Mark's Musings

Whitmore Capital Management Quarterly Newsletter

Q3, 2015 **December 31, 2015**

"The problem with bubbles is that they force one to decide whether to look like an idiot before the peak, or an idiot after the peak."

- Unattributed

In Defense of Being Defensive

The third quarter of 2015 proved to be a most eventful one for asset markets. US equity markets in particular took their first major swoon in almost a year, dropping as much as 12.5% from their all-time highs in May, before rebounding somewhat towards the end of September. This is noteworthy, as US markets had not been hit with a correction of 10% or greater in over three years. Now bulls took solace in the fact that going back 6 ½ years, each of the three pullbacks that did exceed 10% proved to be short in duration and simply lead to further market highs. Hence, while there were some nerves frayed over the rather dramatic declines in August through September, the conventional wisdom was that savvy investors should see any meaningful declines as yet another "buying opportunity." Indeed, this view was borne out (at least in the very short-term) as markets powered higher through all of October, ending the month within a couple of percentage points of all-time highs!

Bulls took particular comfort from the fact that the current darlings of the market, the FANG stocks (Facebook, Amazon, Netflix and Google/Alphabet), without exception recovered not just all of their losses in October, but powered to new highs. Amazon in particular went parabolic, gaining an unbelievable 50% (!) in just four months from early July through early November. Apologists for the great post-GFC bull market argue that so long as the market leaders are healthy, they will continue to be the engine that should be expected to drive US equity markets ever higher. After all, while US growth may not be exceptional, it is comparatively strong *vis-à-vis* Europe and Japan. Ergo US equity markets should not only continue to attract investable funds domestically due to the fact that in a near-zero interest rate world bonds offer little-or-no real returns, but they should also be the destination of funds from abroad looking for the combination of safety and capital appreciation. Or so the argument goes.

As is usual, I have a dramatically different take on market events than what passes for conventional wisdom. Rather than being a buying opportunity, I see the 3Q swoon as the first cracks in the armor of a US equity bull market that has long since exceeded any semblance of fair-market pricing based upon fundamentals. And while I have been pounding the table for some time now about how medium-to-long-term investors should prepare for extremely disappointing returns for US stocks over the next decade or so (please see 1Q 2015 Report), I now think the chances of a nearer-term and potentially dramatic fall in US equity markets have also materially risen based upon recent developments. As we head into the end of 2015, here are a few reasons to be concerned that 2016 and beyond may not bode well for "risk-on" assets, particularly US equities.

Profits, Profits, Where Art Thou Profits

One of the things I noted two years ago in our quarterly report was that while US corporate profit growth had been truly spectacular (one of the reasons why US equity apologists have been so bullish) it was likely to mean-revert to lower levels. This is a rather big issue. The fact that recent price to earnings (P/E) ratios for the US stock market, while moderately high by historic standards, were not at nose-bleed levels like they were in 2000 (and to a lesser degree 2007) was one of the things that stock bulls could point to in arguing that no significant pullback in US markets is justified. However, I contended that if the denominator in the P/E ratio, earnings, is at cyclical and unsustainable highs and poised to fall, then it is likely that the P/E ratio *will necessarily rise,* making stocks look very expensive.

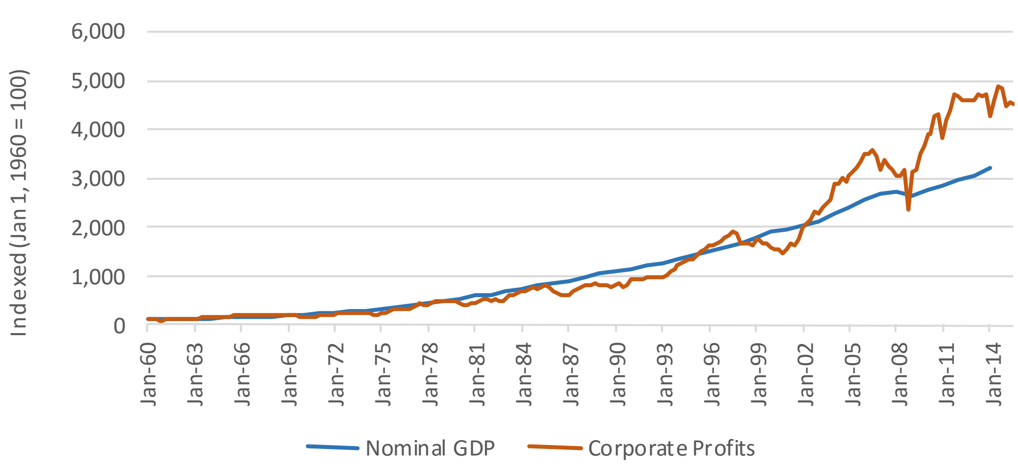
The most recent profits numbers from Wall Street would appear to validate my concerns. The Wall Street Journal recently reported that following the third quarter, corporate profits had *fallen 4.7% year-over-year!* While quarter-to-quarter corporate profit numbers are notoriously variable, year-over-year figures are deemed to be more indicative of meaningful trends. When one looks beneath the hood of the US economy, this decline should come as no surprise.

According to Bloomberg, corporate profits in the US have gone up an astounding 105% since 2008, which annualizes to over 11%. Even in the most robust economic environment conceivable, that level of profit growth is extraordinary. To put it into perspective, average corporate profit growth over many decades has been in the neighborhood of **7%**. Moreover, that level of corporate profit growth was powered by economic growth that has been on average much higher than what we are seeing today. According to the US Bureau of Economic Analysis average inflation-adjusted GDP growth in the US has been around 4% over the last 80 years. Not coincidentally average inflation over that time period was roughly 3%, making average nominal GDP growth also approximately 7%. This helps make manifests a very important relationship: **Over long periods of time nominal GDP growth and corporate profit growth are essentially identical** (see Exhibit 1, below). Intuitively this makes sense. Commerce is what determines economic growth and job creation. In terms of gross financial impact, the vast majority of business and commerce is done by corporate entities. Therefore, it should come as no surprise that corporate profit growth and general economic growth should mirror one another.

But let us return to the extraordinary corporate profit growth of 11% since 2008 and its

"Rather than being a buying opportunity, I see the 3Q swoon as the first cracks in the armor of a US equity bull market ..."

Exhibit 1. US Nominal GDP & After-Tax Corporate Profits



** Corporate Profits includes Inventory Valuation Adjustment (IVA) and Capital Consumption Adjustment (CCAdj).*
*** Values are indexed to 100 at January 1, 1960.*
Source: Federal Reserve Bank of St. Louis

significance. A logical question to pose would be whether nominal GDP growth also increased dramatically. If it did, one might say a spike in corporate profit growth is both justified and might be sustainable if somehow our economy was moving into a permanently higher gear in terms of growth. But the facts show that the *exact opposite has happened*. Far from the historic norm of roughly 7%, nominal GDP growth has averaged an anemic **2.8% annually** over the last seven years!

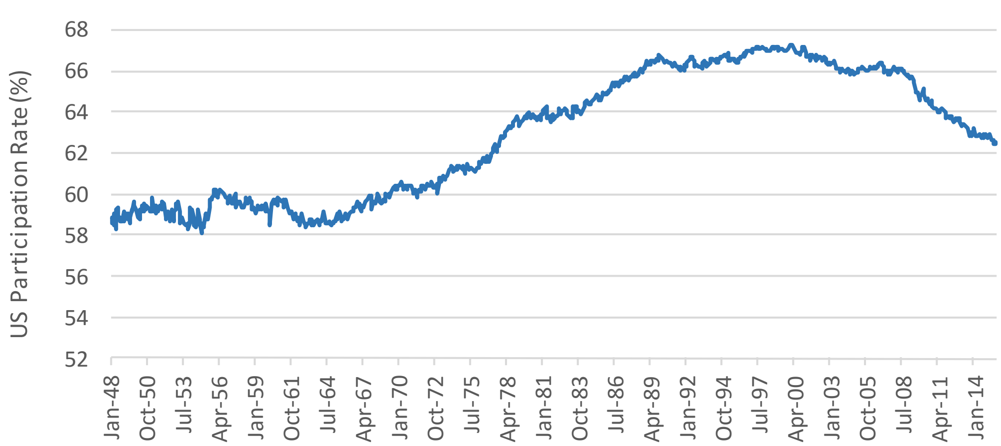
As we have seen, historically the relationship between growth in corporate profits and nominal GDP growth has been 1:1. And indeed over long periods of time this has to be the case, as economic growth is derived from business activity, and in terms of transactional value, the vast majority of business activity is done by corporations. Yet since 2008 corporate profit growth has been **four times** the rate of economic growth.

"At some point profits have to be led by healthy revenue increases to be sustainable. However, there appears to be no such catalyst."

So other than being a statistical anomaly that economic geeks can get excited about, why should you or anyone outside of the financial world care? Because if I am right, and the relationship between corporate profit growth and economic growth is likely to approximate 1:1 going forward, one of two things **must** occur, either of which have extremely profound implications for US investors. In the first instance economic growth could spike massively to the upside, catching up to the very robust levels of corporate profit growth enjoyed by US companies. In that event stock market bulls will be vindicated, and the very frothy valuations sported by US stocks could be supported, and possibly be propelled even higher. After all, in a low growth world (one in which even China has materially slowed down) the US would be both the main engine powering the global economy and the envy of every developed (and most developing) economies in the world. US equity markets would not just attract domestic capital *en masse*, but huge sums of foreign capital as well. In such a scenario, one with nominal GDP pushing double digits and inflation still under control, one could easily see Dow 20,000 or even much higher.

But let us take a step back and consider the likelihood of economic growth catching up to the supercharged corporate profit growth of the last seven years. I have not heard even the most diehard bulls contending that the US is on the cusp of an economic explosion to the upside. While unemployment is down, it masks the fact that millions of able-bodied people have simply given up looking, as total workforce participation has dropped to levels not seen since

Exhibit 2. US Civilian Labor Force Participation Rate in the US (%, Seasonally Adjusted)



Source: Federal Reserve Bank of St. Louis the 1970's (see Exhibit 2). Inflation-adjusted wages have not increased over the last thirty or so years. And despite interest rates being at essentially zero, borrowing activity has remained muted. It would thus appear that the odds of any imminent, massive resurgence of economic growth seems remote at best.

Which leads to the only other possibility – corporate profits decline significantly to match sluggish economic growth. In my opinion this is the only outcome that makes sense. To better understand why this is the case, it is important to examine both the nature of those profits and what is done with them. One might reasonably ask how corporations are making such great profits if the economy is just putzing along. In normal times robust profit growth is supported by significant gains in sales and revenue. This in turn causes corporations to increase investment in plants and equipment, as well as hire more workers. However, with little to no economic growth, revenue growth for corporations has been extremely muted. Over the last seven years, revenue growth among companies comprising the S&P 500 has averaged just 1.75% a year, approximately the same pathetic growth rate as the economy overall. So this would appear to present a great profit mystery. How can companies be making such great profits when revenues are barely budging? The answer is through cost-cutting. This helps explain the low level of labor participation and virtually nonexistent increases in capital stock. The problem with this as a means to increased profitability is that it has already appeared to reach its upper limits. In the good time era leading up to the GFC there was lots of low-hanging branches that could be subsequently pruned to reduce costs. But corporations cannot infinitely tighten their belts, as eventually the law of diminishing returns kicks in. With profits diving over 4.5% year-over-year, it appears they have already hit that limit. At some point profits **have to** be led by healthy revenue increases to be sustainable. However, there appears to be no such catalyst.

Now it would be one thing if corporate America were taking its massive profits and plowing them into their businesses through investment in capital stock so as to be better positioned to sell products and services in the future. Then you could argue that even if revenues are pretty flat now, corporations will be well-equipped to be competitive, both domestically and internationally, to improve sales in the future. Yet this is not the case. Corporations are plowing the vast majority of their profits into stock buybacks in an effort to drive up their share prices or returning them to investors through dividends. While this might make shareholders (and company executives possessing huge company stock holdings) happy in the short-run, it does nothing to sustain businesses going forward.

So if I am right, and corporate profits have already begun to fall from their lofty and unsustainable levels, what does that mean for investors? About the only thing fundamentally justifying the dizzying valuation levels in US equity markets has been the boon to corporate profits. As noted above, bull after bull has pointed to the fact that price-to-earnings ratios for the market have not become extreme (while I would disagree with that, it has passed as conventional wisdom). Now if the earnings part of the P/E ratio for the market begins to contract, or even stops growing robustly, it would expose the market as being frightfully overvalued. I was recently reminded of a quote from the intellectual father of value investing, Benjamin Graham, who noted that "purchasers view . . . good earnings as equivalent to 'earning power' and assume that prosperity is equal to safety." This is endemic to human nature – we view the recent past and project it into the future, building castles in the air during boom times and never-ending pits of despair during bad times. This creates an irony that successful investors must internalize. Namely, it is often never more dangerous to invest than in markets that are rife with complacency and conversely there is never greater opportunity when markets are riddled with panic. In the case of US equity markets, participants have viewed corporate prosperity as the new normal, and have priced US

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equity assets as if this prosperity is sustainable *ad infinitum*. I suspect that many, many investors are in for a series of rude surprises in the coming months and years.

Another Fine Mess We've Gotten Ourselves into

Not seven full years from the depths of the GFC debacle and not fifteen years from the dotcom bust, we find ourselves in a very familiar position. Asset prices are at valuation levels only seen in 1929, 2000 and 2007 (none of those time periods proved to be propitious for investing in the stock market). Other than a few bumps in August and September, markets have shown almost no sense of fear. Indeed, as I write this the S&P 500 is about 3% off of its all-time highs reached back in May. Comparing this bubble to the two others since the turn of the century, there is one notable difference. Whereas in 2000 and 2007 markets reached a peak and then almost immediately went down meaningfully, in this case markets have essentially gone sideways for over a year. So the obvious question is what can we expect going forward?

"Investors are not showing broad confidence in equity markets as a whole, but are rather piling into the handful of stocks that seem to defy financial gravity."

Projecting the direction of financial markets, particularly in the near term, is far from a science. At best one can make reasoned prognostications based upon estimated probability bands. Nevertheless, I think there are indications that we may be closer to an imminent market dislocation of greater than 10%, and may perhaps be as severe as what we saw in 2008-09.

One of the individuals whose thoughts on the economy I take note of is value investor John Hussman. I highly recommend his Weekly Market Commentary (http://www.hussmanfunds.com/weeklyMarketComment.html). Despite its title, his Weekly Market Comment almost always focuses on the longer-term prospects for US equity markets. Like me, he believes them to be quite dim. However, in the last few months he has been keen to point out two phenomena that do not bode well for *near-term* prospects for US equity markets, and "risky" investments in general.

First, "market internals" have deteriorated significantly. Specifically, Hussman places great importance on breadth of market performance. At the beginning of this piece I took note of the spectacular performance of the FANG stocks of late. While some take great comfort believing that these "Four Horseman" can lead the market ever higher, their great success may augur bad tidings for the market as a whole. Healthy markets see broad participation by the majority of stocks. A hallmark of bubbles is that the further one gets into a bubble cycle the fewer and fewer participants there are in further market gains. It should be of concern to investors that despite being within a few percentage points of equity indexes trading at all-time highs, fewer than 40% of stocks are trading above their 200-day moving averages. Investors are not showing broad confidence in equity markets as a whole, but are rather piling into the handful of stocks that seem to defy financial gravity. It is noteworthy that earlier this year almost 65% of stocks were trading above their 200-day moving averages.

The image that comes to mind is from my childhood. A highlight of my Saturday mornings was watching Looney Tunes. Road Runner was a favorite of mine. Inevitably the hapless Wile E Coyote would overzealously chase Road Runner around winding mountain roads, missing a turn. Then there would be that reality-defying few seconds where he is suspended hundreds of feet in the air, finally realizing his unfortunate fate. I fear that the market as a whole has veered off the road and now there is nothing of substance (other than some investors' naïve optimism in the new "Four Horsemen") supporting it. Based upon the narrowing leadership of market gainers, I suspect that a gradual realization that gravity may begin to reapply itself in the markets is already underway. When it comes to market manias we lose our minds collectively, but we only regain our senses one by one.

The second phenomena of concern to

Hussman is the fact that spreads on "risky" debt have continued to widen above safer debt instruments. According to the St. Louis Fed in June of last year the difference on yield between Treasury debt and high yield corporate bonds was a mere 3.35%, indicating a strong preference for investors to sacrifice safety for yield. As of late December the spread more than doubled to over 7%! Despite the stock market trading 10% higher now than it was eighteen months ago, the bond market is indicating that its participants are seeking to avoid risk. When the stock and bond markets are in disagreement, I have generally found the bond market to be the "smart money."

Taken together – most stocks showing declines and investors showing increased risk aversion via credit spreads widening – I think there is a very strong possibility that we could see an imminent fall in asset markets. Investors would be well-served preparing for such a possibility

And Now the Bad News

The concern I have articulated in my quarterly missives over the last two years has focused on the fact that asset markets (outside of the commodity complex) were overvalued and set to at least underperform over the next decade. Unfortunately, the gravity of my concerns has escalated beyond mere asset market mispricing, as I think there is increasing evidence that we may be vulnerable to a recession in the coming months. Should a recession come to pass, any potential dislocation in asset markets (particularly US equities) would simply be exacerbated.

While I have already mentioned that low unemployment numbers actually mask the fact that labor force participation is awful, focusing on employment numbers to begin with is not very helpful when trying to assess the future direction of the economy. That is because employment is a classically lagging indicator. Just as companies are slow to hire, they are prone to be even slower to fire. Hence, even if there are indications that business prospects are dimming, companies will generally wait to let people go. What is of greater edification when it comes to trying to predict economic activity is to look at "leading" indicators. Particularly things related to manufacturing, industrial production, orders and inventories. On this front there is a whole spate of data that does not bode well for future economic activity.

To begin with, just this morning the Chicago Purchasing Managers Index (PMI), a barometer of business activity in the Midwest, was released for December. After plummeting 13.3% in November to 48.7, economists were predicting about a 2.5% increase to a neutral reading of 50 (anything above 50 indicates economic expansion and anything below 50 indicates economic contraction). Delivering a belated coal in everyone's stocking, the PMI plunged another 12% to 42.7. Importantly, this was the lowest reading since the middle of 2009. Tearing beneath the headline number, things look even more grim. Order backlogs, a key leading indicator showing the degree of demand for manufactured goods down the road, cratered an unbelievable **37%** in just one month, to a reading of 29.4.

Moreover, the Dallas Fed recently released its December manufacturing survey. It had been negative all year long, but after a disastrous first quarter, the Dallas Fed opined that low oil prices would be good for Texas (?!?), and the prediction was for a reading of only a moderately bad -7. In reality the number came in at -20, the worst reading since the depths of the GFC in 2009! New orders crashed more than 7% from just a month earlier.

More broadly, the Fed recently released data showing that national industrial production, which has been consistently growing for over 55 months straight, just turned negative. According to CLSA, new orders for non-defense, non-aircraft capital goods declined 7.5% in September, reaching lows not seen since the Great Recession.

Marc Faber recently noted that not only did US factory orders for all manufacturing in-

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dustries decline in excess of 7% in October, but that the only times in the last 23 years that there were declines of anything in excess of 1% occurred during the recessions of 2001-02 and 2008-09. In other words, a decline of this magnitude should put one on high alert for an impending recession, if we have not already slipped into one, based upon over two decades of data. Indeed, all four of the data points to which I refer above share one thing in common – their readings are at the lowest levels since 2009, when the US was mired in its worst recession since the Great Depression.

It is worth noting that weak economic data is not limited to the US. According to Zero Hedge, China's containerized freight index hit its lowest reading on record in October. It has essentially fallen off a cliff since March of this year, declining a massive 30%! Global trade is extremely weak right now, and with China slowing considerably, there is essentially no engine for global growth.

I should make clear that I am far from certain that we are entering a recession. It is possible that the very weak economic data we are seeing will prove to be temporary blips, and we could avert an economic downturn. However, I think it is far more likely that these economic indicators, some of which have been flashing red for almost a year, are indicating that a recession is likely. Right now none of the big banks other than Citi are predicting a likelihood of a recession in the next year. Given Wall Street's abysmal track record of warning investors of previous recessions/market crashes, I feel very good about being in the minority on this call.

I am the first to admit that one of the reasons for the fund's poor performance in recent quarters has been my defensive posture, which has not been rewarded by the current macroeconomic backdrop that manifests significant complacency and elevated valuation levels. I assure you that I spend many hours each week assessing and reassessing my position. As the year has unfolded, more and more evidence has come in warning of danger for asset markets and, more recently, the US economy as a whole. While the longer my thesis is not borne out by economic and financial reality, the less credibility I may seemingly have, and the greater the risk I run of being labeled a Chicken Little, I nevertheless believe that investors ignoring the signs of excessively valued financial assets and weak economic fundamentals do so at their own peril. I do not like being bearish. I have found it to be far easier to make money in an environment where one can reasonably expect asset prices to be increasing. Unfortunately, I find myself stuck with a world which presents little reason to be sanguine on that front.

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Using Currencies to Build a Robust Portfolio Across Market Outcomes

Readers familiar with our investment approach will know that we place a high degree of importance on the prevailing global economic backdrop when analyzing currencies and constructing our portfolio. Certain currencies (often those of Emerging Market economies with higher interest rates and/or growth prospects) tend to perform better in periods of strong global economic growth and ample liquidity, whereas other currencies tend to outperform in global risk-off environments when capital tends to emigrate from "riskier" investments to so-called safe haven destinations.

In our estimation, discerning and navigating the current economic environment is particularly fraught with peril as we are in the midst of a global game of tug-o-war between deflationary forces and inflationary policy responses, the outcome of which will have important and distinct ramifications for investors' portfolios. As readers of our past letters will know, we have been quite bearish on the prospects of financial markets and US equity markets in particular, over the last year and a half. We have positioned our portfolio defensively as a result. Recent economic data has done nothing to dissuade us from this position. Indeed ongoing declines in commodities, global trade and industrial production (especially in the US) have increased our conviction that there is a large and growing disconnect between the real economy and financial market valuations.

Nevertheless, owing to what we view as a distinctly bi-modal deflation/inflation outcome, our favored approach has been to augment our defensive positioning by investing in currency pairs that tend to trade in similar directions to one another regardless of the global economic backdrop, but in which one currency is fundamentally more attractive than the other, so that we may expect it to outperform the other independent of the global economic backdrop. Investing in such currency pairs allows us to inject (in theory) an element of agnosticism into our overall portfolio in regards to global economic or financial markets' performance, allowing our portfolio to potentially benefit regardless of which way the global economy breaks.

One of the pairs that we believe to be particularly well suited to such an approach is the Indian rupee (INR) and Turkish lira (TRY). Whereas both are currencies of Emerging Market economies and, historically, have tended to appreciate during benign global economic environments and depreciate during episodes of global economic or financial market distress, the INR appears to be much more attractive from a fundamental standpoint than the TRY. Thus, we expect the INR to outperform the TRY across market outcomes – appreciating more during periods of global economic strength and depreciating less during risk-off episodes. Indeed, this has been the case over much of the current decade. Since the beginning of 2010, the rupee has appreciated by more than 35% against the lira (see Exhibit 1). All else being equal, such a significant appreciation would leave us cautious on the prospects of the rupee vis-à-vis the lira going forward; however, we believe the disparity in fundamentals between the two currencies is so great that the rupee is likely to continue to achieve meaningful outperformance against the lira.

To begin with, whereas both currencies appear to be undervalued from a purchasing power parity perspective, the rupee is especially so once standard of living adjustments are taken into account. As such, we would expect the rupee to benefit relative to the lira from a longer-term gentle tailwind as its market exchange rate moves to lessen this disparity.

Both currencies offer relatively high interest

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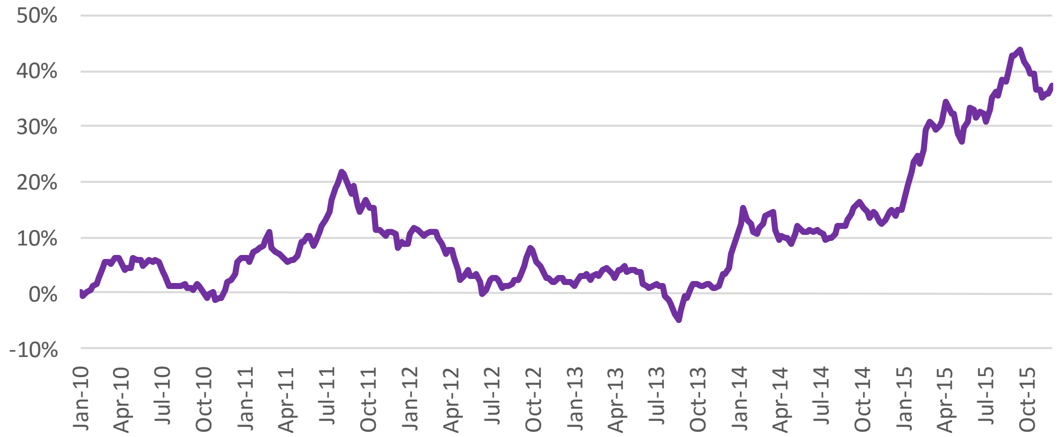
Exhibit 1. Nominal Performance INR/TRY (% Change, January 1, 2010 = 0%)



Source: OANDA

"… Turkey appears far more vulnerable to an environment in which capital flows away from Emerging Markets."

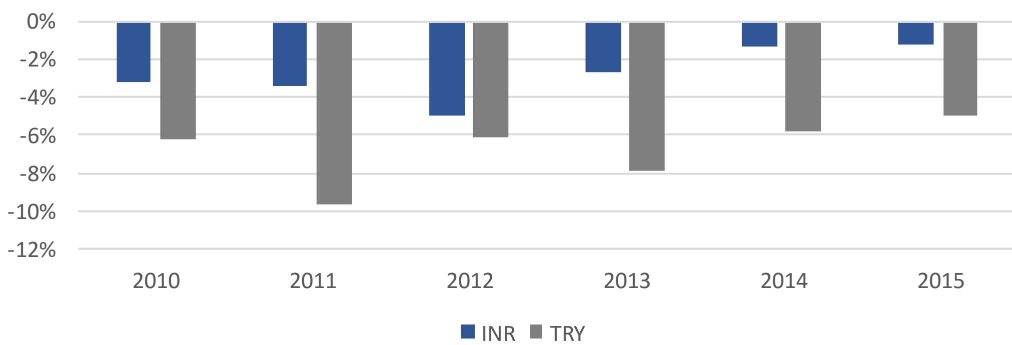
rates (6.75% for the rupee and 7.50% for the lira), which should attract foreign capital during periods of global economic strength and ample international liquidity. (As an aside, the roughly equal interest rates are an added bonus as much of the negative carry headwind from a short TRY position is offset by the positive carry associated with a long INR position). However, India's economy is expanding at roughly twice the pace of Turkey's (estimated 7.3% annual GDP growth against 3.9%). Moreover, while the inflation rate in India has recently increased to 5.1%, slightly above the central bank's target of 5%, Turkey's inflation rate is closer to 8%, nearly 200 basis points above its target rate of 6%. Consequently, we believe India (and by extension the rupee) is better positioned to weather an international economic downturn as its economic growth rate and comparatively benign inflation offer a more attractive destination for capital relative to the lira.

The relative ability to attract capital inflows is important as Turkey is far more dependent on foreign capital in order to finance its larger current account deficit (see Exhibit 2). Both currencies have seen reductions in their current account deficits recently – a development that has been aided in large part by a decline in global energy prices as both India and Turkey are dependent on imported energy to meet a large percentage of their energy consumption, particularly for liquid fuels. However, Turkey's current account deficit (as a percent of GDP) remains over three times larger than India's and, as such, Turkey appears far more vulnerable to an environment in which capital flows away from Emerging Markets.

Exacerbating Turkey's relative vulnerability to capital outflows is that while it holds approximately the same amount of foreign reserves relative to GDP as India (roughly 15% of GDP as of 2014), because its current account deficit is substantially larger, it effectively has far less ability to combat capital outflows.

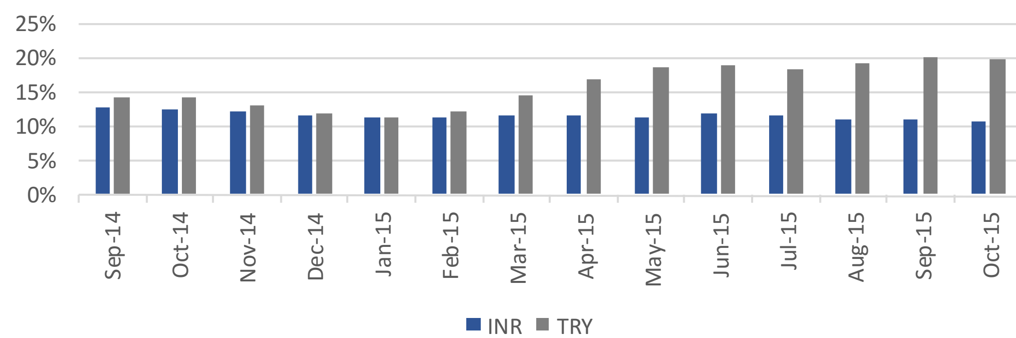
Finally, Turkey has demonstrated an extreme willingness to expand its money supply at a dramatic clip. Year on year growth in M3 money supply (the broadest measure of money supply tracked by the OECD) in Turkey has grown to 20% (see Exhibit 3). India, by contrast, has expanded M3 supply by a comparatively austere 10-11%. The disparity in money supply growth becomes even more stark once each country's rate of economic growth is taken into account. Annual M3 growth less GDP growth in

Exhibit 2. India and Turkey Current Account Balance (% of GDP)



Source: Economist Intelligence Unit

Exhibit 3. India and Turkey M3 Money Supply (% Change Year-on-Year)



Source: Economist Intelligence Unit

Turkey and India is approximately 16% and 3.5%, respectively. All else being equal, Turkey's absolute and relative juicing of its money supply should exert downward pressure on the lira going forward.

To be sure, the rupee is not superior to the lira in all areas. India is running a larger fiscal deficit than Turkey (-3.8% of GDP compared to -1.6%). Also, India's debt to GDP ratio of 65% is twice that of Turkey's. On balance, though, we believe these areas are far outweighed by the rupee's strong economic growth fundamentals – including a high savings and investment rate and growing labor force – and comparatively constrained current account balances and money supply growth.

What could go wrong with our assessment of the sunny prospects for the rupee relative to the lira? As with all investments, plenty of things. To begin with, unlike Turkey's government, which recently re-secured a parliamentary majority (that in theory should allow it to achieve political stability and implement economic reforms), India's ruling party does not have a majority in the upper house, which has impeded its ability to implement its economic reform agenda. There are other potential issues that may weigh on the rupee's value, including geo-political tensions or increasing pressure to weaken the rupee to make exports more competitive with the currencies of competitor export countries. However, Turkey may face similar, if not more acute, vulnerabilities and question marks in these areas.

There are, doubtless, other potential developments that may cause us to reassess the relative attractiveness of the rupee against the lira. Nevertheless, we believe that fundamentally the rupee is far more attractive than the lira. We expect this to continue to be borne out over the medium-to-long-term in the foreign exchange market regardless of the global economic backdrop.

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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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