VOSS
CAPITAL

Dear Partners,

In Q3 2017 the Voss Value Fund returned 3.58% to investors net of fees and expenses, compared to a 4.48% total return for the S&P 500 and 5.6% for the Russell 2000. The Fund's total gross exposure stands at 107.2% and the net long exposure is 34.2%.[1] Our top 10 longs have a 60.6% weighting and our top 10 shorts have a gross weighting of -9.26%.

Voss Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE ׀ 2017			
PERIOD	VVF (Net)	VVF (Gross)	S&P 500 TR
JANUARY	0.12%	0.23%	1.90%
FEBRUARY	3.14%	4.01%	3.97%
MARCH	0.38%	0.56%	0.12%
1st QUARTER	3.66%	4.83%	6.07%
APRIL	0.39%	0.57%	1.03%
MAY	-2.01%	-2.41%	1.41%
JUNE	1.50%	1.96%	0.62%
2nd QUARTER	-0.14%	0.07%	3.09%
JULY	0.31%	0.47%	2.06%
AUGUST	0.61%	0.84%	0.31%
SEPTEMBER	2.63%	3.34%	2.06%
3rd QUARTER	3.58%	4.69%	4.48%
OCTOBER			
NOVEMBER			
DECEMBER			
4th QUARTER	0.00%	0.00%	0.00%
YEAR TO DATE	7.22%	9.83%	14.24%

The table below shows the Voss Value Fund's Net Returns compared to some of the relevant indices over various timeframes:

Return Comparison as of September 30th 2017					CAGR		
	1 Month	3 Month	YTD	1-Year	3-Year	5-Year	ITD
Voss	**2.6%**	**3.6%**	**7.2%**	**15.0%**	**17.8%**	**18.0%**	**18.1%**
S&P 500	2.1%	4.5%	14.2%	18.6%	10.8%	14.2%	16.8%
Russell 2000	6.2%	5.7%	10.9%	20.7%	12.2%	13.8%	16.6%
Russell 2000 Growth	5.4%	6.2%	16.8%	21.0%	12.2%	14.3%	16.9%
Russell 2000 Value	7.1%	5.1%	5.7%	20.5%	12.1%	13.3%	16.3%
Credit Suisse L/S Index	0.2%	3.0%	9.8%	9.6%	3.9%	6.9%	7.1%
Credit Suisse HF Index	-0.2%	1.8%	4.7%	5.9%	2.0%	4.2%	4.5%

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.

One driver of the stock market's positive performance lately has been ongoing earnings growth and sales growth that continues to beat expectations in the aggregate. Sales growth in Q3 for the S&P 500 companies was +4.6% (Q2 was +5.1%) and Q3 EPS growth is estimated to be about +8.2%.[2] Revenue is beating expectations by 1.2%, which is the best topline surprise level since Q4 2015, when it was +1.5%.[2] EPS growth for small caps the last two years has been -2.3% (in 2015), +0.3% in 2016, and is estimated to be +2.8% in 2017, followed by an explosion to +20.8% in 2018 (consensus estimates).[2] This seems a rather curious earnings growth inflection point in the 9th year of a bull market and economic expansion and after three years of flat earnings. Just in Q2 of this year, small cap EPS growth was -11%, a far cry from the acceleration to +20% expected.

One reason for continued small cap underperformance has been that, as just pointed out, small caps' earnings growth has lagged large cap earnings growth the last four years, with this year a continuation of that trend. Within small caps, Value stocks have had much worse earnings growth compared to Growth stocks, which is also a contributing factor to Russell 2000 Value Index underperformance (-1.1% earnings growth for 2017 versus 10.3% estimated for the Russell 2000 Growth index constituents).[2]

Small caps have, however, perked up in recent weeks as tax reform optimism has resurfaced and small caps have a higher median tax rate[4], so will likely be greater beneficiaries of reduced corporate tax rates. On a forward P/E valuation basis (albeit with the explosion of earnings growth embedded), small caps are in their 97th percentile since 1979 (with the median in the 100th). For this forward P/E calculation, a full 1/4th of the Russell 2000's market is being excluded due to the companies not having positive earnings (by comparison, just 2% of the S&P 500's market cap comprises companies with negative earnings). For the S&P 500 and larger companies, the median valuation of most standard valuation metrics is in either the 99th or 100th percentile, meaning stocks have never in history been more expensive.[3] Long term, valuation is all that matters. Yet with the short term spanning from a few months to a few years, valuation considerations remain irrelevant and are making value investing appear obsolete.

Unfortunately, the outflow of capital from active small cap strategies continues. Within that, the negative fund flows are more heavily skewed to value oriented strategies. Of note is that valuation as a factor was the best performing in the month of September, but still the worst performing factor in Q3 and YTD.[4] High Net Debt/Market Cap is the best factor for small caps YTD, meaning the most levered companies' stocks are doing best. On a trailing 12-month basis, Price Momentum is the best performing factor.[4] Neither of these factor drivers are providing a tailwind to Voss. Additionally, pairwise correlations among the 50 quantitative factors has fallen to the lowest level since Bank of America began tracking them in 2004. There has been extreme factor differentiation, thus we believe sector selection and factor exposure has been more important than stock picking lately.

Another worrisome development is that small cap leverage is near an all-time high, and at all-time highs if excluding the 2001 recession.[4] The median Net Debt/EBITDA ratio for Russell 2000 stocks is a full 10% higher than the previous all-time peak (including that recession, when the leverage ratio rises quickly because EBITDA drops quickly) in 1999. Leverage for larger companies is also at an all-time high.[4]

When a bear market or stock market correction finally comes to pass, there will be very few places to hide. Some value stocks will be completely washed out (as many are below 2008 level trough valuations now) and outperform in the second half of a bear market, but generally speaking, there is substantial downside to most equities just from valuation multiple mean reversion, which will be exacerbated when combined with all-time high leverage.

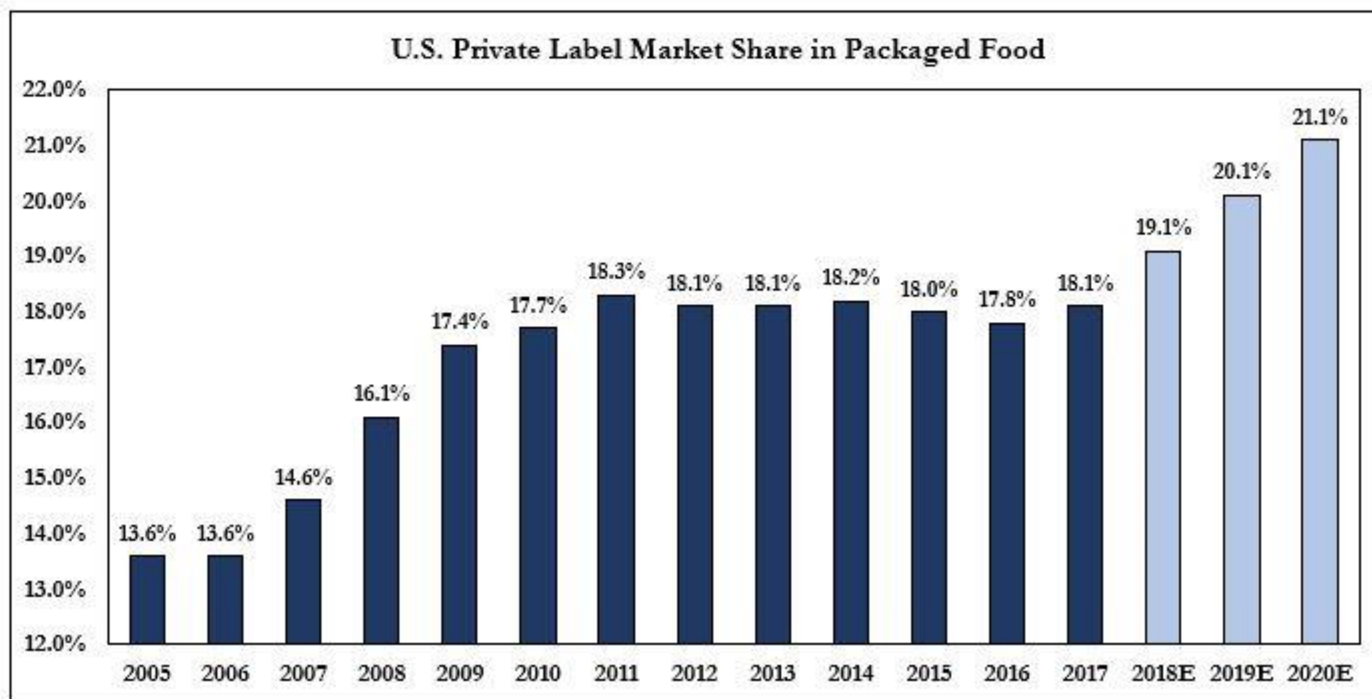
We still like our long exposure to retail REITs, believing their operating performance will continue blowing away overly dour expectations, and their valuations are still languishing at extreme discounts to the ongoing private market transactions that we are monitoring. We still like our regional bank exposure. Our bank basket has upcoming catalysts, ongoing brisk growth at multiples of the overall industry, well above average profitability along with no credit issues,

and a forward P/E multiple of around 10x for the basket. We are still long some of the publicly listed private equity firms that continue to grow consistently and create new investment products that demonstrate strong institutional investor demand.

A successful and ongoing short thesis for us this year has been our bet against food focused consumer product goods (CPG) companies, such as KHC, PF, MDLZ, CPB and others. One of the primary themes underpinning this thesis is the increasing trend whereby food retailers are cutting shelf space for these players and increasingly focusing on their own private label brands.

The grocery industry has been dealing with an unusual non-recessionary period of food deflation, shifts in technology, changing consumer preferences, as well as the rapid expansion of European discounters, Aldi and Lidl. Private label, if done right, can be a lucrative way for a grocer to gain a much-needed edge in this hyper-competitive period for the industry. Private label is usually a better value for the customer, yields significantly higher gross margin for the store (500 - 1,000 basis points higher), and provides grocer-specific brand differentiation that encourages customer loyalty.

Private label market share in grocery has historically averaged around 15%, but has crept up around 17% - 18% since the financial crisis.[6] Despite the overall economic recovery since 2009, the majority of the country hasn't seen their financial situation improve, and people continue to opt for more affordable private label options.



Source: Credit Suisse, Packaged Food Sector Review, May 18th, 2017.

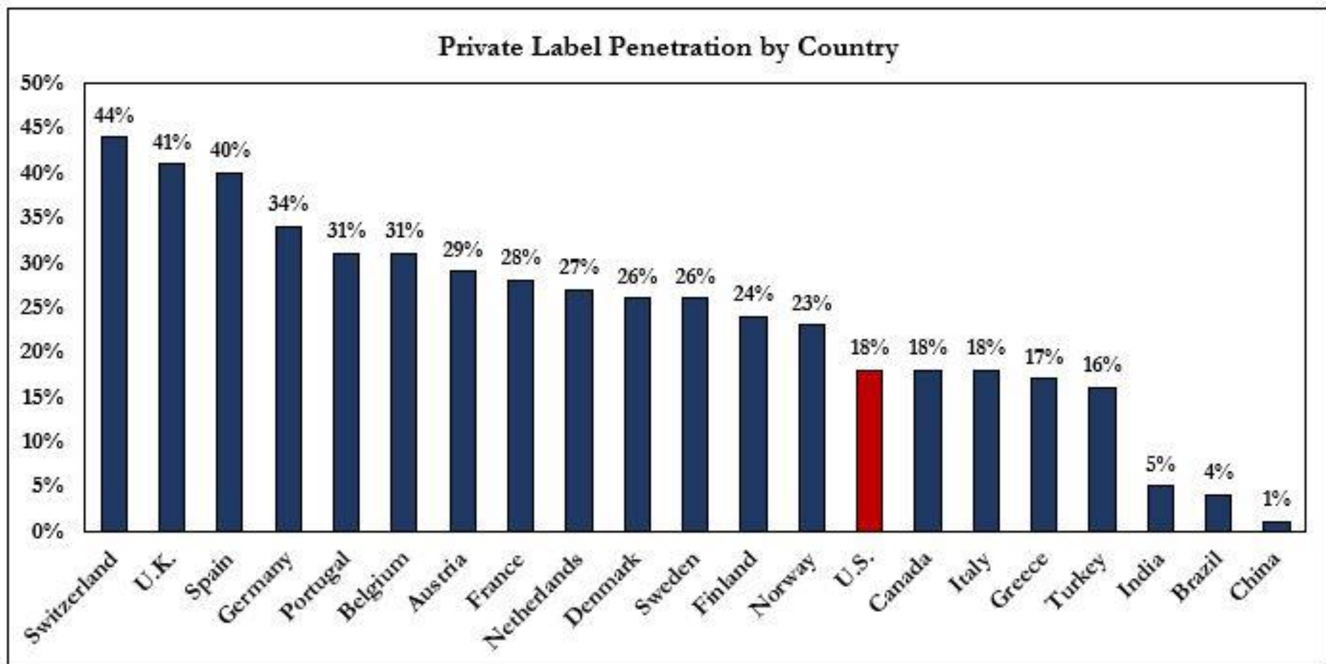
The successful grocers noticed this shift in consumer preferences and improved the breadth and quality of their store offerings with some grocers like Kroger now generating 25%+ of their sales through private label products. These efforts to improve their offerings have helped erase the historical negative stigma of store brands being low quality, and now a younger generation of consumers aren't as loyal to the big CPG brands as previous generations. Many people view their trusted store brands as fresher, less-processed and a better value than the big brand products.

An additional headwind facing the CPG companies is the expansion of Aldi and the entrance of Lidl to the U.S. Both are discount grocers who are dominant in their markets in Europe. Aldi and Lidl stock their shelves with 90%+ private label goods, and together they plan to open 1,700+ U.S. locations over the next five years. This means tens of millions of square feet of grocery space coming online that won't be selling branded CPG products. Amazon is also

pushing their own private label goods and Millenials have shown a spending shift towards buying more prepared meals (e.g. Whole Foods hot bar), both further chipping away at the major CPG firms.

This isn't the first time there have been concerns about CPG companies losing market share to private label. There were similar worries during prior periods of grocer consolidation and when Walmart expanded into food retailing. During these periods, the CPG companies defended their market share by increasing their product innovation and marketing spend. The difference today is that younger generations aren't as swayed by the big brands as their parents and are already accustomed to viewing their stores' brands in a more favorable light, so we believe increasing marketing will only serve to put pressure on the companies' near-record high margins. Furthermore, grocers like H-E-B and Whole Foods are arguably more innovative with their store products than the CPG brands, so that strategy may not be as effective, either.

We look to private label penetration in Europe as a road map of where the U.S. could possibly go. With private label market share of 23% - 44% in most major European countries[6], the U.S. private label market share growth has plenty of runway over the coming years.



Source: Credit Suisse, Packaged Food Sector Review, May 18th, 2017.

As private label market share grows due to the reasons mentioned above, the demand for CPG products is lessened at the margin, and we don't believe these factors are properly priced into these negative growth, secularly challenged CPG stocks, many of which are still trading near peak valuations. Combined with peak leverage, their equities still have substantial downside as earnings could be continuously revised lower over the next few quarters and years. With extreme trading liquidity, low short interest (typically 1-2%) and low beta, this is a basket of shorts we are comfortable with in size, along with a basket of puts due to record low implied volatility and cheap options.

We believe the market continues to be characterized by an "ignorance of ignorance," which Alfred North Whitehead said is the death of knowledge and so we do not expect a big bull market like this one to end in any rational fashion. Manias and tidal waves of lopsided mass sentiment have a tendency to sweep across markets at any time. Historically speaking, they are the norm, the standard, the rule—not the exception. Most evidence (and consensus) points to rampant speculation continuing to escalate to alarming and historic proportions. The extreme outlier of the 1999

bubble era is still the benchmark of choice of investors everywhere when comparing and sizing up the countless present absurdities. Knowing when not to bet heavily is important for capital preservation and compounding longer term. At present, we continue to temper our bets. We do, however, have a backlog of short ideas we have teed up on stocks that we believe have practically zero fundamental downside protection. We stand ready to "gross up" exposure to these ideas and increase position sizes once we believe their price momentum and relentless positive fund flows subside.

In the early 1970s when Chairman Mao[5] was once asked to comment on the significance of the French Revolution (an event from the 1790s), he reportedly stated that it was "too soon to tell." While this is extreme (and likely apocryphal)[5], in most aspects of life and especially equity investing, it is advisable to take the long view. The patterns, cycles and subsequent narratives that will be ascribed to them take a long time to play themselves out. In the short run, anything can happen in the markets. In the long run, the market demands the utmost in realism, and our current excesses should be corrected.

Everything in the market conspires to push investors to the path of least resistance—into the middle of the herd and into complacency. For now, we aim to practice continuous critical reflection to avoid such complacency and control what we can—a repeatable investment process that consists of the disciplined application of timeless value investing principles. It is not necessary to do anything more extraordinary than that to achieve extraordinary results over the long term.

Sincerely,

Voss

Footnotes:

1: Estimate of Total Gross Exposure and Beta-adjusted net exposure for Voss Value Fund, LP as of 11/2/2017.
2: Source: Credit Suisse: US Equity Strategy, Earnings Brief, October 19th, 2017.
3: Source: Goldman Sachs Equity Strategy report, October 17th, 2017.
4: Source: Bank of America Merrill Lynch Small/Mid Cap Chart Book from October 17th 2017 ("Living on a Tax Reform Prayer")
5: Or was it Zhou Enlai, Prime Minister of Maoist China? https://stockerb.wordpress.com/2011/06/11/myth-busting-mao-and-the-french-revolution-with-reference-to-quentin-tarantino/
6: Source of charts: Credit Suisse, Packaged Foods Sector Review, May 18th, 2017.

Disclosures and Notices:

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Indexes are unmanaged and have no fees or expenses. An investment cannot be made directly in an index. The Fund consists of securities which vary significantly from those in the benchmark indexes listed below. Accordingly, comparing results shown to those of such indexes may be of limited use.

The S&P 500 Total Return Index is a market cap weighted index of 500 widely held stocks often used as a proxy for the overall U.S. equity market.

The Russell 2000 index is an index measuring the performance approximately 2,000 small-cap companies in the Russell 3000 Index. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.

The Russell 2000 Growth Index measures the performance of those Russell 2000 companies with higher price/book ratios and higher predicted and historical growth rates.

The Russell 2000 Value Index measures the performance of the small-cap value segment of the U.S. equity universe. It includes those Russell 2000 companies with lower price-to-book ratios and lower expected and historical growth values.

Using only liquid securities, the Credit Suisse Long/Short Liquid Index seeks to reflect the return of hedge funds as represented by the Long/Short Equity sector of the Credit Suisse Hedge Fund Index.

The Credit Suisse Hedge Fund Index is compiled by Credit Suisse Hedge Index LLC. It is an asset-weighted hedge fund index and includes only funds, as opposed to separate accounts. The index uses the Credit Suisse Hedge Fund Database, which tracks approximately 9,000 funds and consists only of funds with a minimum of US $50 million under management, a 12-month track record, and audited financial statements.

Past performance does not guarantee future results.