods where the lemmings are driving the markets further away from their fundamentally justified valuation levels.

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[*] 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.

Q2 2015 Performance Summary

Whitmore Capital LP was up 6.31% net of all fees for the second quarter of 2015. (Note: In the period between the end of 2Q 2015 and the publication of this letter, the Fund has received finalized performance figures for July and August, 2015. The investment results for these months are –2.55% and –12.09%, respectively.)[1]

By comparison, the BarclayHedge Currency Traders Index (our narrow benchmark) returned -1.23% for the second quarter, and the Credit Suisse Hedge Fund Index (our broad benchmark) returned -0.47%.[2,3]

The Fund was able to continue the strong start to the year, returning 11.42% in April and 6.36% in May. However, overall second quarter returns were tempered by the -10.30% performance in June. Year-to-date, the Fund is up 39.85%. This brings Whitmore Capital LP since inception returns to 32.62% and annualized returns to 9.59%.

Review of Select Positions' Performances

This content is available exclusively to Whitmore Capital LP investors.

A Long-Term Approach in Action

As we have said before, markets often do not respond nimbly to mismatches between a currency's market price and its underlying fundamentals. Indeed, over the short-run market prices can become even further detached from underlying fundamentals. This tendency is exacerbated when market participants *en masse* accept or are driven by a dominant narrative that obfuscates the underlying fundamental picture. However, we contend that over the long-term, Mr. Market exerts its hand, bringing market prices inline with our fundamental analysis.

The New Zealand dollar is a great example of this phenomenon. We identified the New Zealand dollar as a fundamentally weak currency over two years ago and took short positions in it as a result. As can be seen from Exhibit 1 (see next page), in spite of what we identified as an overvalued and unattractive currency at the time, the New Zealand dollar's nominal exchange rate appreciated a further 10%+ from June 2013 to July 2014. Eventually, however, our patience was rewarded and we are seeing good profits from our short positions as the New Zealand dollar declined nearly 22% from its high in July 2014 through the end of 2Q 2015.

While the timing or proximate cause of a reversion toward fundamental value is nearly (if not completely) impossible to determine in advance, the further a currency's

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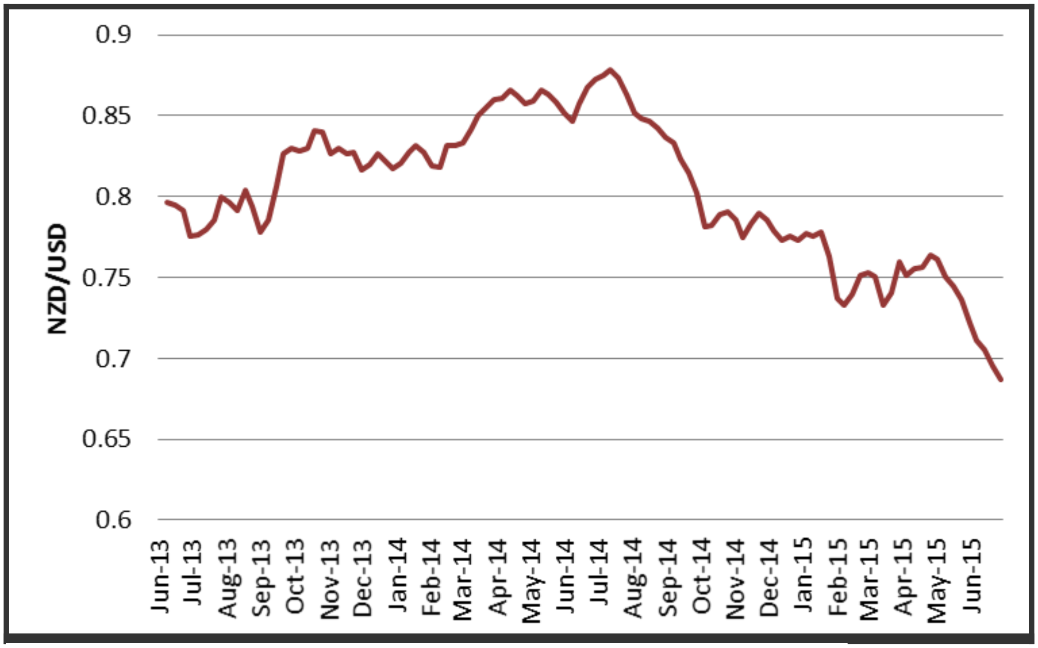
[1] Past results are not necessarily indicative of future results. You should carefully consider whether your financial condition permits you to participate in a commodity pool. In so doing, you should be aware that commodity interest trading can quickly lead to large losses as well as gains. Such trading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

Exhibit 1. Nominal Performance of NZD/USD Exchange Rate from June 2013 to June 2015



Source: OANDA

price strays from its fair value range, the more vulnerable it becomes to internal or external shocks (this is a concept that applies to all asset markets. We continue to believe that as patient, long-term investors we will be rewarded as fundamentals ultimately impose themselves on market pricing.

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*** 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.**

An Introduction to REST

While the focus on my reports has always been on matters of finance and investing, it is easy to forget that money just represents our ability to get "stuff." I would thus like to draw my readers' attention to an issue that supersedes merely material matters. Several years ago I had the good fortune to meet Brent Turner, a very successful local executive in the Seattle area. Upon getting to know him better, I discovered he had essentially personally bankrolled and got off the ground an organization called REST (http://iwantrest.com/), or Real Escape from the Sex Trade. I have been a supporter of REST for several years now, and it has grown substantially in that time period. As Brent aptly noted to me when we recently met, they are focused on the opposite spectrum of the 0.1% that gets so much attention in our society. Given that their focus is on reaching underage girls who are caught in the sex trade, I cannot think of a more compelling domestic cause. REST is now positioning itself to finance a facility where they will be able to provide emergency housing. This addresses a huge problem as even when girls are rescued by law enforcement or can be otherwise persuaded to escape from the sex trade, there are often no local shelters that will take them (especially if there are issues of substance abuse). Brent and REST are thus trying to share their vision for what this project can do to be a real catalyst for transforming the lives of girls who are at serious risk of being indefinitely marginalized in society. I would encourage anyone who finds this cause to be as remotely compelling as I do to consider whether you might become a supporter of REST. But let me now allow Brent to tell the story of REST.

In 2008, an anthropologist named Debra Boyer published ***Who Pays the Price?***, a multi-year study of minors who had been trafficked into prostitution in the Seattle area. Among many insights, she revealed that there were between 200 and 500 girls accepting customers on any given night; that each of them entertained between seven and fourteen customers per night; that most of them were local runaways and former victims of sexual abuse at the hands of a family member or friend; and most importantly, that the resources in place to help them were almost nonexistent. Moreover, Ms. Boyer painted a dark picture of hopelessness for these girls without a strong push to build services to serve them more effectively. In short, because the girls believed that there was nobody to turn to for help, they were very hesitant to testify against pimps or johns when arrested. As a result, police and local officials did not prioritize prostitution arrests or cases in the courts, feeling that convictions were unlikely. As a further result, changes in the law were not considered a priority. Subsequent research has revealed that there are likely another 1000 women from 18 to 24 in the Seattle area who are currently under the control of a pimp.

There has been a limited number of responses to this report, but one of the most successful ones has been the creation and growth of REST (Real Escape from the Sex Trade), a faith-based nonprofit based in the Rainier Valley. REST's strategy is to **radically reverse the existing perception that there are no reliable resources available for victims of trafficking in Seattle**, and as a result, empower the police to pursue trafficking cases with more confidence in a conviction, and to give the state confidence that changes in the law that can help trafficking victims are worth pursuing. REST's engagement style is amazingly on-the-ground and hands-on. The organization literally has volunteers that go out onto the street, approach bikini barista stands, visit jails, and go into strip clubs in order to let trafficking victims know that an organization exists that can and will help them. For victims that ask for help, REST offers case management, educational and health services, and a restorative housing program where girls who need a place to live can stay for up to two years. This combination of tactics is working; not only has REST pulled over 60 girls out of a life of sexual exploitation, it has also helped lead a multi-organizational charge that is making it meaningfully harder to operate as a pimp in Seattle. Most recently, King County's "Buyer Beware" program, which aims to target buyers of sex in Seattle, was informed in part by demand-reduction pilots conducted by REST nearly four years ago.

REST has grown impressively in both results and critical infrastructure over the past four years, but is making a hard push in FY2016 toward a major expansion in services, largely at the request of the city. An Emergency Receiving Center (ERC) is needed, where girls can be taken on a "right now" basis for intake, stabilization, and evaluation. No such facility exists today, and service providers in town identify the ERC as the single most important expansion in services necessary to further accelerate the war against sexual exploitation in Seattle. The price tag for the ERC is roughly $500k annually, and REST has undertaken a major fundraising drive to get it open. I urge you to consider becoming a supporter of REST, specifically to help accelerate the opening of the ERC. If you would like more information, you can contact Brent Turner at brent @iwantrest.com. To learn more about the organization, you can visit iwantrest.com.

WHITMORE CAPITAL MANAGEMENT

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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