Private Client Program

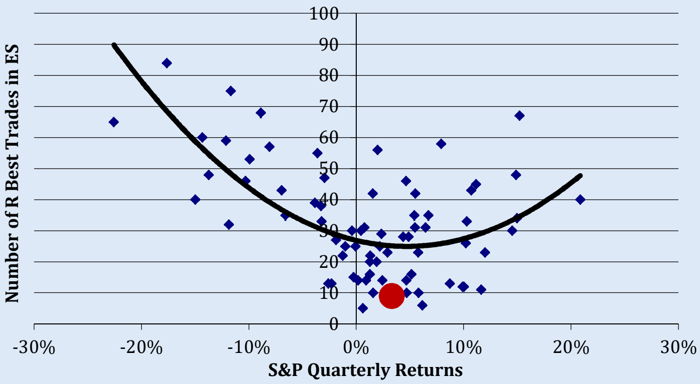
An Intraday Approach

2016 Report 3Q

Following a highly volatile first and second quarter, the third quarter of 2016 was characterized by low volatility and a "risk on" rally. Global stocks rebounded from post-Brexit blues, reversing the losses suffered after British voters approved a referendum in June to leave the European Union. Additionally, major central banks reiterated their commitment to lax monetary policy, strong corporate earnings were released, and generally upbeat economic news persisted. This all contributed to a 4 percent gain in the S&P 500 Composite Index for the quarter, posting a solid increase in July, then moderating a bit in August and September. Typically, positive quarterly equity returns in the low single digits have meant a quiet market with few opportunities for R Best, and last quarter was no exception with the Private Client Program posting a small loss of -0.22%.

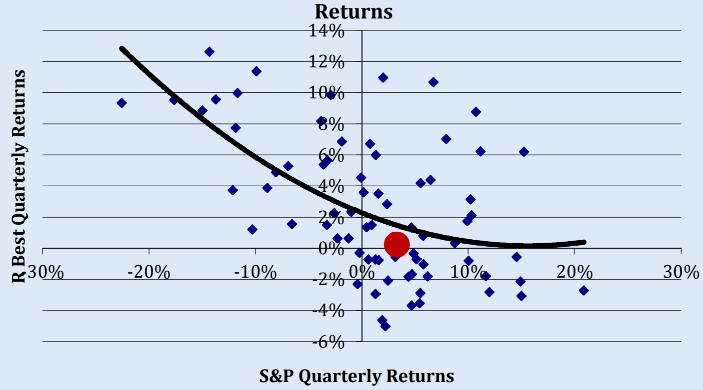
Graph 1 below illustrates the historical relationship between the quarterly returns of the S&P 500 cash index (x axis) and the number of trades executed quarterly by R Best. (y axis).*

Graph 1
S&P Quarterly Returns vs # of R Best E-mini Trades



Graph 2 illustrates the relationship between the quarterly returns of the S&P 500 cash index (x axis) and R Best's historical quarterly returns in the S&P 500 e-mini futures. (y axis)*

Graph 2
S&P Quarterly Returns vs R Best E-mini Quarterly Returns

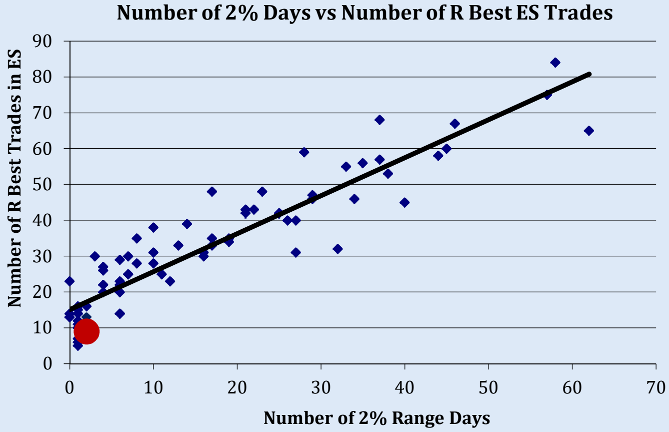


In all graphs, the large red dot represents R Best Private Client's most recent quarter's *actual* activity and performance.

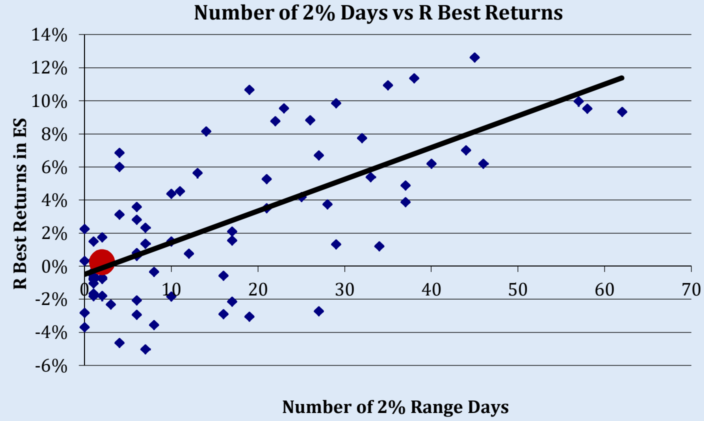
As the graphs show, there is an inverse, nonlinear relationship with quarters where the S&P Index had (a) extreme negative returns, generating the most trades and largest returns for R Best, (b) extreme positive returns, generating a large number of trades but a mixed composite of R Best returns, and (c) moderate returns, generating the fewest trades and lowest returns for R Best.

Another predictor with an even stronger ability to explain our strategies' behavior in the S&P is a simple count of the number of days in a given quarter that the S&P futures had an intraday range in excess of 2 percent. Intuitively, the greater the number of such volatile days, the greater our activity and performance tend to be. Graphs 3 and 4* illustrate the relationship between the volatility in the S&P futures (x axis) and R Best's E-mini activity and performance (y axis).

Graph 3
Number of 2% Days vs Number of R Best ES Trades



Graph 4
Number of 2% Days vs R Best Returns

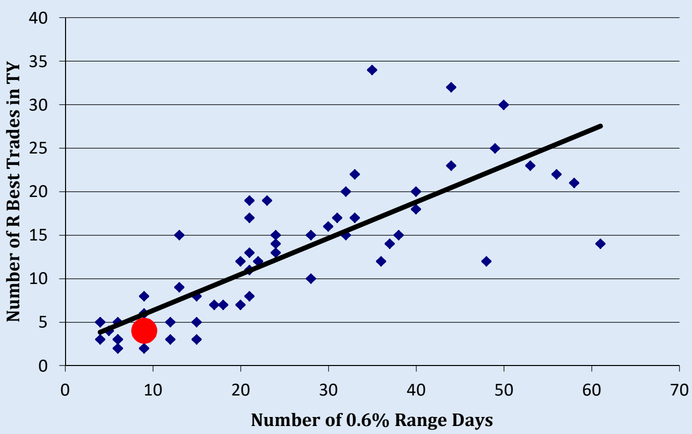


Taken together, these two measures (quarterly returns and number of 2% days) have captured an impressive 85 percent of the quarterly variation in our number of S&P trades and more than 50 percent of the variation in our S&P returns in the past, providing much needed context and a general guideline for where we are today, given the current market environment in stocks.

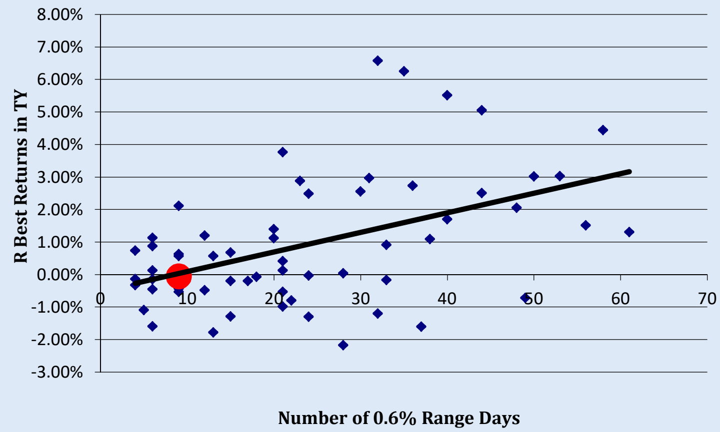
PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS

Similar analysis in the 10-year Treasury reveals the same general tendencies, with a few notable differences; (1) The threshold for a volatile day is much lower than in the S&P (0.60% vs 2%), (2) there is no directional preference, i.e. R Best's returns are not dependent on the general market being up or down, and (3) the strength of the relationships in this market is not quite as strong as it is in the S&P, capturing just 65 percent of the variation in quarterly trading, and 25 percent of the variation in returns.

Graph 5
Number of 0.6% Days vs Number of R Best TY Trades



Graph 6
Number of 0.6% Days vs R Best TY Returns



At R Best, we value transparency and accountability and welcome this opportunity to give our investors the tools with which to evaluate our performance and place it in the proper context. As the above graphs make apparent, our ability to describe the contemporaneous relationships between the markets that we trade and our trading strategies is far from perfect. Our trade selection algorithms make decisions based on a diverse set of inputs, and the markets are influenced by hundreds of external factors not considered in our model, leaving a material amount of variation unaccounted for. However, our goal is not to build a model with a close fit, but rather to introduce clear and simple measures and benchmarks that are relevant to the way we trade. We also strive to set realistic expectations of our results. Given the historical correlations in both markets, Q3 performance and the relative lack of trade opportunity do not look like outliers but are very much in line with expectations. In fact, we view the recent market environment as a continuation of a pattern of mainly quiet markets, with the occasional burst of volatility that began almost 5 years ago. In those less than ideal conditions we have more than held our own by being selective and disciplined in our approach, waiting patiently for the right trades, taking as few as 7-8 in an entire quarter, and being aggressive when the markets were busy generating as many as 80 trades in a quarter. We believe it is that kind of flexibility that is instrumental to capital preservation and long-term results, and we are confident our customers will see the benefit of it as well.

Please feel free to call us with any questions or comments you may have. We value hearing from you.

Note: The graphs shown in this report are based on historical simulations of the current strategies employed by R Best.