2365 Rice Blvd Suite #217 | Houston, TX | 77005 |713-328-1126 | t@vosscap.com

October 19th, 2013

Dear Partners,

Please be advised we've changed our name from Southpaw Capital LLC to Voss Capital LLC. Please also take note of our new address and contact information. The Voss Value Fund achieved 4.94% returns net of all fees and expenses for the third quarter of 2013, +6.20% gross of fees. The Fund's net long exposure concluded the quarter around 55% and in the mid-20s when considering exposure on a beta-adjusted basis. These numbers resulted in annualized alpha of 20.5% for Q3, 28.6% YTD, and 15.2% annualized alpha since inception. Our position concentration is low and our correlation coefficient to the S&P 500 for the quarter was 0.037 and our coefficient of determination (r^2) was 0.001. Needless to say, we have experienced a lessening day-to-day correlation to the broader indices.

Voss Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE | 2013

PERIOD	SVF (Net)	SVF (Gross)	HFRX Index	S&P 500 TR
JANUARY	7.22%	9.10%	1.96%	5.18%
FEBRUARY	-0.18%	-0.15%	0.43%	1.36%
MARCH	2.18%	2.76%	0.72%	3.75%
1st QUARTER	**9.36%**	**11.95%**	**3.13%**	**10.61%**
APRIL	-0.63%	-0.68%	0.67%	1.93%
MAY	8.80%	10.87%	1.16%	2.34%
JUNE	0.29%	0.42%	-1.89%	-1.34%
2nd QUARTER	**8.43%**	**10.58%**	**-0.10%**	**2.91%**
JULY	3.32%	4.08%	0.78%	5.09%
AUGUST	0.02%	0.11%	-1.03%	-2.90%
SEPTEMBER	1.55%	1.93%	0.73%	3.14%
3rd QUARTER	**4.94%**	**6.20%**	**0.47%**	**5.25%**
OCTOBER				
NOVEMBER				
DECEMBER				
4th QUARTER	**0.00%**	**0.00%**		**0.00%**
YEAR TO DATE	**24.44%**	**31.46%**	**3.53%**	**19.79%**

All YTD performance figures are unaudited, estimated, and may be subject to subsequent adjustment. A limited partner's actual returns may vary from published fund returns based on the timing of capital and fee arrangements. This statement represents information based on the policies of the fund's managers and general partner. Please contact Travis Cocke, Managing Partner of Voss Capital, LLC, with any inquiries.

"Much has been written about panics and manias, much more than with the most outstretched intellect we are able to follow or conceive, but one thing is certain, that at particular times a great deal of stupid people have a great deal of stupid money. At intervals, from causes which are not to the present purpose, the money of these people—the blind capital, as we call it, of the country—is particularly large and craving; it seeks for someone to devour it, and there is a plethora. It finds someone, and there is speculation, it is devoured and there is a panic."

Walter Bagehot, first editor of The Economist

The dispersion and divergence between stock returns is growing, which would be ideal and highly encouraging if it weren't the money-losing companies most reliant on a long chain of positive transformative events that are separating from the pack. There is yet to be any sign of buyer's exhaustion in the most speculative of names from the "blind capital" and the disheartening trends articulated from last quarter not only continued unabated into Q3, but accelerated emphatically as evidenced by the growing number of unmistakably parabolic stock charts of very low-quality companies dependent on immediate as well as distant future hyper-growth. This aptly describes many biotech and healthcare related issues (where there has been the highest number of IPOs this year since 1999), as well as most "clean-tech" names. Credit Suisse recently had a report out showing how low quality/high short interest names are outperforming by upwards of 13% YTD (probably by more when taking into consideration October data) within the Russell Mid-Cap index and this was described as a "slight" bias towards low quality.[2] In the future if we are ever underperforming a broad index by 1,300 basis points or more over a 9-month period, I would appreciate everyone to look upon such *slight* underperformance with the same leniency and nonchalance. Another sign of the massive rift that emerged in Q3 in terms of high-quality versus low-quality is the fact that within the Russell 2000 negative EPS stocks as a group returned 11.8% during the quarter, bringing the positive spread over those companies with positive earnings to over 12% YTD.

A market outsider casually observing the broad indices will not get an accurate sense of the rampant speculation taking place due to these divergences. Lack of certainty when describing a potential investment or security may be perceived as a sign of weakness. However, we view it a character strength for a portfolio manager, an admission of potential infallibility in one's own perceptive and predictive abilities ("LeBron stays humble just by being LeBron," real quote by @KingJames. No better way to express humility than by talking in the third person, eh?). There is seemingly no lack of certainty on the part of speculators as their previous hesitation to buy on notable strength has been entirely extinguished by their collective and fiery impetuosity to chase the best performing stock prices. We see innumerable instances of pockets of the market being dominated by lop-sided trend following and herd-like behavior—that is, people buying in response to a rising stock price in a powerfully self-reinforcing manner. The advances are perhaps increasingly driven by uninformed or unsophisticated investors. A major clue pointing to this is the fact that favored momentum stocks are moving together day-to-day regardless of the market or news pertaining to them. The slightest dips that we would actually characterize as below-normal volatility are perhaps at first pondered as if something is adrift that they do not know of (when it is just noise), but…then these fleeting worries are quickly dismissed and the 2% or less price drops are viewed as generous gifts from the high heavens to wholeheartedly hop back aboard the unstoppable Momentum Express. Additionally, when the money is flowing in regularly, such as it is now with record equity ETF inflows, managers are tempted to hold less cash than usual as they anticipate an endless stream of incoming funds that will immediately be put to work, not to mention the ongoing widespread underperformance of active managers leaving them in a frenzied high-beta buying panic driven by a "better late than never" mentality towards risk-justification. "Buy any pullback"[1] has also become a more commonly used phrase in the titles of research reports and analysts are stretching more into the realm of self-delusion in order to rationalize higher valuations in some of their most cherished names. They're struggling mightily to keep up with the price rises as aggressive 18-month price targets can often be hit two weeks later…tweak operating margins upwards here, roll forward to 2018 estimates there, increase peak multiple, create innovative new valuation metrics, lower your DCF discount rate, and use the word exciting or the phrase "interesting things" more frequently to communicate the upside potential of a cash-burning story stock.

The Consumer Discretionary sector has outperformed the S&P 500 for six years in a row, by an astounding 8.48% annualized per year since 2008, or 10.1% annualized from the start of 2009.[3] The last time a sector outperformed for even five years in a row was Utilities up until the year ended 2008, when it had outperformed by 10.4% annualized over the prior five years. Fast forward five more years and Utilities have cumulatively underperformed by 46.6% since 1/2/2009, or 6.4% per year and are at a ten year low in terms of relative performance to the S&P 500 and are just now forecast to have the worst returns of any sector.[4] Looking at the individual components of the Consumer Discretionary sector, a large fraction have been warning on profits, consistently lowering guidance, and altogether experiencing weakness. The sector is being increasingly led by massive outperformance in just a handful of names including many within the media space such as: CBS, Discovery Communications, Netflix, Scripps Networks, Time Warner, and Viacom. The sheer level of recent outperformance and crowded nature of the industry is enough to give us pause and reason to fish in more out of favor waters.

Massive index-linked ETF inflows continue to embody a meaty tail that is wagging a scraggly equity dog. For example, of the $25.9 billion in net flows in the five trading days prior to 9/18/13, $24 billion went into just four ETFs: SPY, IWM, EEM, GDX.[5] Of the total net inflows into US equities, 100% was attributable to ETFs (thus, money is flowing out of individual stocks). According to UBS reports on their retail client fund flows among the top five investment vehicles of choice for July were SPY, IWM, VTI (Vanguard total stock market ETF) and TSLA.[6]

I would be remiss if I didn't make a quick comment on this as it has continued to be our biggest loser on a both percentage and dollar basis and is still front and center on everyone's mind. Thomas Paine might as well have been speaking about Tesla when he quipped that "Time makes more converts than reason." The longer the stock continues to rise, the more people make the error of circular references and point to it as validation of their perception of the fundamentals and vindication of their beliefs, though as we all know nothing could be further from the truth.

> "I actually think the value of Tesla right now is...the market is being very generous. The valuation we've gotten is more than we have any right to deserve, honestly." - Elon Musk on CNBC, August 22nd, 2013

In the same vein, Netflix's Reed Hastings had a similar statement when he cautioned of his stock price being dominated by "momentum-investor-fueled euphoria." Kudos to Mr. Hastings and Mr. Musk for publicly acknowledging their self-enriching predicaments. Of course, much of it was brought about by their earlier pumping. From an executive's point of view, I'm sure a collapsing stock price can wreak havoc on employee morale as well as employee retirement and stock compensation plans, therefore a bubble in one's stock is an unwelcomed affair. These not-so-subtle warnings for shareholders remind me of the documentary *Kumare: The True Story of a False Prophet*, whereby a young man "impersonates a wise Indian Guru and builds a following in Arizona. At the height of his popularity, [he] must reveal his true identity."[7] After a while to try and temper enthusiasm, Kumare is often stating in plain English that he is not who everyone thinks that he is, albeit with a heavy accent. Finally he changes his appearance and speaks with no accent and reveals himself essentially as a fake and 90% of this followers rejoice with applause and line up to embrace him. Only two people walk out of the room and one poor soul ask afterwards "But you do have psychic abilities though, right?" Even when told flat out, she clung to her beliefs. In much the same way as Kumare's early statements, Musk's warning was brushed off and TSLA's equity value rose the next day (the half-life of the pullback was limited to the after-hours trading session) and went on to add another $4.5 billion more in equity valuation, before now pulling back slightly. If the frequency of warnings picks up, there is no doubt the disciples will dismiss his comments and begin to say that "even he just doesn't get it," such as they did about the Chairman of Toyota Motors with statements like "he doesn't understand cars" or "he doesn't understand the future of industry." Shareholder responses to warnings in 1929 were also very poor.

The mistake in shorting Tesla and a few other momentum driven names has not been in misdiagnosing them as a tremendous bubble, but in inaccurately anticipating the magnitude and especially duration of irrationality inflating them. The problem for a prudent investor or bears is that events in the distant future are as hard to disprove as they are to prove, so logical arguments dissuade very few believers from buying at extreme levels.

Everyone wants to talk about their recent successful speculative episodes. People inevitably get giddy to tell you about how they bought SCTY calls before a pop or day-traded a triple leveraged ETF. I vaguely remember a striking quote from the showman David Blaine that I'll paraphrase. Although I cannot quite remember the context, that is not what's most important: "As a kid I liked to hold my most prized possession out the window of my parent's car as we sped down the highway, seeing just how lightly I could hold onto it without losing it forever." Like Mr. Blaine, some participants in the market are aware that they are tap-dancing on thin ice and perhaps actually enjoy the thrill and sense of danger of losing their personal savings or previous investment gains (easy come, easy go), while others are altogether oblivious to the risks they are taking and to quote GG who likes to quote GG (George Giannukos/Gordon Gekko) they "don't know the difference between livestock and preferred stock." These noise traders are vehemently defending or promoting stocks with impassioned garble that 90% of the time neglects what is most central to any investment decision: valuation. More and more we hear the meme that valuation doesn't matter (10/11/13 WSJ article headline: "In Latest IPOs, Profits Aren't the Point: Two-Thirds of U.S.-Listed Tech Debuts in 2013 Lost Money.") Often the logic precluding this meme is a misplaced anchoring to either extreme historical valuations, e.g. the attitude that "this is nothing compared to 1999", which I was repeatedly told at a recent Venture Capital conference, or an equally unsettling comparison to some irrelevant and overvalued trading or transaction comp. In situations where someone acknowledges valuation of a certain company or market niche as untethered to reality, they often concede to the omniscient Federal Reserve in an attitude that can be summed up as: "Ahhh, no taper, so screw it, why fight the Fed?"

Market participants and all humans in general are so pre-disposed to retain a strong confirmation bias that providing more information usually does zero help bring about change and usually has the opposite of the intended effect. This is indeed one of the greatest negatives of publicly sharing any stock picks or investment ideas—losing the flexibility to change one's mind. Nonetheless, here goes another: we are short shares of TherapeuticsMD, ticker TXMD. TXMD is an oil and gas company that merged with a medical office television programming provider then transitioned into a prenatal vitamin distributor that is now pursuing hormone replacement therapies for women with health problems associated with menopause related hormone deficiencies. The attention trigger for TXMD was the was board-level overlap with another one of our short positions with questionable insider dealings and lack of essential intellectual property, Revolution Lighting Technologies, Inc. (RVLT). In an industry where IP is everything, TXMD's first patent application was met with rejection. For the sake of brevity, we are only going to briefly touch on a few of the technical aspects of TXMD to show the challenges in this market environment and will instead save the comprehensive fundamental short thesis for a report that is forthcoming and will be circulated to Partners separately. TXMD was added to the Russell 2000 and Russell 3000 and has since been added to 18 different ETFs, thus buoyed by substantial amounts what I'll characterize as blind capital. As of mid-October said ETFs own 3,257,326 shares in TXMD, which is 12.8x the trailing 3-month average daily volume.[8] Said another way, if you add up every share that has been traded since TXMD's inclusion into the Russell Indices, ETFs have accounted for 17.0% of all buy orders from July 1st – October 17th. Mutual Funds who are explicitly passive and whose goal it is to mirror the Russell indexes own *at least* another 12.2 million shares. This is another 48+ days of trailing 3-month average daily volume, and cumulatively ~63% of all volume since July 1st. Other mutual funds, mostly biotech related, own another 9.2 million shares, but it's hard to tell if they are active or passive and may have bought in large blocks via the follow-on offerings. Mix together some optimistic initiation reports touting massive end markets from the i-banks who have been book runners in all of the recent follow-on offerings, a "perfect storm of good news"[9], a literal tsunami of passive buying, a low volume market, a high short interest ratio and the outcome is a parabolic stock chart and company that has gone from having "substantial doubt about [its] ability to continue as a going concern"[9] and on the brink to a $777 million diluted market cap. This valuation discounts 0% probability of failure of any of the meager 3-product pipeline that has zero issued patents and a cumulative $7.9 million in R&D expenditures. Imagination is the most powerful faculty of man, as you know, perhaps followed by avarice.

In what could only be described as deft and dissonant logical acrobatics, management teams are traveling around the country on their shareholder's dimes pitching the grandeur and exponential growth of their company's future while simultaneously cashing out of their holdings, in some cases, entirely and without regard to price. In other instances, they've unknowingly purchased first-class tickets to their own flight of fancy, so perhaps either aren't selling as aggressively or never had a meaningful stake to begin with. Managers with a pining for perceived revenue growth at any cost and hype are being handsomely rewarded in the present environment. The deceit or puffery of such managers is generally superficial, therefore the superficial generally fall prey to it. More than ever we must ensure we are properly aligned with managers who act as owners and have a meaningful amount of skin in the game and be willing to bet against those who do not. In the case of TXMD, the insiders unwillingly have their skin pinched in the shares for just a few months longer. They at TXMD have demonstrated their anxiousness to cash out of their holdings, often at below market prices in poorly subscribed equity offerings. I anticipate the pace of no-proceeds equity offerings to pick up substantially. The insiders' big day is coming on December 31st, 2013, when a full 80.6 million shares become available for sale post-lock-up, out of a total 144.96 million shares outstanding. When you boil it down, a stock price is driven by supply/demand and for TXMD the supply has the potential to almost double at the end of this year. The 18 ETFs will certainly increase their weighting in the shares as a result of the increased float, but this may only be in the millions of shares and can be swamped by the 80.6 million coming off of lock-up depending how aggressive insiders will be. Assuming insiders continue to show no price sensitivity in their share sales, can the blind capital mobilize enough folly to continue propping up the stock after the end of 2013? I'm betting no, but then again, I could be wrong.

Within our book of shorts, Insiders have cumulatively cashed out of $252.5 million worth of their company stock just since the end of Q1, versus just $15.8 million of sales by insiders in our long positions. Unfortunately, in the perverse float-adjusted world we live in it is our shorts that will now get rewarded with larger ETF and index weightings. Of our top 10 short positions, TXMD actually is in the lowest number of ETFs by a wide margin at only 18—the average number is actually 39, and the median is 31. The highest is 72. And if the explicitly passive mutual fund ownership ratio relative to ETFs is the same for all holdings as it is for TXMD at around 3.8:1 then you can get a sense of the seemingly bottomless well that is entirely blind capital that short sellers are up against in a market environment with record ETF and equity mutual fund inflows. The average number of ETFs our top ten longs are in is 7. This is skewed higher by one of the larger names (AXL) that is in 31, so the median is just 3. This probably explains a lot of the valuation discrepancies and high beta/low beta disparity between our longs and shorts.

As repeated ad nauseam, we aim to keep a low noise-to-signal ratio by focusing on infrequently issued source documents among a narrow band of companies that we think systematically have higher chances of delivering solid absolute returns. One recent successful long idea came out of an area of increasing focus for us, which is companies that announce they're "exploring strategic alternatives." There are a quite few companies that announce this in one way or another on a weekly, if not daily basis and the impetus is often shareholder activism. This is also often a pre-cursor to other investors' idea of "special situations"—increased buybacks, debt refinancing, Dutch tender offers, divestitures, spin-offs, carve-outs, M&A, etc. To state the overly used hockey strategy turned cliché investment quote by Gretzky, "skate to where the puck will be."

Flow International (FLOW) came onto our radar when the hedge fund Otter Creek Management sent a letter to the Board in late March. We knew Otter Creek had been buying shares in the $3.50-$3.80 range. They were submitting shareholder proposals to eliminate the staggered Board and urged for an auction process of the entire company. After failing to bend to Third Point's desire in 2007 for a quick sale and the stock being down ~50% since then, Otter Creek ended their letter with the following: "We urge the Board of Directors to hire a reputable investment bank with a mandate to explore strategic alternatives including the sale of the company. The environment is receptive. Do not make the same horrendous mistake twice." FLOW subsequently hired UBS to evaluate strategic alternatives on June 7th while simultaneously announcing substantial cost-cutting initiatives. FLOW announced $13 million in annualized identified op-ex cuts to be fully implemented by the end of fiscal 2014 (period ending April 30th, 2014). Suddenly, the company's op-ex in the future could look very different from the past. Looking backwards one saw a slow growth cyclical, FCF neutral business, with sales and marketing expenses up dramatically yet sales flat and share count up over the last few years. The stock certainly did not appear cheap on a trailing nor a "status-quo" basis but now if one were to give management credit for these promised cost cuts, at an enterprise value of ~$175 million at the time we looked in earnest and $17 million in trailing EBITDA the enterprise ratio could go from 10.3x trailing to just over 6.0x forward estimates, assuming slight revenue decline. This aggressive restructuring dynamic made the situation much more appealing in case no bidders emerged. FLOW is a global leader in versatile abrasive waterjet machines used for cleaning (coating removal) and cutting glass, stone, composites or metal. We liked the fact that there was a slight razor/razor blade aspect to the business model. Sell the expensive systems and then sell consumable replacement parts for those machines at decent margins. Unfortunately they face competition for some non-proprietary replacement parts. We also liked the main end markets and geographic exposures: automotive and aerospace, ~54% North America, 20% Europe, 15% Asia, and 11% Other geographies. As FLOW launched a few new product lines and built up inventory, as well as extended more customer credit for high end systems, it obscured what could otherwise be a decent free cash flow generative business, albeit an economically sensitive one. This is all well and good…but it was actually the CEO's opening remarks in the September 9th earnings conference call that really got us interested:

"I will comment briefly on our process for investigating strategic alternatives. We are very pleased with our progress to date, which is tracking well for the timeline we have set for ourselves. **Given the timing of our process, we have delayed our Annual Shareholders' Meeting** to a future date to be determined. Other than that, we are not going to provide further updates or field questions on this topic today."

Bingo. To me, this nuanced statement was the equivalent of Teddy KGB in Rounders eating his Oreos. We thought there were no possible negative reasons they would delay the annual shareholder meeting, but rather there was not likely going to be one because a sale may be imminent. Fortunately the quarterly results were mediocre with a lot of one-time expenses and noise and the stock actually declined slightly after the earnings announcement. It was after this 'tell' that we started buying the shares more actively. A buyout came 16 days later. On September 25th, FLOW announced it had agreed to be acquired by middle market focused private equity firm American Industrial Partners for $4.05 a share in cash, or 11.3x TTM EBITDA. Our average purchase price is $3.52 and although the takeout premium was not what we would have liked, at the current price of $4.01 the trade has returned ~14% and represents well over a triple digit IRR even for the shares we are still holding nearly a month later . With a time-frame of only about three and a half months from the announcement of hiring UBS to evaluate strategic alternatives to the announcement of a sale, FLOW had one of the quicker successful outcomes from exploring strategic alternatives.

Companies can announce they are exploring strategic alternatives for any number of reasons, which can include the fact that the internal management outlook is very poor and they may be quite leveraged and up against a temporal constraint. For example, FLOW announced the strategic review process in conjunction with a negative earnings pre-announcement. One of the great risks of companies announcing they are exploring strategic alternatives, or hyping near term growth prospects, is that they are doing anything they can to buy themselves time. This idea of trying to buy time is captured in the following parable: The sultan of Persia had sentenced two men to death. One of them, knowing how much the sultan loved his stallion, offered to teach the horse how to fly within one year in return for his life. The sultan, fancying himself as the rider of the only flying horse in the world, agreed. The other prisoner looked at the man in disbelief. "You know horses don't fly. What made you come up with a crazy idea like that? You're only postponing the inevitable." "Not so," said the first prisoner, "I have actually given myself four chances for freedom. First, the sultan might die during the year. Second, I might die. Third, the horse might die. Fourth....I might teach the horse how to fly." This is also comparable to Elon Musk telling the world that Tesla will "build every kind of car imaginable." Such a ridiculous and implausible statement cannot be disproven in the near term and allows excitable investors to apply equally farfetched projections to calculate an equity valuation. In this optimistic environment, such statements buys oneself time for the potential manifestation of a scenario slightly resembling one's fabricated lies or others' lowly ideas of success. TXMD represents the quintessential promise of teaching a horse to fly….the ultimate positive reflexive situation, whereby the speculative equity environment has allowed insiders to issue equity and buy themselves time to further line their pockets. This situation is more the norm than the exception. I don't know how the flying horse story turned out, but, alas both the prisoner and the market require a sucker on the other side who is either too trusting and/or naïve, so shame on us.

"Great things are not accomplished by those who yield to trends and fads and popular opinion." – Jack Kerouac.

We realize more than ever we need to be doing things others are not to have a chance at long term success and so we continue focusing on our favorite niches, such as those companies exploring strategic alternatives. An investor must discard the great majority of their work and ideas they've looked at as un-investable. The good news is investing is a game of cumulative knowledge and experience so tidbits picked up along the way are either added or discarded to create a more optimal portfolio management strategy in the future. It takes a lot of volume and digging through the special situations or "event driven" haystack to get to the needles like FLOW, but this strategic alternatives haystack is as good as any to dig through.

Investors are not necessarily overweight equities yet and from our conversations with many large institutions and individuals, they will certainly continue to buy dips aggressively. This likely means they'll continue to add high-beta exposure while increasingly piling into some companies with the worst prospects and shunning defensive, more easily quantifiable stocks. We've remained cautiously positioned with a sub-30% beta-adjusted net exposure yet are continuing to participate in most of the market's advance with solid risk-adjusted returns and low concentration. Seth Klarman said to "learn to relish drawdowns" in your holdings which is akin to the famous TE Lawrence response when asked about putting out matches with his fingertips, "The trick is not minding it hurts." Despite the increasing divergence to the upside between some pockets of the market we have regrettably been short, the good news for our Partners is that this is probably the worst possible low volatility environment for us to operate in. Should the momentum-driven names take any kind of breather, our relative performance could improve nicely from here. We don't mind that the shorting hurts for now. These sorts of setbacks within the fund and life deepen our resolve so long as we remain introspective and flexible in our willingness to evolve and use the sufferings as helpful opportunities for growth and better risk controls. Overtime—hopefully—we'll continue getting better at getting better. Welcome to the new Partners that came in during the third quarter. We can put fresh capital to work confidently as our idea pipeline remains full of situations, both long and short, to profitably invest in. Voss' high-quality and long-term oriented investor base will prove to be a real source of competitive advantage in future volatile times.

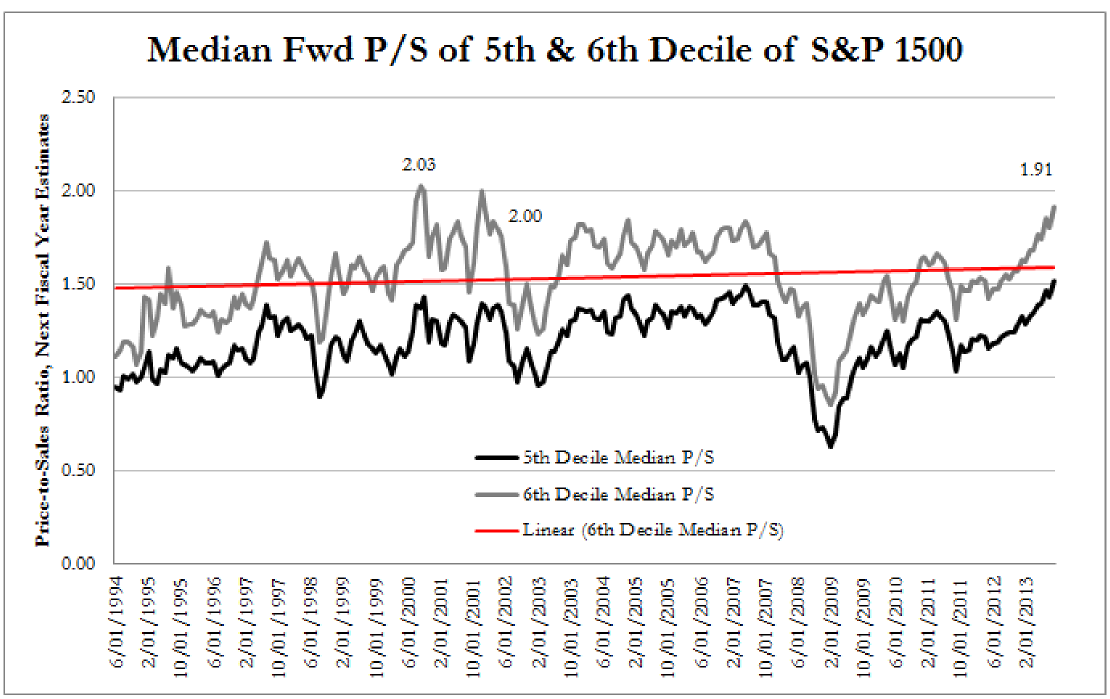
Thank you kindly for your ongoing support and for investing your hard earned capital in Voss as well as for your valuable time in reading our lengthy update. Please reach out if we can be of assistance to you in any way.

Until next time,

Voss Capital, LLC f/k/a Southpaw Capital, LLC

713-328-1126 | www.voss-capital.com

Appendix:



The chart above shows the median P/S ratio for the 5th & 6th most expensive deciles of the S&P 1500 over the last 20 years. The 5th & 6th were selected to show a representative sample of the "middle of the pack." As you can see, the median P/S ratio for these groups of stocks are significantly above the 20 year average; 25-27% higher to be precise, as detailed in the table below. The only time that was marginally higher was the period around late 1999. As shown below, stocks appear to be above average valuations as judged by median forward P/E, forward EV/EBITDA, and forward P/S. They only appear normal on a trailing earnings basis. They can certainly go higher, a la 1999, and that is the false anchoring to an overvalued era that I mentioned in the body of the letter above. In fact, the median P/S ratio only needs to rise by ~6.5% to surpass the previous peak. The 10th (most expensive) decile is the only decile that is not already at or near a new peak as the most expensive stocks during the TMT bubble are such an outlier. On a forward P/E basis, it is the most expensive and least expensive deciles that are farthest above their historical averages. The forward P/S ratio of the cheapest decile is the most above its historical average. This will be slightly skewed from high and implied high net margins. Simply put though, there are fewer and fewer cheap stocks that appear when measured against their own historical standards. The Russell 2000 data would likely look much worse, but was harder to come by. Valuation should be driven by growth, returns on capital and the cost of capital. As articulated across all financial media the low cost of debt is certainly skewing things. There are always cheap and always expensive stocks. You can get a sense of this by looking at the 1st decile versus the 10th decile in each valuation category, e.g. cheap EV/EBITDA decile over last 20 years has average 4.3x while the most expensive has averaged 21.7x. By and large, the market as a whole is usually fairly priced within a narrow band, with certain pockets of discrepancies that do not persist for too long that average out to something resembling fair value. It is these discrepancies we attempt to exploit while avoiding making a more generalized overall directional bet. When deviations from intrinsic value occur, they can take years to correct themselves. We are well aware an investor with short positions in certain companies must have sufficient liquidity to maintain the position and sit patiently through possible periods of even greater mis-pricings.

Data is for S&P 1500

Price/Earnings (Next Twelve Month Estimate)	1st Decile	2nd Decile	3rd Decile	4th Decile	5th Decile	6th Decile	7th Decile	8th Decile	9th Decile	10th Decile
Current Median	9.9x	12.2x	13.7x	14.8x	16.0x	17.2x	18.7x	20.9x	25.5x	46.8x
20-Year Average Median	8.6x	10.8x	12.2x	13.4x	14.6x	16.0x	17.8x	20.4x	24.9x	41.3x
Difference %	15.9%	13.4%	12.0%	10.4%	9.8%	7.5%	5.2%	2.5%	2.6%	13.4%

(Positive=More Expensive, Negative=Cheaper)

Price/Earnings (Trailing Twelve Months)	1st Decile	2nd Decile	3rd Decile	4th Decile	5th Decile	6th Decile	7th Decile	8th Decile	9th Decile	10th Decile
Current Median	8.7x	11.7x	14.1x	15.6x	17.3x	19.2x	21.8x	26.0x	35.4x	80.3x
20-Year Average Median	8.8x	12.0x	14.0x	15.7x	17.6x	19.9x	22.8x	27.3x	36.4x	74.3x
Difference %	-1.2%	-2.5%	0.7%	-0.8%	-2.0%	-3.3%	-4.4%	-4.9%	-2.6%	8.1%

EV/EBITDA (FY+1)	1st Decile	2nd Decile	3rd Decile	4th Decile	5th Decile	6th Decile	7th Decile	8th Decile	9th Decile	10th Decile
Current Median By Decile	4.9x	6.4x	7.4x	8.4x	9.2x	10.1x	11.0x	12.1x	14.5x	20.3x
20-Year Average Median by Decile	4.3x	5.7x	6.6x	7.4x	8.1x	9.0x	10.1x	11.6x	14.3x	21.7x
Difference %	14.7%	13.6%	13.0%	14.0%	13.8%	12.1%	9.2%	4.6%	1.7%	-6.7%

Price/Sales (FY+1)	1st Decile	2nd Decile	3rd Decile	4th Decile	5th Decile	6th Decile	7th Decile	8th Decile	9th Decile	10th Decile
Current Median By Decile	0.34x	0.65x	0.92x	1.21x	1.52x	1.91x	2.37x	3.02x	4.15x	7.02x
20-Year Average Median by Decile	0.26x	0.50x	0.72x	0.94x	1.19x	1.53x	1.98x	2.61x	3.59x	6.33x
Difference %	31.1%	30.9%	28.4%	28.7%	26.9%	24.9%	19.6%	15.4%	15.6%	10.9%

(Positive=More Expensive, Negative=Cheaper)

Source: Factset

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