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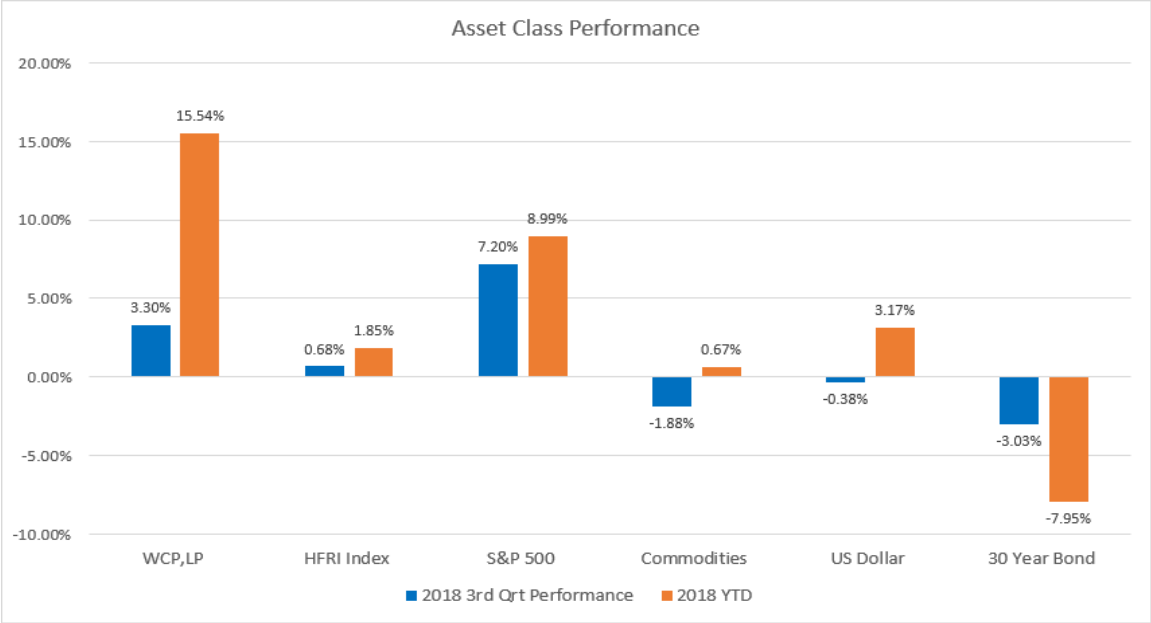
Dear Investors and Friends,

Third Quarter 2018 Performance

Worch Capital Partners, LP (WCP) finished the third quarter of 2018 with a healthy return of +3.30% bringing our year-to-date net return to +15.54%. This drastically outperformed our benchmark the HFRI Equity Hedge Index on both quarterly +0.68% and year-to-date performance +1.85%.

The third quarter was robust for domestic equity indices across the board. There was a rotation out of growth/momentum stocks and small caps into more traditional value ideas as the Dow Industrials led the performance among the five big US indices. While strength resided with U.S. domestic markets, the same cannot be said of the bond market. Fixed income continues to lag as it experienced a tough third quarter bringing its year-to-date losses close to 8%. This asset class hasn't offered much of a safe haven as it remains the biggest loser of the major asset classes for 2018. Emerging markets have struggled all year and remain firmly in a downtrend, while the slide in China's stocks has put their equity indices into bear market territory.

With this backdrop, we look forward to a strong finish for the remainder of the year. We will not get complacent in our effort of delivering market generating returns with less risk while providing an uncorrelated asset for our partners.



Current Market View

Momentum picked up in the 3rd quarter as the Dow Industrials joined the S&P 500 in notching fresh multi-year highs in the third quarter. Equity markets escaped the historically weak months of August and September and set the stage for a solid year as we begin the home stretch. We view the fresh new highs as confirming evidence which supports our ongoing secular bull market theme. Whether you believe the bull market started in 2009 or 2013, secular bulls typically last 15 years or more; confirmation in the form of new highs validates the trend. Below are some quantitative studies, courtesy of Nautilus research, that show how current momentum justifies future upside.

1. A new multi-year high for the Dow for the first time in six months is a powerful trend following signal. 6-month gains average +6% (30 up vs. 7 down) going back to 1900.
2. When the SPX and the DOW both make multi-year highs on the same day for the first time in six months, which occurred yesterday, gains for the SPX average +11% one year out and +20% two years out. The Dow Industrials tend to perform similarly.
3. Further, please note that when the DOW Industrial Index is up between 5% and 10% through 9/20, returns for the rest of the year average +7.53% (9 up vs 1 down), while the SPX gains an additional +6% through year end (9 up vs 0 down).
4. Since 1927, when the SP500 is up more than 8% through September**,** rest of year gains have averaged +4.02%**.** (31 up vs. 7 down).
5. Since 1927, when Q3 returns for the SPX exceed 7%**,** 6-month returns average +9.31% (17 up vs. 5 down) while 3-month returns average 4.53% (18 up vs 4 down).
6. The SPX just notched 6 straight consecutive monthly higher closes**.** 3-month returns average +3.85%**.** (23 up vs 4 down).

Many want to question why the markets behave in certain ways. At any given time, you can find perspectives both bullish and bearish; however, the facts are the facts and the U.S. equity markets have all notched new highs in 2018. Below is a recent note from Jeff Saut at Raymond James that tries to answer the question:

"So what's driving it? Well, back in 2014 we wrote about a book titled Unleashing the Second American Century: Four Forces for Economic Dominance by Joel Kurtzman. In the book, Kurtzman, a senior fellow at the Milken Institute, focused on "Four Forces": soaring levels of creativity, massive new energy reserves, gigantic amounts of capital, and unrivaled manufacturing depth. Each of these transformative themes is outlined below:

Soaring levels of creativity- *No other country in the world, in such a short time, has created so many scientific, technological, industrial, commercial, financial, and artistic*

innovations. Not only has America's creativity changed science and business, it has changed world culture.

According to Kurtzman, "Creativity is important. If it wasn't, no one would marvel at Apple, or be impressed with innovations from Pfizer, IBM, Tesla, or Boeing. No one would listen to our rock 'n' roll, rap, and country and western songs; watch our movies and TV shows; or come to America to study or work. I doubt creativity is in our genes, but creativity is in our culture. Let me explain a little more about the forces I am referring to by taking a visit to 'innovation corridor.'"

The author continues, "America's research centers are scattered around the country. There are impressive concentrations of talent, knowledge, and resources everywhere. While biotech and pharma are vibrant growth areas, computer hardware and software, telecom, tech, advanced manufacturing, materials science, chemistry, aeronautical and space engineering, electrical engineering, artificial intelligence, 'big data,' analysis, and many other fields - all have their own centers of expertise scattered around the country.'"

***Massive new energy reserves**- America is headed for energy independence around the year 2020, and it is on track to be a net energy-exporting nation by 2025. These new sources of energy can be used as fuels or turned into products. Imagine a future in which oil and natural gas wealth flows to our shores and not to the Middle East, Russia, or Venezuela.*

***Gigantic amounts of capital**- As a result of the Great Recession, business has renegotiated its debt, and businesses and individuals have become ultraconservative with capital. Trillions of dollars of investment funds are in private hands, waiting for the go-ahead to be deployed.*

Kurtzman writes, "When you have access to capital, the result can be magical. The Milken Institute studies show that when capital is plentiful, and prudently lent, and borrowers can obtain it in transparent ways and under good terms, economies grow."

***Unrivaled manufacturing depth**- America makes a myriad of things, and now it will make more as businesses move to the United States to take advantage of abundant energy and capital and to tap into our vast reserves of intelligence and creativity.*

According to Kurtzman, "Americans produce about 20% of all the stuff in the world. Given that we are just 4.5% of the world's population, and China is 19%, that's quite an achievement. America's productivity, measured on a per capita basis, remains the world standard. America works smart and our factories are top-tier, second to none."

Bull markets tend to sprint to the finish line, and investors who exit the market too soon risk leaving considerable performance on the table. The cycle remains intact, supporting earnings, and our non-recession bear market checklist does not suggest that multiples are in imminent danger of unraveling. Taking some money off the table is prudent in an

environment with elevated risks, but we cannot see a path to underweighting equities at the current time."

This might be one of the best explanations of the current bull market and one that is easy to understand. If Mr. Saut and Katzman are correct, this secular bull market has plenty of upside left and the future is very bright.

Outlook – How long can it last?

The next logical question facing investors right now is how much longer will the equity bull market last? We continue to operate under the premise that the U.S. markets remain firmly entrenched in a secular bull market. Even with this backdrop there will certainly be cyclical bear markets as this bull market will not last forever. Can experts predict when bear markets will begin and call market tops? We believe this to be fool's gold and is much more useful in creating page views rather than actionable ideas. There are no magic formulas to identifying when the trend will reverse. In real-time these inflections points are extremely hard to determine.

Traditional measures such as valuation and sentiment are very poor at forecasting bear markets. From decades of experience and participating in bull and bear markets we know that valuations can stay expensive or cheap for much longer than most can stay solvent. The same can be said with sentiment, as it gets excessive on both sides, and proves to be an unreliable gauge of an impending bear market. According to BCA research, *"equities are surely more vulnerable when they trade at high multiples than when they trade at low multiples, but conventional valuation measures have been all over the map ahead of the eight bear markets that have occurred over the last 50 years. The late-'80-to-early-'82 and 1990 bear markets occurred despite P/E, Shiller P/E and P/B multiples that were all comfortably below their long-run medians. The dot-com-bubble bear market occurred when every valuation metric was at an all-time high, to be sure, but our composite valuation indicator had spent three solid years in extremely overvalued territory before the bear finally arrived."*

However, we don't discount these valuation factors; we monitor them consistently. As they are part of the process that formulates ongoing due diligence in our market research. As active managers, it isn't useful to predict where the market is going. While we shy away from forecasts, we do attempt to ascertain different viewpoints to shape our current market thesis. Most of the data presented above has a bullish bias to it. One such negative outlook comes from Jeffrey Gundlach founder of DoubleLine Capital. *"We have repeatedly pointed-out that raising deficit spending near the end of an economic cycle, with the Fed tightening policy, is unprecedented. Moreover, raising the cost of borrowing when the U.S. is going to account for over 75% of developed-country government borrowing over the next five years, with personal saving rates near historic lows (having fallen from over 6% in October 2015 to 2.8% in April 2018), and with the U.S. being the world's largest debtor nation to the tune of $7.8 trillion, strikes us as unwise. And, entering into a trade war with all your major trading partners at the same time you are so dependent on foreign capital and "the kindness of strangers" is even harder for us to reconcile."*

We prefer to position our exposure levels on the right side of the trend. We will never call market tops or bottoms as we'll leave that to the pundits who prey on lofty forecasts and fear mongering. We expect and even encourage corrections particularly during secular bull markets, but we won't waste time trying to pinpoint and predict them. Once the trend does change and an uptrend turns into a downtrend we are confident in our abilities to sidestep major declines as we monitor an array of market indicators that produce real-time feedback. Yet, if we can capture a majority of the trend on the upside, while side-stepping downside volatility, we can accomplish our goals.

What is WCP Edge?

Given 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 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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