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Dear Investors and Friends,

2019 3rd Quarter Performance

Worch Capital Partners, LP (WCP) finished the third quarter of 2019 with a net loss of -6.81% while returning +5.68% YTD. Our benchmark the HFRI® Equity Hedge Index gained +0.39% in the second quarter while returning +8.06% YTD. We remain committed to being good stewards of your capital and are grateful for the opportunity to serve our partners.

A major market theme during the current secular bull market has been the outperformance of growth stocks versus their value counterparts. This outperformance had a major reversal in the third quarter that we'll touch on later. Meanwhile, the general markets stagnated the last three months while major sector rotations took hold. The S&P 500 has only inched up 1% since April's close though plenty of volatility along the way has frustrated many market participants. Interestingly, bonds had the best performance in the third quarter rallying 4.5% outpacing the US dollar's 3.51% gain.

Current Market View

While the third quarter was difficult for our strategy with massive rotation out of growth and momentum equities, we want to reiterate that WCP stuck to our discipline and process and in the intermediate term this approach has historically served our partners well. There are market environments that reward certain strategies and other times that challenge the approach. Two factors tested our methodology in the third quarter including the rotation out of growth stocks and range-bound market action. Let's take a closer look. First, was the destruction in growth and momentum stocks. During the quarter, the momentum-to-value ratio had the largest 3-day decline since 2013. We haven't seen this type of extreme rotation out of momentum and into value since 2009. These type of sector rotations are not unusual; however, what surprised most professionals was the speed and magnitude in which the reversal occurred. A tweet from @ivanhoff2 sums it up perfectly, "I know that bull markets often correct through sector rotation. It is just the velocity of the rotation that is a bit puzzling. From momentum to value…."

We feel fortunate to have escaped while still holding onto gains for the year considering many growth stocks in our universe are in a bear market, falling anywhere between 20% to over 50%. Our sell discipline had us selling to protect capital before larger losses set in. Below is a list of some of the most followed growth stocks and their losses off recent highs demonstrating the depth of the correction in many previous leaders.

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Name	Ticker	% Off Highs
Slack	WORK	-49%
CrowdStrike	CRWD	-49%
Zscaler	ZS	-49%
Beyond Meat	BYND	-44%
Roku	ROKU	-44%
MongoDB	MDB	-39%
Trade Desk	TTD	-38%
Uber	UBER	-36%
Etsy	ETSY	-35%
CyberArk	CYBR	-35%
Okta	OKTA	-34%
Twilio	TWLO	-31%
Zoom Video	ZM	-31%
Shopify	SHOP	-30%
Alteryx	AYX	-30%
HubSpot	HUBS	-30%
Universal Display	OLED	-29%
Atlassian	TEAM	-20%
ServiceNow	NOW	-19%

More specifically, the chart of growth stock Roku (below) is an example of the velocity of the recent weakness in momentum stocks. Roku was one of this year's market leaders and in just 15 trading sessions this growth stock darling gave back 3 months of gains and plunged 44% from its high.

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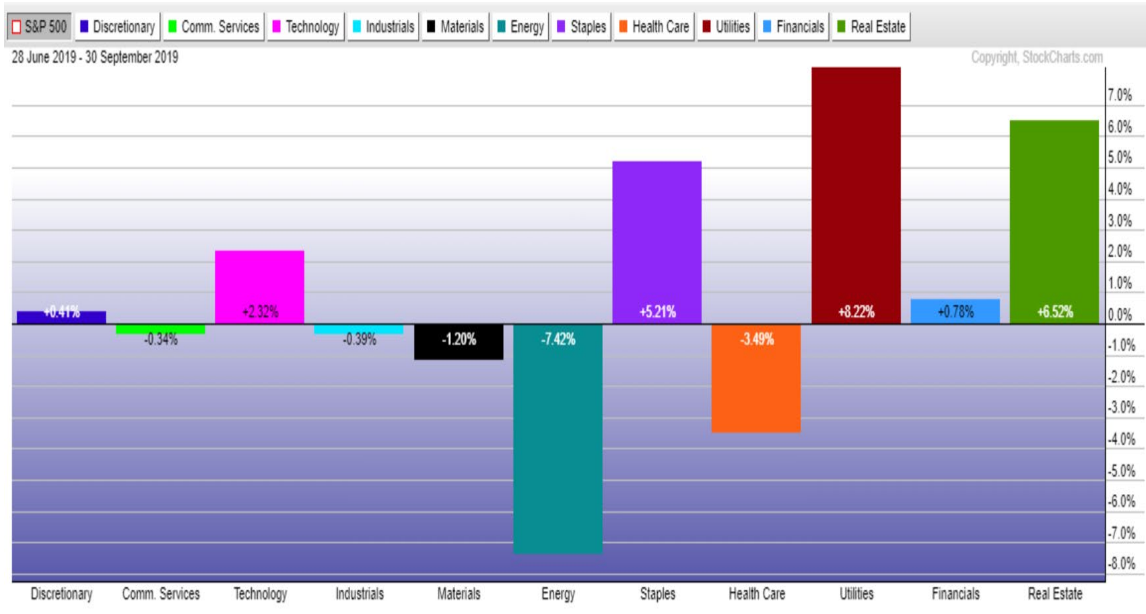
As mentioned, the second factor that tested our methodology this quarter was the volatile and choppy market action. Wide, range-bound markets make trend trading challenging. If we look at the chart of the S&P 500 for the last two years, we can see not much progress has been made in the last calendar year. The S&P is trading roughly where it was at the end of September 2018. Since April of this year, the index has been in a wide range bound environment with plenty of uncertainty.

If we look at the sector winners and losers from the quarter, we can get a better gauge of money flows. Clearly sector performance has a defensive posture with utilities, real estate, and consumer staples leading the way (refer to chart below).



The uncertainly in the economy has likely created the sideways nature of the markets since April of this year. A key metric, the ISM Manufacturing Index, shows the US economy slipping into a contraction from expansion. The dividing line between expansion and contraction is 50%. The ISM reading for September slumped to 47.8% which marks the second straight month the index has been below 50% and the lowest reading since June 2009. This in turn has created a battle between bulls and bears and is reflected in the trendless nature of the market over the last few months.

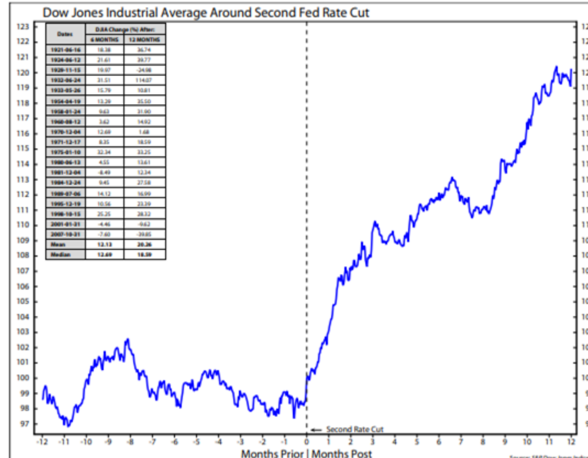
Outlook

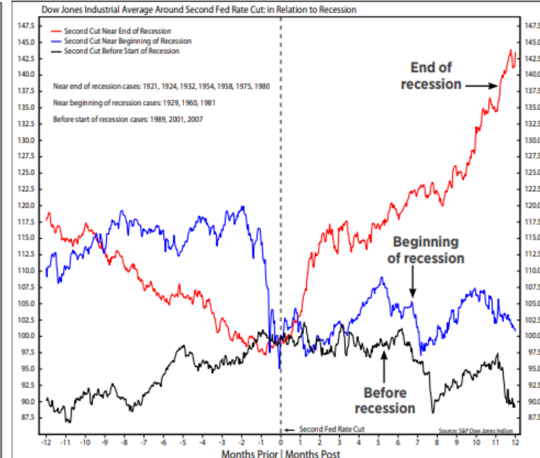
Notwithstanding the weak ISM numbers there is still plenty of healthy economic data to support a bullish thesis. With the Fed actively supporting lower rates the chances of a recession in the next year are low. According to Bloomberg Economic's New Recession Probability Model the chance of the US heading into a recession in the next year is just 16%. Historically, the fourth quarter is strong and averages a 4.2% return. However, considering how weak Q4 was last year we are always aware of that possibility. With investors on edge and no shortage of news headline risk with China trade talks, Brexit, uncertain Fed moves, and Middle East tensions among others, we expect volatility to remain high versus the first half of the year. Even if the market does sell off, we believe it will be limited (since the last bear market ended just over 9 months ago) and the foundation is set for a year-end rally. As always, we are excited about future opportunities and will be vigilant in seeking to participate in the next crop of leaders when the secular bull market resumes.

Researcher Ned Davis lays out some interesting possible future market scenarios based on the Fed's actions:

If the market can resolve the breadth divergences that emerged in August, the combination of a friendly Fed and a friendly tape would be a compelling reason to upgrade our U.S. equity outlook from neutral to bullish.

- Two is Better Than One: The Dow Industrials slipped an average of 1.5% in the year after a singular rate cut versus +17.0% for all first rate cuts and the market has responded particularly well to the second cut, jumping an average of 20.3% one year later. This may be because the 2nd cut demonstrates the Fed's commitment, or perhaps because the liquidity from the first cut had already started to have an impact.
- Recession vs. Non-Recession: The most popular chart in our first Fed rate cut series was S01726A, which shows that the DJIA has gained an average of 24% in the year after first cuts that do not coincide with a recession. It illustrates the positive effect extra liquidity can have on the stock market if it is not being diverted to the real economy. For the second rate cut, the recession/non-recession divergence
- Recession Timing Matters: In most cases, the Fed has waited until near the end of the recession before beginning to cut. In those cases, the DJIA bottomed about a month before the 2nd cut, and surged an average of 43.6% a year later. When the Fed began to cut near the beginning of a recession, the 2nd cut did not help much. The weakest stock market performances have come when the Fed tried and failed to prevent a recession.
- Implications for This Cycle: Since the U.S. economy is almost certainly not in recession today, the historical analogs provide two distinctly different outcomes. If the economy avoids a recession, the average gain is 18.2%. The other possibility is that the economy enters a recession in the next 12 months, in which case the average loss is 10.8%.





<u>What is the WCP Edge?</u>

Despite what we outlined above, predicting market environments remains a futile exercise. So, what then is our advantage in creating value for our partners? We've always emphasized a concentrated portfolio where our investment edge is the result of our **ECLASS (Earnings, Cycle, Leadership, Acceleration, Sales, Surprise) methodology**. This results in an active portfolio of superior growth stocks that display exceptional relative strength and momentum. Flexibility in our exposure levels, coupled with our unemotional decision-making, keeps our portfolio on the right side of the market trend while attempting to limit our downside exposure. Our strict adherence to risk management and position sizing keeps our losses small while riding our winners.

We would add another important overall factor that is overlooked by most — keeping assets under management small. Most of our competition only cares about growing larger and accumulating assets under management. While we believe WCP has plenty more capacity, we also believe in diminishing returns. As active managers, a smaller asset base allows us the flexibility to change our exposure levels with more ease which is critical for extracting alpha for our partners.

We are always available to discuss our approach. Contact us if you wish to inquire about a possible investment in WCP. Additionally, if you know of anyone who might be interested in our strategy, please feel free to make the introduction. Please do not hesitate to call us with any questions or comments.

Kind Regards,

Ryan Worch
WCP, LP Principal and Fund Manager

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The performance data represents the performance of Worch Capital Partners, LP ("WCP"). The results reflect the deduction of: (i) an annual asset management fee of 1.0%, charged quarterly; (ii) a performance allocation of 20%, taken annually, subject to a high water mark; and (iii) transaction fees and other expenses incurred by WCP. During the time period shown, WCP used only those investment strategies disclosed in its Private Placement Memorandum. Results are compared to the performance of the S&P 500 Index (excluding dividends) for informational purposes only. WCP's investment program does not mirror the S&P 500 Index and the volatility of WCP's investment program may be materially different. The performance figures include the reinvestment of any dividends and other earnings, as appropriate. All investments involve risk, including the loss of principal.

PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

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