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Dear Investors and Friends,

Worch Capital Partners, LP returned -0.69% in May as domestic equity indexes moved steadily lower over the first 20 days of the month with most falling 1% or more. Those losses would not hold however as stocks were able to put in yet another swift reversal and finish in positive territory. All told, the S&P 500 finished up 1.5% for the month after bouncing 3.5% from the May 19th bottom at 2,025. It's a broken record at this point but the directionless environment in which the market is stuck has been a source of utter frustration for pretty much all fund managers regardless of strategy. At its outset, May looked like it would be a continuation of the weakness that began in the back half of April. And for a time it was as the index was down more than 4% from its April peak of 2,111. The S&P 500 had fallen back under its 50-day moving average and appeared destined for a date with its 200-day MA which sat just a hair above the 2,000 mark. That's not how the story would unfold though as the index ultimately staged a near 3-week rally that would carry through the first part of June and eclipse April's highs.

We consider ourselves to be risk managers first and foremost yet this environment continues to be our foil. When the market of the last two years has gone through periods where it weakened and looked as if it wanted to rollover further, we have proven to be rather apt at getting out of the way before the bottom dropped out (example: most recently, see January & February of this year). However what we, and many others, have struggled to identify are the sharp bottoms that this market continues to favor. Nearly every instance of weakness has been met with an even more severe and powerful rebound. These conditions have routinely left us feeling good about our risk management on the downside yet then completely dissatisfied with our level of participation in the ensuing bounce.

The current environment has definitely increased the motivation for internal reflection as you challenge your systems for ways to participate in these moves higher while honoring the need to stay disciplined to your core strategy. And many times, the best answer to this dilemma is to do absolutely nothing as markets and strategies will always be cyclical and none will ever work to precision 100% of the time. However, as we've done regardless of climate or performance over our 8-year history, we'll continue to challenge our assumptions, models and inputs in hopes of staying as in-tune with the market as possible for as long as possible.

If one were to give a theme to the market action and data points we saw over the course of May and so far in June, the word ***indecision*** would play well. In early May, it was all but a given that the FOMC and Chair Yellen were not likely to touch interest rates until much later in the year and fed funds futures prices were reflecting that belief. As the month carried on though the market seemed to make an about-face after a number of Fed officials came out and suggested that an increase at their June policy meeting could be warranted. In fact, the minutes from the committee's April meeting (released in mid-May) echoed that same sentiment:

> *"Most participants judged that if incoming data were consistent with economic growth picking up in the second quarter, labor market conditions continuing to strengthen, and inflation marking progress toward the Committee's 2.0% objective, then it would likely be appropriate for the Committee to increase the target range for the federal funds rate in June."*

As a result, over the course of a week the fed funds futures market's probability of a June rate hike jumped from 8% likelihood to over 30%. And the likelihood of a July increase leapt all the way to 55%. And the market appeared to cheer all of this news as it coincided with the rally that held through the end of May and into the beginning of June. Then we got the latest Non-Farm Payroll report on Friday, June 3rd and it was a real stinker. Only 38,000 new jobs were created versus an expectation of 170,000. The April and March numbers were also revised lower by a total of 59,000 jobs. These developments left the trailing 3-month job creation average at 116,000 versus the 12-month average of 212,000 jobs. Not exactly a glowing endorsement of the economy or the Fed's hope to move forward with a near-term rate increase. And now with the June Fed meeting having come and gone, we know that the jobs report along with other recent economic data was enough to push off a rate hike until July at the earliest.

As the Fed has been doing its job of throwing more confusion into the crowd, there's been a clear ramp in volatility over the last several days. In fact, the VIX aka the fear index made a near 60% surge over the course of the last week. One could have normally expected the market to wilt in the face such increased volatility yet the S&P was down less than 1% over that span. This stands in complete contrast to historical precedent as the market has averaged a drop of nearly 7% when the VIX has risen 55% or more in a given 6-day period. In addition to the Fed's lack of movement, the rise in volatility has been aided by investor nervousness in advance of the "Brexit" vote (the British referendum to exit the European Union). It appears investors are doing their positioning on whether Britain will stay or leave via the options market and this has made the VIX even more spastic.

One thing is clear, when we examine the chart below we see that the market has held a great deal of angst ever since the end of QE3, onward through the first rate increase in December 2015 and to present day as we wait to see what will finally push the Fed into action for rate hike #2. There's been essentially zero price progress made by the S&P in the last 18 months.

Further, besides the charts, there are plenty of other data points that show the level of indecision held by investors and fund managers right now. Bank of America/Merrill Lynch's latest global fund manager survey shows that despite corporate bond prices and US stocks being at or near all time highs, there appears to be great amount of unease. In fact, BAML's June measure of fund managers' allocation to cash in their portfolios was at its highest mark since the post-9/11 panic in November 2001. Higher even than at the depths of the 2008-2009 financial crisis. At the very least, this measure shows that fund managers worldwide are simply running out of ideas for where to invest capital and would rather hold cash. Couple that with the survey's respondents voting "long quality stocks" (think US Large Caps) as being the most crowded trade and you get a better idea of just how hated the recent moves of the S&P 500 might be. But be aware, these data points have a tendency of being contrarian in nature. BAML's measure of fund managers' cash levels sits at 5.7%. It was at 5.6% during the year-to-date lows in February and the S&P proceeded to rally 17% from that level. The same goes for November 2001, which was not a bear market low, the S&P managed to rise 10% over the next 2-months. The difference today being that we're within earshot of all-time highs yet cash levels are abnormally high.

We are always available to discuss our approach or 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,

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[1] Individual Accounts will vary

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