VOSS CAPITAL

VOSS VALUE FUND, LP

INVESTOR LETTER

Q4 2018

Dear Partners,

In Q4 2018 the Voss Value Fund, LP returned -8.6% to investors net of fees and expenses, compared to a -20.2% total return for the Russell 2000 and a -13.5% total return for the S&P 500. The Fund's total gross exposure stands at 135.7% and the beta-adjusted net long exposure is 57.4%. Our top 10 longs have a 61.1% weighting and our top 10 shorts have a gross weight of -16.8%.

Voss Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE | 2018				
PERIOD	**VVF (Net)**	**VVF (Gross)**	**Russell 2000 TR**	**S&P 500 TR**
JANUARY	0.61%	0.85%	2.61%	5.73%
FEBRUARY	1.49%	1.94%	-3.87%	-3.69%
MARCH	1.84%	2.37%	1.29%	-2.54%
1st QUARTER	**3.99%**	**5.25%**	**-0.08%**	**-0.76%**
APRIL	0.67%	0.91%	0.86%	0.38%
MAY	3.40%	4.28%	6.07%	2.41%
JUNE	5.90%	7.32%	0.72%	0.62%
2nd QUARTER	**10.22%**	**12.93%**	**7.75%**	**3.43%**
JULY	3.48%	4.31%	1.74%	3.72%
AUGUST	6.45%	7.84%	4.31%	3.26%
SEPTEMBER	-0.93%	-1.03%	-2.41%	0.57%
3rd QUARTER	**9.13%**	**11.33%**	**3.58%**	**7.71%**
OCTOBER	-4.92%	-5.78%	-10.86%	-6.84%
NOVEMBER	-1.16%	-1.31%	1.59%	2.04%
DECEMBER	-2.70%	-3.17%	-11.88%	-9.03%
4th QUARTER	**-8.57%**	**-9.96%**	**-20.20%**	**-13.52%**
YEAR TO DATE	**14.38%**	**19.15%**	**-11.01%**	**-4.38%**

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

Net Return Comparison as of December 31st, 2018							
					Compound Annual Growth Rate		
	1 Month	**3 Month**	**YTD**	**1-Year**	**3-Year**	**5-Year**	**ITD**
Voss Value Fund, LP	**-2.7%**	**-8.6%**	**14.4%**	**14.4%**	**16.4%**	**13.2%**	**16.7%**
S&P 500	-9.0%	-13.5%	-4.4%	-4.4%	9.3%	8.5%	14.0%
Russell 2000	-11.9%	-20.2%	-11.0%	-11.0%	7.4%	4.4%	12.3%
Russell 2000 Growth	-11.7%	-21.7%	-9.3%	-9.3%	7.2%	5.1%	13.0%
Russell 2000 Value	-12.1%	-18.7%	-12.9%	-12.9%	7.4%	3.6%	11.5%
HFRX Equity Hedge Index	-4.2%	-8.6%	-9.4%	-9.4%	-0.1%	-0.2%	1.8%

All 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. While performance results might be shown as compared to various benchmarks or indices, there is no guarantee that the strategy behind the performance results is similar or fully comparable to that of the benchmarks or indices listed. Please contact Kelli Walter, COO of Voss Capital, LLC, with any inquiries.

The sell-off late in 2018 was brutal and broad based. Political chaos undermined fragile sentiment. Those overseeing hedge fund redemptions, liquidations and retail funds withdrawals prioritized speed of egress over price of execution that coincided with a liquidity collapse at year end. 57% of the S&P 500 constituents ended the year down more than 20% from their high.[1] The S&P 500 had its first negative total return year out of the last ten years at -4.4%. Equal weighted indices, such as the Value Line Index performed even worse at -15.9%. Nine of the 11 GICS sectors had negative returns for the year with only Healthcare (+4.7%) and Utilities (+0.5%) eking out gains.

The carnage in small caps was even worse with the Russell 2000 down 11% for the year with a peak-to-trough drawdown of 27.2%, the majority of these losses coming during the fourth quarter. Size and value were two of the worst performing attributes in 2018. Within the Russell 2000 universe, the largest market cap stocks outperformed the smallest ones, and of the 52 strategies Bank of America classifies, "High Forward Earnings Yield" was the second worst performer in 2018 at -18.7%. In other words, buying the cheapest stocks was the second worst possible strategy last year. Despite these factor headwinds, we outperformed the Russell 2000 index by 25.4% on a net basis and outperformed the HFRI Equity Hedge Fund Index by 23.8%.

Q4, and December in particular, witnessed massive retail fund outflows which has historically been a great contrarian indicator. Mutual fund outflows as a percentage of total assets in the month of December hit extremes only witnessed in three other months since 1992: September 2001, July 2002 and October 2008.[3] However, it wasn't just retail investors, 2018 also ended with record low hedge fund net exposure.

We believe the quick bear market (market briefly crossing the -20% threshold from its peak) that occurred in Q4 was mostly sentiment driven. There was panic of a global growth slowdown with earnings expectations reset lower, but no *new* major negative fundamental developments. Most of the boogey men dominating the psyche of investors are rehashes of old worries and they are simply chewing of the same cud over and over. These include debt/deficits, tariffs escalating to full blown trade war, Brexit, interest rates, Chinese economic slow-down, Italian budget issues, etc. We are also seeing large worries over small negatives, which is ultimately bullish. We've seen presentations from some bearish strategists citing things such as high youth unemployment in Italy as a reason to sell US stocks.[2] While the numbers thrown around do sound sensational, Italy is just ~1.7% of global GDP. Japan is 3.9x larger than Italy in terms of global share of economic output, undergoing a recession in both 2011 and 2014 that did not drag the rest of world down. As stocks decline it is common to start searching far and wide for reasons that may explain *why* and December's collapse is no different.

Overall, we believe there is actually underappreciated economic strength. Everywhere we look there seems to be major confusion between decelerating growth rates and outright contraction across many measures of economic activity. The ISM's Manufacturing PMIs (surveys) still show growth and expansion in December. Manufacturing, however, comprises only ~11.5% of the US economy while the services sector is much larger at ~78% and the ISM non-manufacturing PMI in December showed that 15 out of 16 industries are still expanding. More importantly, the new orders index within the PMI showed a strong uptick in December, pointing to strong future growth. However, the PMIs indicate only the breadth of growth, not the magnitude. They are simply a binary measure via a survey. A much better gauge is the Leading Economic Indicators Index, which is high and rising in the US, also signaling continued economic expansion in the near term.

Another concern has been the yield curve. Even if the yield curve spread in the US inverts, it doesn't spell the immediate end of stock's bullish run as it takes many months and quarters to cycle through and slow bank loan growth. For now, on a global GDP weighted basis, the yield curve spread remains nicely positive and loan growth remains a healthy +6% y/y*, which is just about the same growth seen during this entire expansionary cycle. Furthermore, the US yield curve spread (the US 10-year minus 3-month treasuries) has widened quite a bit to start 2019.

The S&P 500 correction of ~20% matches the historical drawdown of a recession-linked bear market that occurs within a secular bull market.[4] Equites have essentially already priced in a mild recession within the next year. Cyclical stocks have massively de-rated with many getting close to or below trough multiples from previous cycle lows. There could be a

recession and many of the housing/auto related stocks could still rally as any economic slowdown has been pre-priced and widely expected for a long time.

The swiftness and magnitude of market turbulence during the quarter provided a great opportunity to test and expand our threshold for psychological discomfort. We should not be surprised to be surprised again, and again, in the future as many more such battles await us. Market conditions will not always be calm or reasonable, nor will they always be best suited for our investment style. In a perverse sense, the more adverse the environment, the better it will be for us in the long term provided we remain clearheaded and use the short-term panic and chaos to optimize and rebalance the portfolio. While our ideas and portfolio will constantly evolve, our approach will remain rooted in the consistent application of timeless value investing principles. The recent flare up in volatility and chaos under the covers of the market has provided the best stock picking environment we've seen in some time.

Portfolio

We came into the quarter overweight financials which hurt our performance in Q4 due to large positions in regional banks and alternative asset managers. Despite being overweight, we took advantage of the acute panic and sentiment extreme in financials to add a few new names. One is a leading global investment banking franchise that is growing at a high-teens rate with a mid-teens ROE. We established at 4% position at 0.8x tangible book and 6x 2019 EPS estimates. With an explosion of corporate actions being announced lately we think the pipeline of investment banking activity is strong and underappreciated. We look to trim or exit in the 1.1-1.25x price/tangible book range, providing upside of up to 25% (and 50% from cost). We bought another second-tier investment bank at less than half of tangible book value per share and will look to exit closer to tangible book value at prices ~80% higher.

We have maintained our long retail REIT positions that have a collective portfolio weighting of 9%. They're putting up terrific fundamental numbers and continue to trade at substantial discounts to private market liquidation value while steadily growing and proactively creating value. Our base case price targets based on conservative implied cap rates give these stocks a total return upside of 60-70% over the next 12 months.

Levered stocks were hit particularly hard in the market correction, rightly so in most cases, but not so in others. We quickly looked for levered software names that had massively de-rated yet have high recurring revenue and stable cash flow and therefore can easily manage their debt. We purchased SSNC once again in the low $40s at 12x earnings and a 12% discount to the S&P 500's earnings multiple. This was the cheapest SSNC had ever been on a relative basis (it has averaged a >20% premium to the S&P 500) and was happening in conjunction with large upwards earnings revisions for 2019 and 2020. SSNC is one of the best businesses we are aware of with one of the greatest management teams of all time. We believe that at a bare minimum SSNC should trade in-line with the S&P 500 on an earnings basis given its superior financial profile and long track record of deleveraging. Shares have upside to $60+ at just 15x our 2020 EPS estimate representing 50% upside. If SSNC returns to its historical premium of ~20% over the S&P 500, shares would be $90.

We also purchased CDK during the quarter, an auto dealer software provider. This is a business we are intimately familiar with as Jon is on the board at one of their smaller competitors and we have followed it for years. Our cost basis is $47 and we think shares should be worth at least $65 with a re-rating to an S&P 500 equivalent earnings multiple (+38%).

We bought Dave & Buster's (PLAY) again around $43/share or less than 9x our EBITDA minus maintenance capital expenditures estimate, a historically cheap multiple for a highly profitable and unique restaurant concept that has a long runway for store growth with greater than 60% year-one ROIC on new store builds. There is 55% - 70% upside to our target of 10x – 11x estimated 2019 EBITDA.

Finally, we added a few biotech stocks that traded close to their net cash positions and have upside asymmetry, multi-bagger potential, and near term catalysts.

While we are already off to a good start in 2019, the portfolio's embedded return prospects are even stronger as we are not currently firing on all cylinders. Our second and third largest positions in the portfolio are trading within a few percent of our bear case valuation targets and both are down to start the year. We think both companies will be put up for sale in 2H 2019.

The market's rebound so far (+16.3% in the Russell 2000 as of 1/25/2019 from the December 24th, 2018 bottom) feels as if it has been concentrated into high-flying money losers and stable non-cyclicals. With many of these cash burning "high fliers" up 30-80% off the bottom in just the last four weeks and some back to all-time highs we are once again provided with attractive shorting opportunities. Investors have also continued to crowd into non-cyclicals due to their perceived "safe haven" nature. We however believe it is these non-cyclicals, including Consumer Staples, Healthcare, and Utilities where the real froth and bubble valuations in the markets reside. Many companies within these sectors are at all-time-high valuations, both relative to the S&P 500 and in absolute terms, despite higher than historical leverage, limited-to-no organic growth and numerous secular headwinds. If the market resumes an uptrend, we believe these "safe havens" will underperform and money will rotate out of them and back into cyclicals. However, if the market tanks once again and we enter a prolonged recession-driven bear market, there is a high likelihood that the names we've shorted will "catch down" to the market, just as they have in all the past bear markets that we've studied. In summary, investors continue to overpay for unprofitable growth as well as growthless profits and these are the main themes or areas we are looking to exploit on the short side.

Outlook

Back in April of 1985, well into an economic expansion that began in November 1982, economic forecasters were polled as to when they expected the next recession to begin. The average response was 20 months from then, which would have put the peak of the expansion in December 1986. This turned out to be over three and half years before the cycle actually ended. Even the most optimistic forecaster at that time picked Spring 1988 as the latest date for the start of the next recession. In reality, the next recession would not start until July 1990. Furthermore, after the October 1987 stock market crash economists reduced their GDP growth estimates for 1988 from 2.8% to 1.9%, the largest one month drop in the history of the survey at the time. The economy grew strongly despite the market collapse and GDP growth was actually a robust 4.2% in 1988. On the eve of a worldwide recession in May 1990 the senior economic editor of the New York Times wrote an article titled "Is There Really a Business Cycle?" By that time, *no* economist was forecasting recession before 1992. Fast forward to September 2001 (just before 9/11 attacks) and only 13% of polled economist believed the US was in a recession, when in fact the NBER subsequently indicated that a US recession had begun six months earlier. All of this is to hammer home the point that economists have always been unable to call turning points in the business cycle, so now is unlikely to be any different and we do not try.

There is a Chinese fable called The Old Man and His Horse. In it, an old man is poor but owns a prized white horse that he refuses to sell. One day when it is discovered that the horse is not in its stable, the man's neighbors rush to judgment and tell him how dumb he is and how he is now poorer than ever. The old man responded, "Don't speak too quickly. Say only that the horse is not in the stable. That is all we know; the rest is judgment."

Two weeks later, the horse returns and brings with him a dozen wild horses. The villagers gather around and exclaim: "Old man, you were right and we were wrong. What we thought was a curse was a blessing. Please forgive us." The old man responded, "Once again, you go too far. Say only that the horse is back. State only that a dozen horses returned with him, but do not judge. How do you know if this is a blessing or not? You see only a fragment."

The old man's son begins to break the wild horses. After a few days, he falls from one of the horses and breaks his legs. The villagers again criticize the old man and again the old man tells them, "do not judge". A few weeks later the country goes to war and all the young men in the village are required to join the army, all accept the old man's son who was excluded

due to his injuries. One by one the series of seemingly negative or positive events or circumstances happening to the old man later flip to seem like a sudden reversal of fortune.

While unpleasant in the moment and disappointing to have given back some of our earlier gains, perhaps the 20% market drawdown was a net positive for Partners in the long run as we were able to put our cash to work by buying cheap, high-quality stocks with significant upside potential. Perhaps January's rally to start the year is only a head fake in a longer-term bear market and we should be reducing our net exposure. We cannot know for sure. We try not to rush to judgment and stay open to changing our minds. The market, like life, is a long game requiring mental grit. It comes in fragments and has its highs and lows. All we do know is that we will continue to take the same steady and contemplative approach by applying tried-and-true value investing principles in a creative, consistent and disciplined manner.

To Continued Alpha,

Voss Team

Citations:

1: Source: BofA US Equity & Quant Strategy report
2: Source: Societe Generale's Annual Investment Conference, January 15th, 2019 presentation by strategist Albert Edwards
3: FactSet and Thomson Reuters, as of 1/10/2018. Monthly ICI Equity Mutual Fund Net New Cash Flows and Monthly ICI Equity Mutual Fund Total Asset Values, 12/31/1991 – 11/30/2018; December 2018 net flows calculated using weekly ICI Equity Mutual Fund Net New Cash Flow estimates through 12/28/2018.
4: Source: Bank of America Merrill Lynch Global Research, Bloomberg, NBER

Appendix:

GDP Weighted Global Loan Growth*:

Source: Fisher Investments

Additionally, total loan growth just in the US was 8.9% in December, showing a sharp acceleration in growth. Source: Federal Reserve.

The Old Man and his Horse (a.k.a. Sai Weng Shi Ma)

Once there was an old man who lived in a tiny village. Although poor, he was envied by all, for he owned a beautiful white horse. Even the king coveted his treasure. A horse like this had never been seen before — such was its splendor, its majesty, its strength.

People offered fabulous prices for the steed, but the old man always refused. "This horse is not a horse to me," he would tell them. "It is a person. How could you sell a person? He is a friend, not a possession. How could you sell a friend." The man was poor and the temptation was great. But he never sold the horse.

One morning he found that the horse was not in his stable. All the village came to see him. "You old fool," they scoffed, "we told you that someone would steal your horse. We warned you that you would be robbed. You are so poor. How could you ever protect such a valuable animal? It would have been better to have sold him. You could have gotten whatever price you wanted. No amount would have been too high. Now the horse is gone and you've been cursed with misfortune."

The old man responded, “Don’t speak too quickly. Say only that the horse is not in the stable. That is all we know; the rest is judgment. If I’ve been cursed or not, how can you know? How can you judge?”

The people contested, “Don’t make us out to be fools! We may not be philosophers, but great philosophy is not needed. The simple fact that your horse is gone is a curse.”

The old man spoke again. “All I know is that the stable is empty, and the horse is gone. The rest I don’t know. Whether it be a curse or a blessing, I can’t say. All we can see is a fragment. Who can say what will come next?”

The people of the village laughed. They thought that the man was crazy. They had always thought he was a fool; if he wasn’t, he would have sold the horse and lived off the money. But instead, he was a poor woodcutter, and old man still cutting firewood and dragging it out of the forest and selling it. He lived hand to mouth in the misery of poverty. Now he had proven that he was, indeed, a fool.

After fifteen days, the horse returned. He hadn’t been stolen; he had run away into the forest. Not only had he returned, he had brought a dozen wild horses with him. Once again, the village people gathered around the woodcutter and spoke. “Old man, you were right and we were wrong. What we thought was a curse was a blessing. Please forgive us.”

The man responded, “Once again, you go too far. Say only that the horse is back. State only that a dozen horses returned with him, but don’t judge. How do you know if this is a blessing or not? You see only a fragment. Unless you know the whole story, how can you judge? You read only one page of a book. Can you judge the whole book? You read only one word of one phrase. Can you understand the entire phrase?”

“Life is so vast, yet you judge all of life with one page or one word. All you have is one fragment! Don’t say that this is a blessing. No one knows. I am content with what I know. I am not perturbed by what I don’t.”

“Maybe the old man is right,” they said to one another. So they said little. But down deep, they knew he was wrong. They knew it was a blessing. Twelve wild horses had returned. With a little work, the animals could be broken and trained and sold for much money.

The old man had a son, an only son. The young man began to break the wild horses. After a few days, he fell from one of the horses and broke both legs. Once again the villagers gathered around the old man and cast their judgments.

“You were right,” they said. “You proved you were right. The dozen horses were not a blessing. They were a curse. Your only son has broken both his legs, and now in your old age you have no one to help you. Now you are poorer than ever.”

The old man spoke again. “You people are obsessed with judging. Don’t go so far. Say only that my son broke his legs. Who knows if it is a blessing or a curse? No one knows. We only have a fragment. Life comes in fragments.”

It so happened that a few weeks later the country engaged in war against a neighboring country. All the young men of the village were required to join the army. Only the son of the old man was excluded, because he was injured. Once again the people gathered around the old man, crying and screaming because their sons had been taken. There was little chance that they would return. The enemy was strong, and the war would be a losing struggle. They would never see their sons again.

“You were right, old man,” They wept. “God knows you were right. This proves it. Your son’s accident was a blessing. His legs may be broken, but at least he is with you. Our sons are gone forever.”

The old man spoke again. “It is impossible to talk with you. You always draw conclusions. No one knows. Say only this. Your sons had to go to war, and mine did not. No one knows if it is a blessing or a curse. No one is wise enough to know. Only God knows.”

Disclosures and Notices:

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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.