October 10, 2023

Dear Friend of Valara Capital Management,

For the third quarter and nine months ended September 30, 2023, Valara Partners, LP. produced returns, net of fees, of 0.02%, and 0.73% versus -3.27% and 13.07%, for the S&P 500, respectively.

QUARTERLY REVIEW

The US economy continued to perform better than expected in the third quarter. Even the Federal Reserve expressed a modicum of amazement that the data defied any material drag from higher interest rates. Once again, the likely architects of this outcome are the exceedingly high level of fiscal spending and the generally risk tolerant attitude in both debt and stock markets. The month of June proved to be the low water mark (so far) for the decline in the inflation rate, with July and August both experiencing slight increases. Oil prices rose, ending the period at $90 per barrel and contributing to the uptick in inflation. Unfortunately, the substantial job of refilling the Strategic Petroleum Reserve remains entirely ahead. Second quarter earnings were favorable but had some unfortunate potholes, with disappointments from marquee names like Apple, Netflix, Microsoft and Disney. Embedded in these results (and others), were ongoing signs of profit margin pressures and pockets of weakness in consumer spending - in line with surveys of consumer sentiment. Business confidence has been improving from its June low. Artificial Intelligence remained an area of market enthusiasm, but some sobriety entered the narrative with the recognition that there will be costs associated with its adoption and that its current iteration still has important limitations. The big story for the quarter was interest rates.

With stock markets, globally, selling off and the US Dollar strong, there was a nascent shift to quality generally associated with rising risk aversion. Commonly, when this occurs, US Treasury bonds rally (interest rates fall) because of a surge in demand for the safety they represent. This is especially true when US rates are above the average of other reserve currencies (they were/are) and inflation angst is moderating. The fact that Treasury interest rates ground higher through the quarter, and spiked higher as the quarter closed, is not a good sign. The grind higher was likely due to the surge in supply that came to market after the debt ceiling resolution was kicked down the road on June 3rd. Simultaneously, our primary global creditors are seeing their own agendas change, from reserve accumulation to domestic spending, to non-Dollar strategic issues or simply to alternative assets. China, Japan, the UK, Belgium and Saudi Arabi were all countries that posted reductions in US dollar holdings in the third quarter. The resultant excess supply is a new and unwelcome phenomenon that may just be a temporary aberration. However, given global trends, it may alternatively suggest that the US is nearing its credit limit – at least in the near term. The interest rate spike at quarter end implies that I may not be the only concerned party. The repeat failure to govern, evident in the inability to produce a Federal Budget for fiscal 2024 by the September 30th deadline, was another blow to our creditors' morale. Their wince was reflected in the Treasury market (50 basis point interest rate spike) and was reminiscent of what happened in the UK last year.

Hamas launched a significant attack on Israel as I write this. It's hard not to think of this as opportunistic, with the US so stretched in Ukraine and with Taiwan/China simmering in the wings. The loss of civilian lives appears to be targeted, significant and disturbingly brutal. The impact on global stability, growth and inflation is still to be determined but there is likely to be one.

PERFORMANCE COMMENTARY

As noted above, global stocks sold off in the third quarter. India was the only major market to buck the trend and the US (S&P 500) was slightly above the median at -3.27%. The fact that interest rates rose globally provided a general headwind. In terms of investment style, the results were tightly clustered, with the Russel growth index down 3.13% and value down 3.16%. The leading sectors of the market were Energy (by a wide margin), Communication Services, Financials and Health Care. The laggards were Utilities, Real Estate, Consumer Staples and Transportation. Gold mining, which is important to us, did poorly, as is typical when the US dollar is rising. Our large overweight in

Energy made our overall sector contribution positive. Our performance contribution from stock selection was highly bar-belled, with large winners and large losers. Our leading stocks were NOV, +30.3%, Fluor Corp, +24.0%, TechnipFMC, +22.4%, Amgen, +21.1%, Murphy Oil, +18.4% and Baker Hughes, +11.7%. All of these except Murphy and Amgen were among our top 10 holdings (in terms of position size). Our biggest laggards were Foot Locker, -36.0%, Omnicom, -21.7%, Mohawk, -16.8%, Barick Gold, -14.1%, Warner Brothers Discovery, -13.4% and Newmont, -13.4%. Both Foot Locker and Omnicom are relatively small positions. Foot Locker declined as a result of weak Q2 earnings and a dampened near-term outlook. In the context of other retailers that was not surprising, but I am following the situation closely.

Our trading in the quarter was driven by our reduction of TechnipFMC into strength and the sale of Phinia, Inc., which was spun off to shareholders of BorgWarner in early July. We sold slightly over half of our shares in FTI which was our biggest position at the end of June. The proceeds from these sales were placed in Amgen, Mosaic and Pan American Silver. Our portfolio continues to have a highly attractive valuation and tremendous outperformance potential.

OUTLOOK

The US stock market appears to take the preponderance of its cues from what it expects the Fed to do. Strong economic data or higher inflation means that the Fed must continue to raise rates and the market sells off. Softer data, that does not overly threaten corporate earnings, is reason enough for a rally. Every day is a new trade based on a new metric. Fundamentals play a role, but they seem secondary at the moment.

None of this changes the big picture. The Fed is fighting inflation from behind the curve. Inflation started with a supply shock (Covid and China trade war) and turned into a cost, wage, price cycle. The Fed has been trying to dampen demand to moderate price pressure by hiking interest rates at an astonishingly rapid rate. It remains very likely that something will break in the financial system, the economy or both. I believe they know the risk. If/when it does, they hope to reverse course as demand/inflation drops. Unfortunately, the inflation in the system has a supply chain component, a geopolitical component, a national security component, a social component, a skills/education component, a government spending component, an energy/environmental component... - it's not just consumer demand. But "to a man with a hammer everything is a nail". I wish the Fed a lot of luck – our living standard may depend on it.

If something breaks, the plan appears to be the same as it was the last time - cut interest rates, borrow and spend. Does anyone think that makes sense anymore? As noted earlier, our creditors probably don't. The straws of dissent are in the wind. Government spending must decline from its current level of just under 40% of GDP to something much lower. The obvious first step would be to get our nose out of everyone else's business. Since tax revenues need to be sustained, private business activity (and associated employment) needs to fill that void. Barring a productivity miracle, the obvious way to do this is to cut/simplify regulation and free private enterprise from the accumulated hindrances making the US less competitive. This is going to mean easing up on labor/social protections/compliance, environmental regs, targeted tax cuts/simplification - anything that makes doing business hard and costly. This has to happen and better now than later. Entrenched Washington is dead set on "later" but that will only make the adjustment more painful.

My skepticism that this will happen seamlessly suggests that bouts of inflation and a weaker US Dollar are a likely part of our future. Though no one can predict the exact path, our low multiple, value portfolio should do relatively well (vs. the broader market) through the adjustment period implied. As always, I appreciate your continued support and confidence and welcome any questions you may have.

Sincerely,

Robert W. Simmons, CFA
Managing Member