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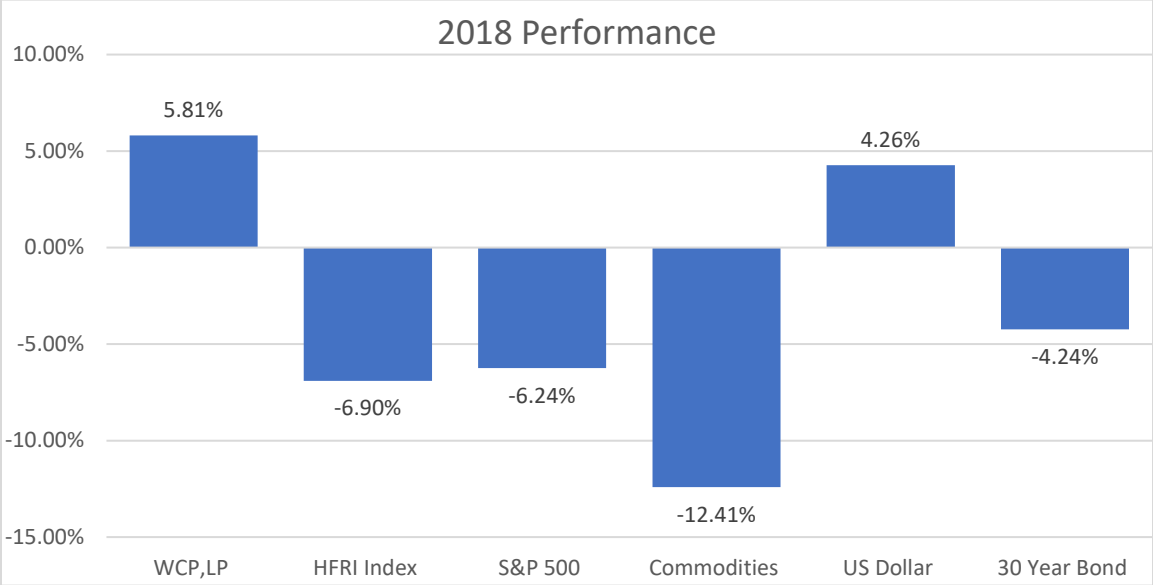
Dear Investors and Friends,

Year-to-Date 2018 Performance

Worch Capital Partners, LP (WCP) finished 2018 with a year-to-date net return of +5.81%. This drastically outperformed our benchmark the HFRI® Equity Hedge Index year-to-date -6.90% performance.

With this backdrop, we feel very fortunate to end the year with a decent gain considering the overall weakness throughout asset classes. Every major asset class except for cash was negative for the year. 2018 was a year in which our risk management was paramount and showed its effectiveness in protecting WCP capital and providing an uncorrelated investment. We prefer to stay modest unlike most talking heads in the public because we know the markets are the most humbling game in the world. Just when pundits think they have it all figured out, the stock market has a funny way of punishing them off their high horse. Hence, one thing we constantly emphasize is our strict adherence to discipline and risk management which gives WCP an edge in the markets. During the fourth quarter this paid off significantly as we avoided devasting losses that occurred in many growth equities while maintaining a profit for the year. Our performance for the quarter was in line with our benchmark. In October we took a defensive stance and stayed that way through the end of the year, allowing us to preserve both our physical and emotional capital. December alone saw losses of over 9 percent on the S&P 500 while WCP losses were contained to just over 1 percent. We now have capital to deploy once the environment is less hostile and sets up for our ECLASS methodology to reengage in the markets.

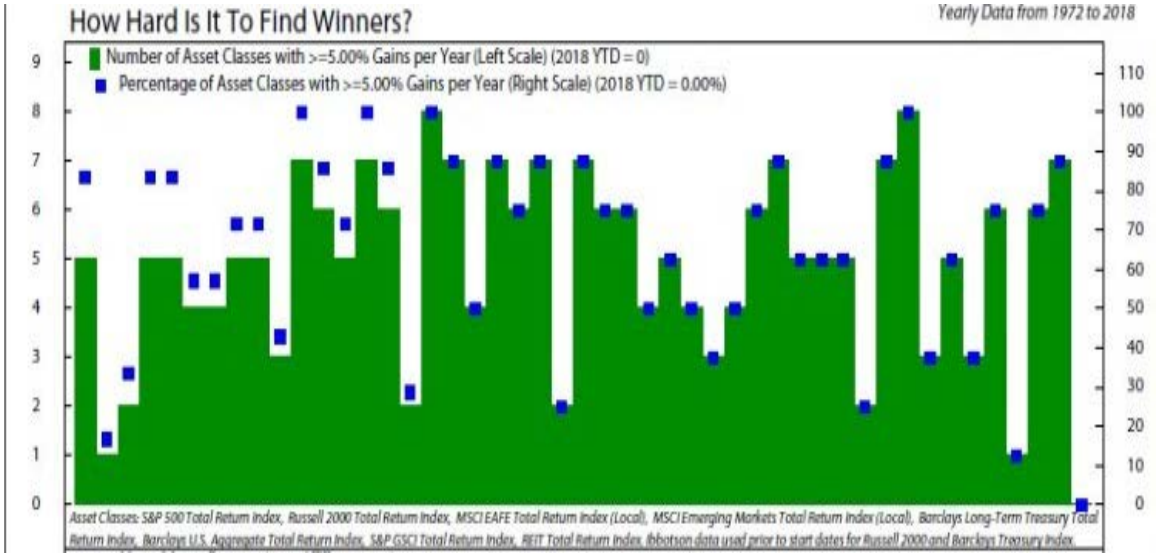


Current Market View

The fourth quarter weakness was driven largely by fears of slowing global growth. US domestic markets finally capitulated to global weakness abroad as the S&P joined most developed and emerging indexes in a bear market. The increased volatility in the fourth quarter can be attributed to investment professionals repricing risk as global growth slows, ongoing trade tensions, and the yield curve inversion. When the yield spread — the difference between the yields on 10-year and 2-year Treasuries — goes negative, it's widely believed to be a harbinger of an upcoming recession. But as this number hovers around its lowest reading since 2007, Wall Street pundits seem keen to explain why this time, it's different, there's no recession in sight, and therefore no danger of a bear market in stocks. According to their view, investors should go ahead and buy the dip. Yet, the major indices experienced a bear market for the first time since 2011. It is helpful to know what a bear market is and how to identify them. The Wall Street definition of a bear market is a decline of 20 percent or more from a recent 52 week high. From peak to trough all but the Dow (barely) experienced a bear market in 2018.

DOW	-19.44%
S&P	-20.21%
NASDAQ	-23.89%
RUSSELL 2000	-27.44%

To show how difficult it was to make money in 2018 the chart below shows zero asset classes with greater than 5 percent gains for the year. That is an all-time low going back to 1972.



But even if we assume there's no recession imminent, a declining yield spread is a reliable signal of slowing growth, bringing with it an increased risk of market corrections. The weakness in the fourth quarter included a heightened sense of fear along with negative sentiment. According to Lipper Fund Flows, weekly outflows of $46 billion from US equity investments was the highest level measured since 1992. Meanwhile panic was rampant as the VIX index (fear gauge) spiked above 35 and the put/call ratio recorded the highest reading on record. The fourth quarter was the most challenging quarter since the depths of the financial crisis as investors remain on edge and anxious. As we enter 2019 with amplified uncertainty, investors have a laundry list of worries. As markets debate the Fed and rising interest rates; tense trade talks with China; global recession fears; and the ongoing government shutdown, we are carefully assessing the potential outlook.

Outlook – Bear Market – Now What?

As we establish our plan for 2019 we need to first identify what volatility regime we believe the market resides in. Looking at historical data helps shape our expectations and creates a baseline outlook. Going back to 1920 the average bear market loss is 32 percent. However, when we break down each bear market in the context of secular bulls and bears the data changes drastically. The average bear market loss in a secular bull market is 23.5 percent while the average bear market loss in a secular bear market is 39 percent. Bear markets in secular bulls last on average 7 months while secular bears last 19 months. Most secular bear markets consist of structural issues and coincide with a recession. These are characterized by longer time frames and deeper losses. Yet, even a growing market with a strong economic backdrop not associated with a recession can be battered by a bear market. Two of the most memorable are the bears markets during the Cuban missile crisis and the 1987 crash. According to the Economic Cycle Research Institute, "our analysis shows that a recession is neither a necessary nor a sufficient condition for a bear market, defined as around a drop in stock prices of 20 percent or more. Of the 14 post-World War II bear markets, nine were associated with recessions; but five occurred when economic growth was positive, but decelerating. That brings us to Paul Samuelson's famous quip, from half a century ago, that the stock market has predicted nine of the last five recessions. Most get a chuckle out of belittling recession risk, but while his precise figures may not have been accurate, he was right on the mark in term of substance. Indeed, the key implication of his statement — that many bear markets were not associated with recession — is widely overlooked, and it underscores the fact that a bear market is possible even without a recession in sight."

The market reached some extremes in the harsh sell off in December. If we look at the data going forward based on these extreme readings, they paint a better picture. After a 20 percent correction, valuations look more reasonable. According to Capital IQ, the S&P 500 trades at 15.8x 2018 earnings estimates, 14.8x earnings estimates for the next twelve months and 14.4x 2019 earnings estimates. That represents a near five-year low and a notable discount to the thirty-year average of just under 17x. According to Sentimentrader.com, the S&P's earnings yield has jumped to nearly 6 percent. The

comparison between bond yields and stock yields is often referred to as an Equity Risk Premium (ERP), the amount that investors are willing to pay for earnings above/below the yield on bonds. ***When the ERP Z-score reaches extremes of 2 or above like we saw one year ago, the average annual S&P return is -4 percent. When the Z-score reaches extremes of -2 or below, the average annual S&P return is 40 percent.***

Returns when ERP is...	Annualized	% Of Time
Above 2	-4.0%	6%
-2 To 2	6.8%	85%
Below -2	40.1%	9%

As we entered 2018, Investor's Intelligence sentiment was in the top 5 percent of all readings - which has historically resulted in an average annual return of -1.6 percent. When their readings are in the bottom 5 percent as they are currently, average annual returns are 10.9 percent.

Period: Weekly, Since 1987	S&P 500 Average Forward Price Returns			
AAII Sentiment (% Bulls minus % Bears)	3-Months	6-Months	9-Months	1-Year
Extreme Fear (bottom 5% of readings)	4.2%	8.0%	8.9%	10.9%
Extreme Greed (top 5% of readings)	-0.7%	-1.1%	-1.4%	-1.6%
Differential	4.9%	9.1%	10.4%	12.5%

Lastly, another blown out breadth reading from sentiment trader and interesting statistic: Since 1984, (Excluding '08), when over 25% of NYSE and NASDAQ stocks are at a 52-week low, the S&P returns the following 12 months were:

-9.5%, 15.5%,17.9%, 18%, 19.6%, 20.6%, 21.1%, 21.7%, 22.9%, 24%, 25.2%, 26.1%, 27.4%, 29.1%, 29.3%, 31.5%, 33.9%, 37.9%, 39.2%, and 66.6%.

The question on the minds of many investors is: When will stocks bounce back? We don't have the answer but assessing the data we don't believe this is a structural issue like the 2000 tech bubble or the 2008 financial crisis. While, the current bear market can play out in two very different scenarios, this is likely a cyclical bear within a secular bull market. If our analysis is correct, we are closer to the bottom considering the magnitude of the

decline so far but have months of choppy action before a real sustainable rally takes hold. We expect volatility to remain elevated in the near term which will make risk management our highest priority. However, when this bear market is over, it will set the stage for a very favorable environment; one which we plan to capture.

What is WCP Edge?

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 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,

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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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