



# BARAC CAPITAL MANAGEMENT, LLC

April 2, 2013

Dear All,

This is the first of regular quarterly reports to provide updates on the Fund's performance. Our fund administrator, Fund Associates, LLC, is also generating monthly investment reports for each Partner, by directly and independently accessing the Funds electronic brokerage data.

For the three months ending March 31, 2013, The Barac Value Fund L.P. (the "Fund" or "Partnership") delivered returns of 7.74% (after deducting fees and expenses) versus a return of 6.24% for the benchmark, resulting in relative outperformance of approximately 150 basis points or 1.50%. Since the Partnership's inception (on July 14, 2011), the Fund has returned 20.54% (after deducting fees and expenses) versus 17.79% for the benchmark, resulting in relative outperformance of approximately 275 basis points or 2.75%.

	Barac Value Fund		60% S&P TR/ 40% Barclay's Agg.
	Gross %	Net %	
2011*	(4.43)	(5.08)	(0.39)
2012	19.69	17.87	11.31
Q1 2013	8.16	7.74	6.24
Cumulative:	23.72	20.54	17.79
Annualized:	13.20	11.50	10.01

\*2011 Performance is July 14th, 2011 to year end 2011

†The results reflect the deduction of: (i) an annual asset management fee of 1.5%, accrued monthly; (ii) transaction fees and other expenses incurred.

**PAST PERFORMANCE IS NO INDICATION OF FUTURE RESULTS.**

While the Fund has performed well since inception, caution must be used when reviewing short-term results and Partners are reminded that the Fund's strategy is very much about investing with a long-term horizon. Over the short-term, the Fund's performance, versus the benchmark, will vary and I hold the most conviction on the robustness of the Fund's investment strategy over the longer-term.

**THIS IS NOT AN OFFERING OR THE SOLICITATION OF AN OFFER TO PURCHASE AN INTEREST IN THE BARAC VALUE FUND, LP (THE "FUND"). ANY SUCH OFFER OR SOLICITATION WILL ONLY BE MADE TO QUALIFIED INVESTORS BY MEANS OF A CONFIDENTIAL PRIVATE PLACEMENT MEMORANDUM AND ONLY IN THOSE JURISDICTIONS WHERE PERMITTED BY LAW.**

## About The Benchmark

As a multi-asset fund whose objective is to seek investment opportunities across different asset classes (e.g. stocks, bonds, etc.), the benchmark used for the Fund is a mix of 60% attributed to the S&P 500 index (including dividends paid) and 40% attributed to the Barclays aggregate bond index. The S&P 500 is a commonly used index of 500 U.S. large capitalization stocks while the Barclays aggregate index is a commonly used index of U.S. high-grade bonds.

The reason for using this specific benchmark is because it is comprised of two very commonly followed indexes for the two major investment classes (stocks and bonds) in the 60%/40% ratio mix, which has been a common allocation ratio recommended for long-term investors. In addition, both of these indexes can be easily purchased through low-fee and highly-liquid index funds, providing an easy alternative for investors. Long-term outperformance versus these indexes is necessary to justify an investment in the Fund and, therefore, this is the yardstick to which the Fund will be compared.

To be clear, the benchmark is chosen only to provide an easy and simplistic comparison to how one's investments might have performed if invested in low-fee index funds allocated in the commonly prescribed mix of 60%/40% (equities/bonds). The Fund does not endorse or make any attempt to follow such an allocation and in periods when I view equities as substantially over-valued, the equity allocation may be much less than 60% and vice-versa. In addition, the Fund will also hold other asset classes, outside the scope of the benchmark, which may include cash, small-cap. equities, foreign equities, and high-yield bonds, among others. Overall, the investment strategy of the Fund is about finding the best value across different asset classes and geographies while sizing positions to best optimize risk/reward.

## What Has Worked So Far

For the first full year of the Partnership (2012) outperformance was particularly strong, with returns exceeding the benchmark by 838 basis points (or 8.38%) on a gross basis and 656 basis points (or 6.56%) after fees. Outperformance for the year was driven by a constructive stance on equities, going into the year, and solid overall security selection. Despite holding substantial cash positions during the year, which were essentially generating no returns (held to provide safety and optionality), the Fund's performance after fees and expenses also outperformed the S&P 500 stock index for 2012 by 187 basis points (1.87%).

Asset allocation (and tending to be more contrarian in nature) is where I believe that the Fund has differed and will differ substantially from traditional mutual funds. For example, under normal times, I would expect that the Fund would have a healthy allocation in fixed-income (and it did have some high-yield bond exposure before they got so expensive and were sold). However, with interest rates and spreads where they are now, there is currently no fixed-income (the "safe" portion of the portfolio is in cash, comprising about 24% of assets under management at the end of the quarter).

By comparison, back in the depths of stock market negativity in the summer of 2011, I added exposure such that cash was only about 6% of assets under management, because I viewed equities as much more attractive at those lower levels. There was also a position in high-yield corporate bonds at that time, when yields were substantially wider (the position has since been sold as I felt that the bonds became too expensive/spreads too tight).

The point of the example is that many multi-asset mutual funds stick closely to rigid asset allocations like 60%/40% (stocks/bonds) and don't dynamically shift allocations too much. I think that's a very important distinction, because identifying bubble and bargain periods for asset classes as a whole, in my experience, has been easier than identifying market inefficiencies in individual securities (although there are plenty of those, too).

I think that the tech bubble in 2000, the housing bubble in 2008, and the Treasury bond bubble today were (or are for bonds) quite obvious, but timing the bursting of the bubbles is impossible and the hard part is having patience (and investors that allow you that patience) to wait them out. There is no doubt that there have been periods since the Fund's inception when it would have been more lucrative to hold bonds over cash; however, I still feel strongly that our avoidance of this asset class was and is the right decision.

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## **The Forward View**

Given extraordinarily low interest rates for bonds, I have a high conviction that bonds are going to provide weak long-term returns from these levels and current risk/reward for the asset class is poor. Furthermore, with 10 year Treasuries only yielding about 1.85% the opportunity cost of sitting on the sidelines is limited (particularly when considering the potential that a 25 basis point interest rate increase can produce capital losses that basically wipe out a full year of interest).

All that said, I would not translate this currently bearish view on fixed-income into taking a position of 100% equities for the Partnership. As such, the Fund held a sizeable cash position, comprising about 24% of assets under management, at the end of the quarter. Apart from providing a diversification cushion and helping to reduce volatility, the Fund's cash position also provides option value and can be put to work in the event of a subsequent pull-back in the equity market or a substantial increase in bond yields (such that the fixed-income asset class becomes attractive again).

With respect to equities, I remain constructive and continue to believe that they provide the best long-term value relative to fixed-income. I believe that earnings multiples remain reasonable, relative to growth prospects, and I think it's hard to say we are near a cyclical peak (as some have said) only 5 years into a recovery from one of the greatest financial crises since the great depression. I also see value across a number of equity sub-sectors (domestic large cap., small-cap., international) although the Fund's equity exposure remains primarily in U.S. large capitalization stocks.

While I remain positive on the long-term prospects for equities, I am also cautious of the potential for a temporary pull-back, given the substantial run that stocks have had and the number of macro-economic and geopolitical risks that could scare investors into a temporary sell-off at any given time. In addition, I believe that a degree of asset diversification is always prudent and for that reason (and the other reasons already given) the Fund will continue to hold a substantial cash balance until the market environment materially changes.

With respect to the Fund's equity exposure, the objective of the Fund is to primarily invest in specific companies and not the market as a whole. I look at many potential purchase targets and select only a small percentage of those that meet the criteria of having the best long-term upside potential relative to downside and I try to size these positions in a manner that best optimizes risk/reward. While I remain constructive on the long-term prospect for the equity markets, more broadly, individual stock selection remains of great importance to the Fund's investment strategy.

As someone who has spent most of their career as a high-yield debt analyst whose primary responsibility was to identify corporate risks and examine companies with a skeptical eye, downside risks are always a primary consideration. In addition, the need for some asset diversification is another main investment consideration. In that regard, the Fund held 21 individual stock positions (the largest comprising less than 5% of asset under management) at the end of the quarter with the rest of the Partnership's equity exposure comprised of diversified ETFs.

Thanks to everyone for your interest and support and please let me know if there are any questions that you may have that I have not answered. The next quarterly report will be for the quarter ending June 30, 2013 and the next subscription period for the Fund will be April 30<sup>th</sup>.

Sincerely,

**Ted Barac**  
**Managing Member of Barac Capital Management LLC**

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