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Dear Investors and Friends,

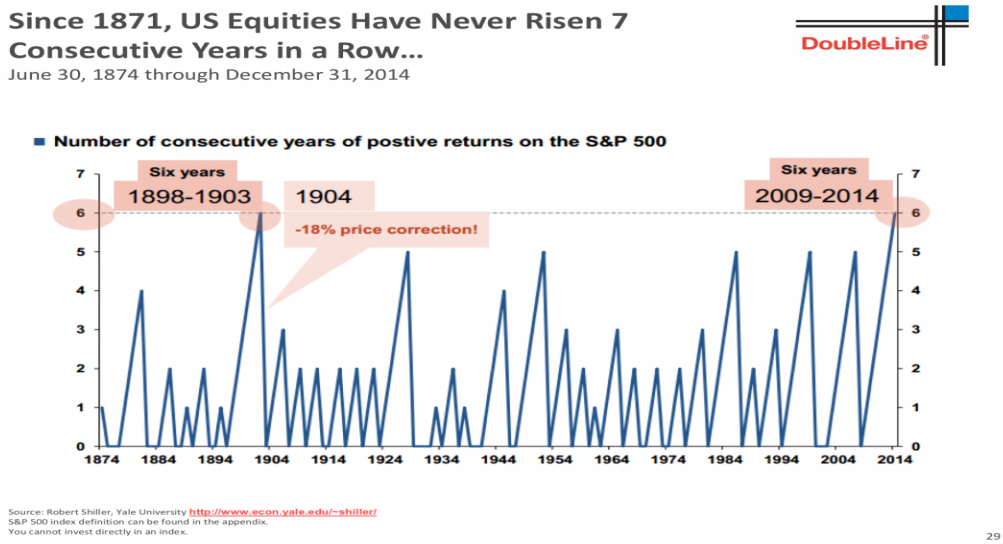
Worch Capital Partners, LP ("WCP") returned 5.5% on a net-of-fees basis in 2014. Through the first 9 months of the year, the fund hummed along in both relative and absolute terms. However, the 4th quarter brought about the choppy type of conditions in which the strategy is most prone to struggle. First, from late September to mid-October, we saw the S&P 500 fall nearly 10% and back to almost flat on a year-to-date basis. Meanwhile, the VIX was simultaneously rocketing nearly 200% from 11.5 to above 31. The S&P then put in a stunningly sharp bottom on October 15th and rode a slingshot to new index highs in a mere 2 weeks. Then in early December we saw a similar swift decline of over 5% in the S&P. Again, the index quickly bottomed and recovered to new highs in only 5 trading days. The winning investment theme in the market over final quarter of 2014 was to buy weakness and sell strength. The "significant" pullbacks that took place came to their ends by way of swift V-shaped rebounds.

Alternatively, our process prefers to capitalize on established strength and market trends while opting to be on the sidelines or short postured when conditions weaken. For instance, our models told us to reduce risk exposure during the market's September-October plunge. We knew the strategy would be at risk of missing some upside if the market made a quick turn around and felt comfortable making that tradeoff. Ultimately, a quick turnaround is exactly what was in store and we were left under-allocated in our long book.

The choppy, trendless 4th quarter led to us giving back our lead on the S&P and finishing the year trailing the index. We did however manage to handsomely outperform the majority of our long/short peers as the HFRI Equity Hedge index was up just 2.26% in 2014. To be clear, our top performance priority is to deliver attractive **risk-adjusted returns** on an annual basis. While we understand the importance of various benchmarks and relative comparisons (S&P 500, HFRI indexes, etc), our primary focus is to provide our partners with a vehicle that stresses capital preservation and minimizing the risk of loss. Hopefully, through that formula, we are able to look back years down the road to find a performance trail that has outperformed most reasonable benchmarks and peers. That would be an optimal outcome.

In our 2013 year-end letter, we highlighted an interesting statistic found in a study by ISI Research. They asserted that since 1950 there had been 11 years (2013 made it 12) where the S&P 500 posted gains of 25% or more. In the following year, the index generated positive returns in 9 out of the 11 instances with average gain of more than 16%. If an S&P 500 investor had operated off of this data point alone on January 1st, 2014, logged off for the entire year and then checked their account on December 31st, they would have been quite pleased with the results. If only it were that easy! As we know, the index kicked off 2014 with a 6% fall from its January peak into early February, trended nicely through the middle months of the calendar, then wiped out all of the year's gains during the September-October swoon only to rebound and finish 2014 with a double digit gain.

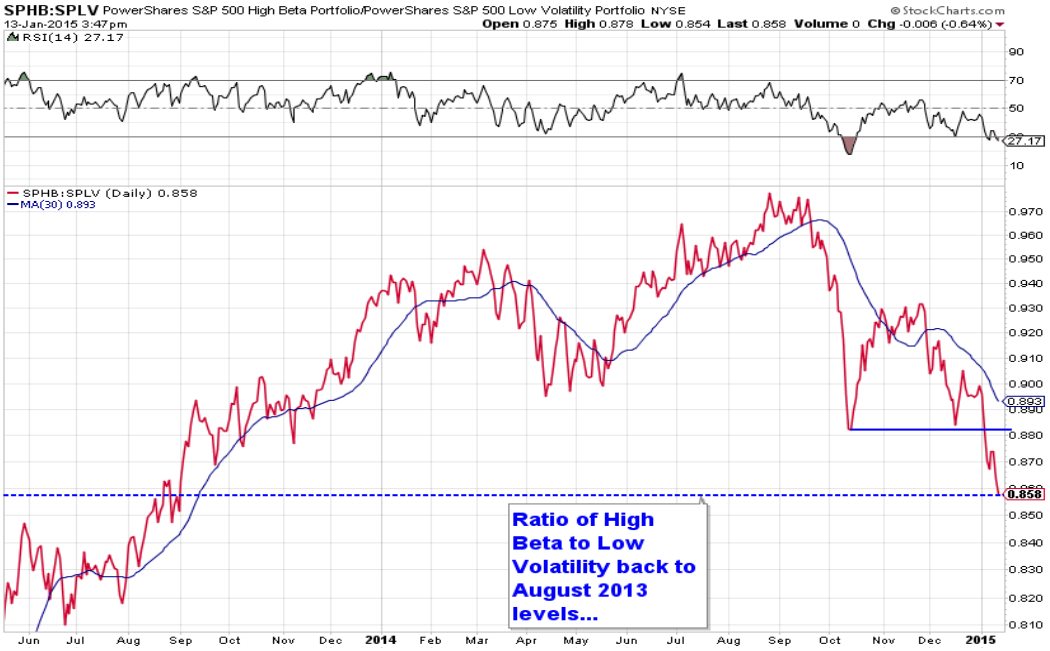
This year's "*past performance is not indicative of future results"* statistic comes from Jeffrey Gundlach's team at DoubleLine (via Robert Shiller, Yale University) and brings with it a sobering tone. On a price return basis, the US stock market has never recorded 7 consecutive years of gains. 2015 represents year 7 since the March 2009 market bottom. The study looked all the way back to 1871 and never have we had more than 6. In fact, most streaks have stopped at 5 with only one other achieving the 6-year milestone.



There's absolutely nothing actionable we can take from the above but it is certainly interesting to know where we stand in terms of historical precedent.

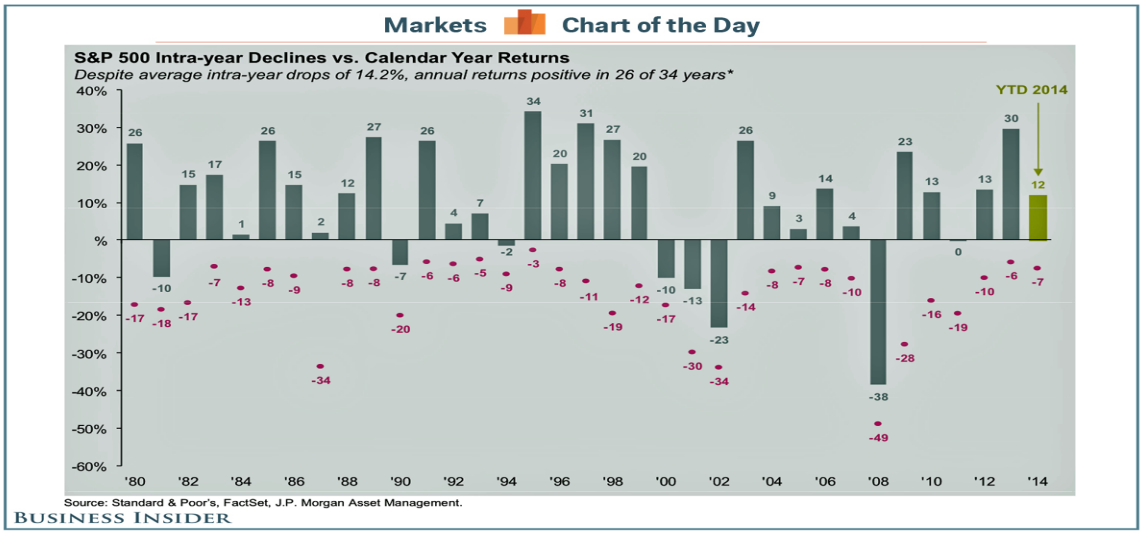
When we look at recent months and early 2015 with more immediate data, we see signs of a market possibly changing its tenor. As mentioned earlier, there has been a notable increase in volatility since September. This uptick has been caused by, among other influences, oil's ongoing collapse, the continued decline in interest rates, worries of slowing global economies, incredible developments in the currency markets and the ongoing guessing game within global monetary decisions. Just this morning, we woke up to unexpected monetary policy announcements out of India and Switzerland that made stock futures go haywire. Bloomberg summarized the events with "central banks are no longer aligned and again a source of volatility rather than calm in financial markets." This news came while the market awaits another event that is sure to spring more volatility: next week's ECB meeting and the potential for further QE in the Eurozone.

Surely the longer-term impacts of recent events are impossible to judge right now but there's no denying that they've lead to elevated gyrations here in the near term. During the last three months of 2014 and early here in 2015, we've seen the S&P quickly fall more than 5% on 3 separate occasions. Before the start of the 4th quarter, the index had 5% pullbacks only twice in the prior 18 months. And that downside volatility has been matched with equally powerful upside moves. Typically when we start to see volatility like this it's a sign that the market is undergoing a directional trend change. As a result, we have seen high beta stocks display some telling weakness relative to lower volatility equities. The chart below by Pension Partners shows that high beta began lagging in late September and has continued downward.



All things considered, the existing trend for US equities and the path of least resistance remains to the upside. We'll see if the bearish crowd has enough ammo to derail the current trend.

As is human nature, we are optimistic investors at our heart. Thus our long-bias. When we look at history the dominant trend of the market is upwards but in any given year there are bound to be bouts of volatility and selling. While these characteristics have been scant in recent years they will undoubtedly arrive at some point and catch many by surprise. This will cause otherwise rational human beings to make very irrational investment decisions. The chart below from J.P. Morgan helps to illustrate. Looking back to 1980, we have seen many more up years than down. However, the average intra-year drop over this span measures at more than -14%.



We ended last year's note with a quote from legendary investor and Chairman of Oaktree Capital Management, Howard Marks and we see no reason to not share his wisdom again. This from his memo entitled *Dare to Be Great II:*

> *"The goal in investing is asymmetry: to expose yourself to return in a way that doesn't expose you commensurately to risk, and to participate in gains when the market rises to a greater extent than you participate in losses when it fails. But that doesn't mean the avoidance of all losses is a reasonable objective…To succeed at any activity involving the pursuit of gain, we have to be able to withstand the possibility of loss. A goal of avoiding all losses can render success unachievable almost as readily as can the occurrence of too many losses…*
>
> *In order to be a superior investor, you need the strength to diverge from the herd, stand by your convictions, and maintain positions until events prove them right…Unconventional behavior is the only road to superior investment results, but it isn't for everyone. In additional to superior skill, successful investing requires the ability to look wrong for a while and survive some mistakes."*

We are truly honored and humbled to have each of our partners and friends of the firm. It is our mission to make this a rewarding journey for all involved. We are always available to discuss our approach and/or the market in general. Additionally, if you know of anyone who might be interested in WCP's approach, please feel free to make the introduction. Please do not hesitate to call us with any questions or comments.

Kind Regards,

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[1] Individual Accounts will vary

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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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