TVI® and CPI

Commentary by Victor Sperandeo

April 15, 2013

In this commentary, Victor Sperandeo briefly examines the relationship between the Trader Vic Index® (the TVI®) and the non-seasonally adjusted Consumer Price Index (CPI) over the period from 1985-March 31, 2013. The "official" track record of the TVI® begins in 2009. However, in order to facilitate comparison over a longer period, this study utilizes the "Simulated TVI®" prior to June 3, 2009, which is based on the retrospective application of the Simulated TVI® to past price histories over the entire period. As a result, this commentary makes use of simulated statistical information prior to June 3, 2009, which has inherent limitations. See "Certain Risk Factors & Disclosures" for an explanation of differences between the Simulated TVI® and the official track records of the TVI®, as well as additional important disclosures.

When you examine and compare the attached simulated 12-month rolling period charts of the Simulated TVI®/TVI® TR and the Consumer Price Index (non-seasonally adjusted), one of the first things you will notice is the apparent correlation between the two over the periods indicated. This is especially noticeable when comparing peaks and troughs over such periods: while the Simulated TVI®/TVI® and CPI do not change direction at exactly the same time, they moved in conjunction with each other quite often.

Without further consideration, this might appear to present an expected and obvious relationship. However, you need to remember that the TVI® is not a simple "Long-Only" commodity index, which would be expected to go up as prices rise and drop as prices fall. Instead, the TVI® is a "Long/Short" index of commodities (except the Energy sector which is positioned long or flat but never short), currencies, and debt instruments designed to reflect sustained price trends within those futures components.

With that in mind, you might find the apparently strong correlation over 12-month rolling periods to be puzzling. But further investigation shows, in my view, that the apparent relationship has a logical basis. The TVI® is designed to perform best in environments experiencing sustained price trends over the intermediate term. The duration of price trends in the TVI® markets is strongly influenced by the extent and duration of inflationary periods. Most importantly, these price trends are affected by the ***rate of change*** of inflation, which in-turn influences interest rate movements, and which in-turn reflect themselves in GDP growth. In

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the TVI®, in the absence of such market conditions, the result is "transitions" (*i.e*., the positions of the TVI®'s components changing positions from long to short or flat (or *vice versa*) on a monthly basis. In other words, the TVI® tends to experience smaller gains, or suffer declines, the more transitions that take place (and the smaller the movements between transitions) -- as it was designed to reflect historically sustained price trends within its components.

The fact that futures are forward-looking − as opposed to measurements of CPI, which are lagging price calculations – also demonstrates why the Simulated TVI®/TVI® "led" the CPI in these transitions 80% of time from 1985 through March 31, 2013, on a simulated basis. Of course, this is only a cursory way to view the TVI®'s potential "leading indicator" status over the time period studied, as many times the Simulated TVI®/TVI® reflected a transition later because many components were positioned short as the CPI was began to decline, allowing the Simulated TVI®/TVI® to "peak" later and thus appear to be "lagging".

The TVI® is not different than any other asset class; it will perform "better" or "worse" based on the current environment. As a formulaic index, it has no choice but to follow intermediate price trends. This mathematical approach has its own advantages and disadvantages, but it was purposely designed this way, and was not meant to be correlated to stocks and bonds (which, in most part, have benefited from current market conditions). "Trendless" markets are rare in 100 years of U.S. history, and this was taken into account during development. The TVI® uses no leverage, and is entirely rules based.

It is extremely rare for a "stable price, low growth" environment to be present in the U.S., as it normally bodes poorly for re-elections. We are seeing the worst recovery in the U.S. since the Great Depression and the lowest CPI (over a 5 year period) since 1961 - 1965.

The charts show history more clearly than a million words would. If a zero interest rate policy and "Quantitative Easing" strategies are not causing a higher CPI, it is highly probable that the current lower CPI environment is caused by another fiscal policy. In the low GDP growth/low CPI environment which exists currently, it is natural for TVI® index levels to underperform either gains in stock or bond market indexes, but TVI® index levels still have the potential to increase overall.

However, if the U.S. Federal Reserve prints enough money, and that money begins to be used by borrowers, it will result in a higher rate of change of inflation. In this way, the Fed would accomplish its goal of stimulating inflation with some GDP growth, thus creating an environment in which the TVI® has the potential to do very well. In contrast, many other asset

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classes would likely underperform, fearing an upcoming environment of tighter monetary policy.

It pays to remember that the most subtle aspect of social government planning by the Federal Reserve is this: you can print money, and even a relatively small amount may trigger an increase in the rate of change if the public believes inflation will occur…and *vice versa* if it doesn't. Perception may therefore become reality in these instances.

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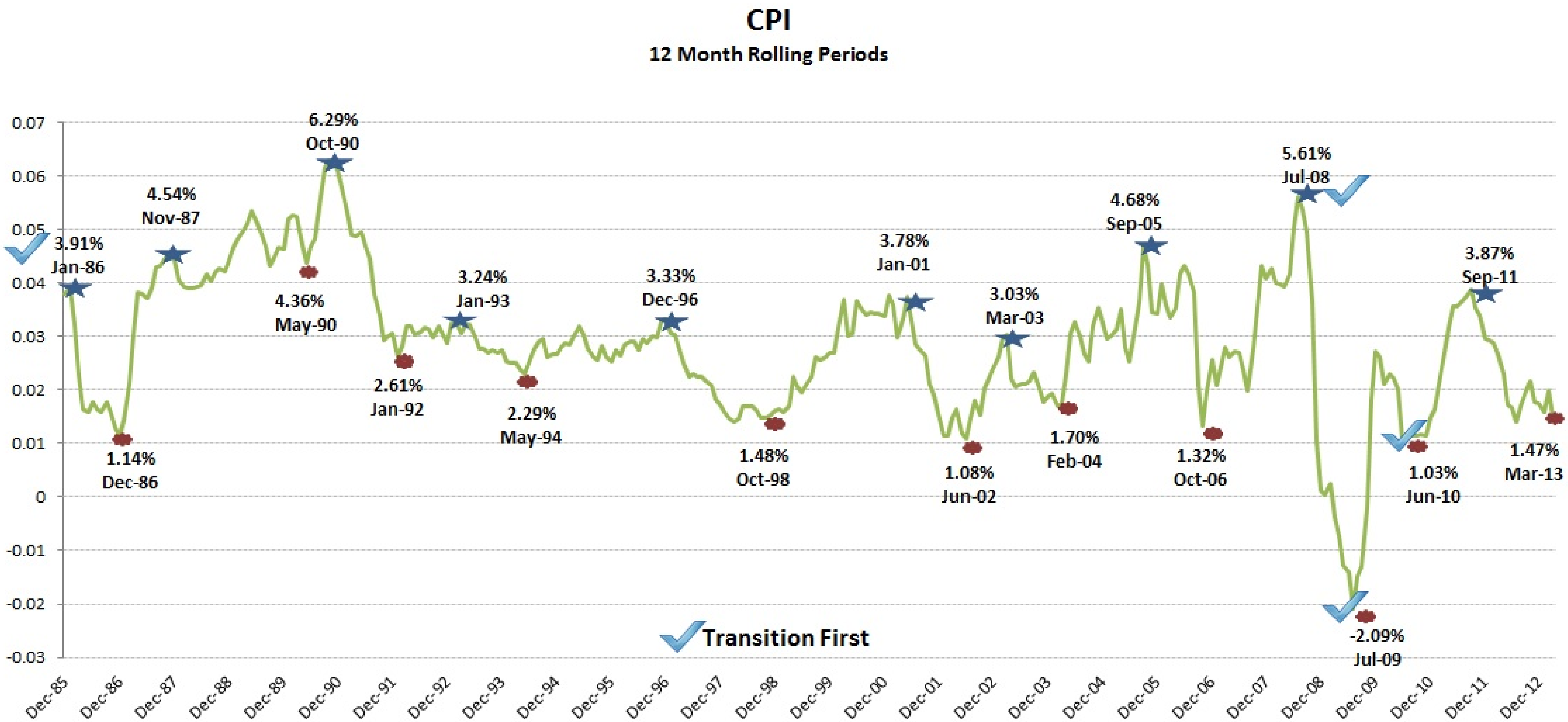

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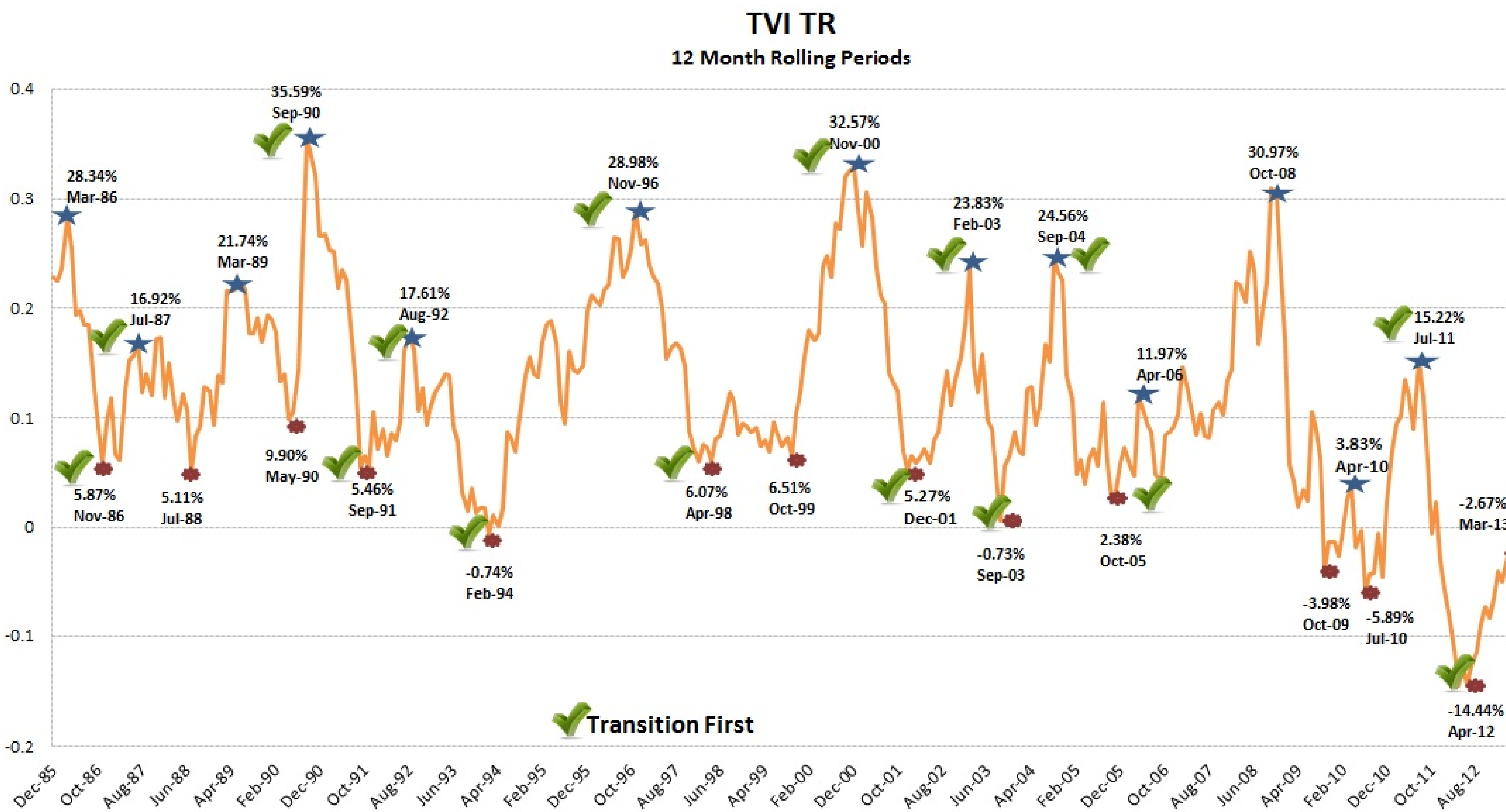

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May 1, 2012 forward, the Natural Gas component of the TVI® is no longer part of the Energy sector, which may be positioned long or flat; instead, the official record of the TVI® is calculated with the Natural Gas component as a separate sector which may be positioned long or short, with such positioning determined independently from the Energy sector. Accordingly, the TVI® may be positioned "short" in the Natural Gas sector when an unexpected natural, sociopolitical or other event occurs that causes rapid increases in Natural Gas prices. Changes to an index methodology may have a material impact on the results of such index, whether positive or negative. Past performance is not necessarily indicative of future results (and particularly because of these changes over the time periods indicated). **Simulated TVI®** - The Simulated TVI® was created and is maintained, owned and calculated by EAM. The Simulated TVI® reflects the retroactive application of the Simulated TVI® to past market histories and not the actual results of the Simulated TVI® or the TVI®. The simulated statistical information for the Simulated TVI® is calculated the same as the TVI® with the following exceptions: (1) the Simulated TVI® is calculated throughout with the Natural Gas component as a separate sector, (2) the following futures contract components were included on the following dates: Unleaded Gas (January 31, 1986), Australian Dollar (February 1988), and Natural Gas (May 31, 1991), (3) Soybean Oil and Soybean Meal were removed from the Simulated TVI® as of January 1, 1991, and (4) the Deutsche Mark was replaced by the Euro Currency in January 2000 and unleaded gasoline was replaced by RBOB Gas on October 31, 1986. Past performance, especially simulated statistical information, is not necessarily indicative of future results (and particularly because of these changes over the time periods indicated). This communication is intended solely to provide an introduction to these products and does not purport to provide complete details thereon. **CPI** - The Consumer Price Index ("CPI") is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The "best" measure of inflation for a given application depends on the intended use of the data. CPI measures inflation as experienced by consumers in their day-to-day living expenses. Other indexes are used to measure inflation at earlier stages of the production process, in the labor market, for imports and exports, experienced by both consumers themselves as well as governments and other institutions providing goods and services to consumers, or to provide a specialized measures, such as measures of interest rates. There is no necessary correlation between the Product(s) and the CPI. Those seeking exposure to the TVI® must not rely on either the existence or the absence of any such correlations in the future, particularly over the short-term. CPI data source: St. Louis Federal Reserve.

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