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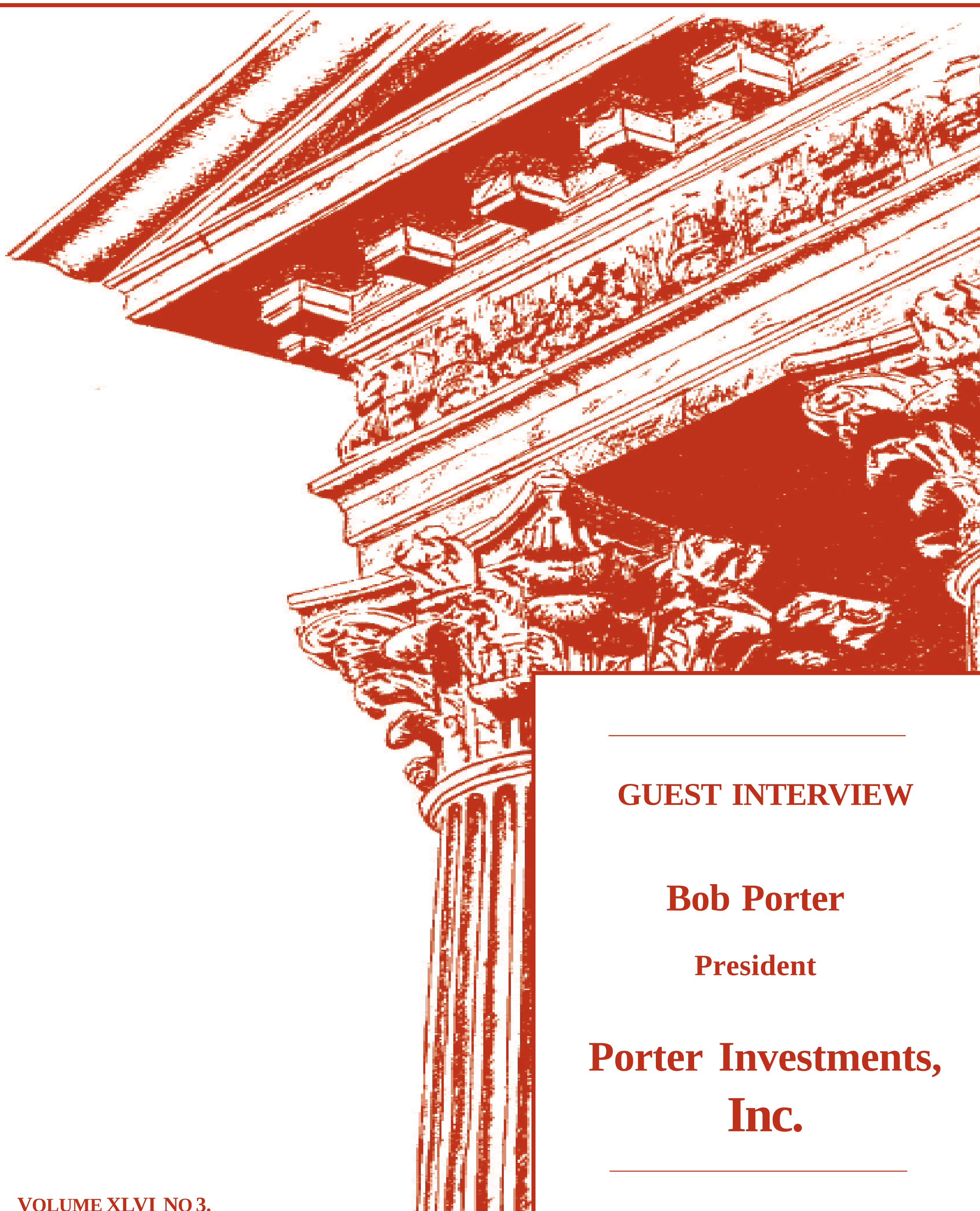

GUEST INTERVIEW

Bob Porter

President

Porter Investments, Inc.

VOLUME XLVI NO 3.

Guest Interview:
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Bob Porter
President

Today, Money Manager Review has the pleasure to interview Bob Porter, President of Porter Investments (http://porterinv.com/about/)

Bob, what were the motivating factors behind the founding of Porter Investments?

When I came into the investment business 25 years ago, many of my colleagues and I were taught the same basic investment approach. That is, to invest their clients in a broad mixture of uncorrelated asset classes, spread them across different sectors, and they should be fine if their time frame is long enough. After years of doing this, Porter Investments realized this may not be the best approach for your entire portfolio. Obviously, nobody likes to make money for 4-5 years, only to lose back a bulk of those gains over the following year or two. So we founded Porter Investments because we feel a better approach, for at least some of your money, is to participate in the meaningful, upward trends in the market while limiting your losses or even adding to your prior gains during significant market downturns.

How would you sum up your investment philosophy?

Our philosophy is that the individual investor finally has access to good Quantitative models that can identify meaningful trends in the markets. This can help them avoid harmful periods where they could give up a significant portion of their prior gains.

How did your background lead you to offer this approach?

Before entering the investment business, I worked for technology companies and in software development. You could see how continual advances in software and programming tools helped to disrupt many industries. My technical background also allowed me to better understand the concepts that form the basis for many of the investment models we used today.

Please explain your statement "Porter Investments strongly believes that individuals cannot consistently outperform proven Quantitative models."

It is just very hard for mere humans to process and react to events in an unbiased manner as fast as a software system that utilizes Quantitative models can. These are models that have been designed with an understanding of Quantitative analysis and mathematics, and similar models have successfully been used in hundreds of other environments. Examples could be complex control systems used in commercial aircraft, power plants, and medical devices.

Many managers use models and how do you use them differently?

Some managers will use models to screen for buy opportunities based on fundamental or technical characteristics. They could also use them to run various projections on specific securities. In contrast, we do not buy individual stocks and instead focus on the broad equity market and indices such as the S&P 500. We use models to tell us whether the broad market is trending up or down. Our process is also 100% mechanical. Our difference is we use models to tell us when to buy, not what to buy.

What aspects of traditional money management does your approach attempt to improve upon?

There are two main aspects we address. First, a traditional manager purchases securities based on a perceived fundamental value. When markets pull back, which they will eventually do, they may stay fully invested and add to some positions if they can. Unfortunately overall market prices might not rise above their prior levels before you need a portion of your funds. Our approach can allow accounts to raise significant levels of cash during market downturns. Secondly, your money manager can interject their feelings or opinions anytime during their buying or selling process. While many managers can have a good year due to a favorable event or call on the market, it is not repeatable process.But with models, it can be repeatable. The math, based on proven concepts, is telling the model what to do.

Are you trying to time the markets?

We obviously will not know in advance when a trend will change from up to down or down to up. Models cannot time the markets, but they can react, allowing us to follow the markets into meaningful trends.

How often will a model signal a trend change?

That depends on the model but we look for models that follow more intermediate trends, lasting weeks or months. We have no interest in trading the daily or weekly "noise" that accompanies the market. Trading activity may increase during times of extreme volatility, but models can also go many weeks or months without signaling a trend change.

Explain how you conduct your research to find superior models?

Porter Investments and its technical advisors have spent hundreds of hours searching for, learning from, and doing business with model developers that have developed some of the very best stock market models commercially available. We insist on knowing and talking directly to the developers. We assess the subtle distinctions between different developers' models that can cause two very similar ones to perform vastly different. In addition to the studying the efficacy of the various models, we also evaluate how well they can complement each other. This extra research time is essential to "get under the hood" because the results can be disastrous if you randomly combine 3-4 models together and have no idea how well they work together.

How many different types of quantitative models do you use?

We seek to always have a broad group of models to utilize in our Strategies. All models, by deploying different quantitative analytics, can react slightly different in certain market environments. For instance, a "trend following" model will not react exactly the same as a "reversion to the mean" model or a "relative strength" model. It is not only important to utilize multiple types of models, but also to know which market conditions favor certain types of models.

Would you describe the models as mostly technical, fundamental, or both?

As a group, they will contain both type of algorithms

Have your models been used successfully in the markets?

The majority of the models we use have been verified by independent third parties, some for more than 10 years. If a developer introduces a new model that does not have a verified track record, then they should have a history of producing other models that have proven themselves in the markets over time. Our Conservative and Balanced Strategy's core models use trade signals independently verified by TimerTrac.com since late 2005, and others have been verified by trusted services since 2002. Our other core models, which have been verified for at least 2 years, retain much of the original code from their predecessors. Additional models are continually being researched that complement these core models.

What investment instruments do you use and how do they help manage your portfolios?

We use very liquid, transparent Exchange Traded Funds that are designed to mimic a broad market index such as the S&P 500 or the Nasdaq 100.

Do you invest internationally?

All of the investments are US equity Indexed based ETFs or Index Mutual Funds.

How are the models applied in an investment strategy?

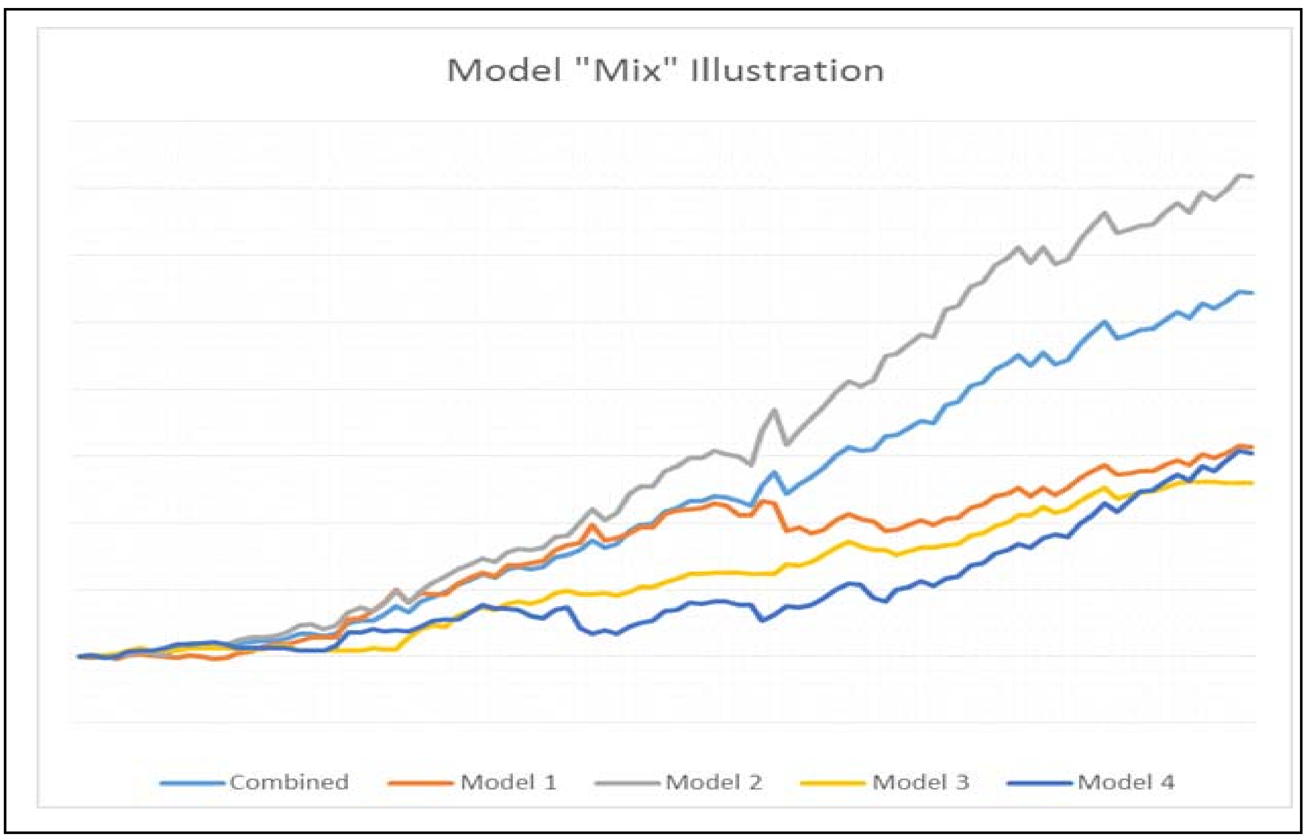
We define a “Strategy” as a proprietary "mix" of up to 3-4 different models to achieve our risk/reward goals. Of course, our Strategies' model mix and percent allocation is different for each strategy. We analyze the subtle nuances of the various models to determine the best “mix” and allocation of models for each of our Strategies. Our policy is to offer Strategies where at least 60% of its model weighting has been verified by outside sources. Hence, in some of our Strategies, 100% of the models used have been verified, and in others at least 60% of the models used have been verified. By combining an optimum number of models, in a proper allocation, we produce a multiplicity of strategies that fit certain risk/reward ratios for our clients.

How do you determine which models to mix in a strategy?

Each model is selected to complement the other models in a Strategy. The strategies' goal is to have each model minimize the limitations in the other models, while not detracting much from the strength that any one model brings to the mix. A hypothetical mix could look like the graph below.

How does historical upside and downside risk compare for of each of your strategies?

We tend to concentrate more on downside risk or downside volatility, as measured by semi-standard deviation. If you look at the semi-standard deviation in the summary table at www.porterinv.com/our-performance, you will



The lighter blue line represents a hypothetical strategy created from 4 models.

see that the downside risk stays consistently low while gradually increasing as the return potential increases. Our Strategies are designed for this. You should always want your downside volatility to be commiserate with your return potential.

Why mix models if you can get better returns by just using the top one or two performing models?

The main reason is that you can produce a smoother ride by mixing them into a strategy. Because you cannot accurately evaluate it ahead of time, it is very likely that the one model you may want may end up having a volatility or monthly drawdown that you cannot stand. So, the goal of the Strategies is to seek a return potential close to its best performing model, and given a proper mix and allocation, deliver a downside deviation and monthly drawdown that you can handle

Do your Strategies use leverage?

Only in the more aggressive strategies.

Will a Strategies' allocation and models change often?

Our attitude is, if you do your research and due diligence on the front end, you should not be changing the models very often. But, we always have the freedom to change any component of the strategy. It's important to realize this is different from trying to ride a hot stock or a sector mutual fund. All models will have periods where the conditions will cause them to not perform as well as they did in the past. You don't necessarily kick it out, because that particular model could be the best contributor to the Strategies performance in the future.

Are your Strategies always invested?

Sometimes, such as during 2015, there can be extended periods where the Strategies may hold a large amount of cash.

Do your Strategies ever go short?

Yes, but much less in the more conservative strategies. We "short" using measured amounts of inverse ETFs. Shorting was the main reason for the highly positive outperformance in 2008.

How are the five Porter Investment Strategies different from each other?

The Conservative strategy seeks capital appreciation consistent with the broad equity markets during rising periods, while attempting to protect account values during periods of sustained market downtrends.

The Balanced strategy seeks capital appreciation consistent with the broad equity markets during rising periods, while attempting to add to account values during periods of sustained market downtrends.

The Moderate strategy seeks capital appreciation consistent with or above the broad equity markets during rising periods, while attempting to add to account values during periods of sustained market downtrends.

The Growth strategy seeks capital appreciation above the broad equity markets during rising periods, while attempting to add to account values during periods of sustained market downtrends.

The Aggressive strategy seeks maximum capital appreciation in excess of the broad equity markets during rising periods, while attempting to add to account values during periods of sustained market downtrends.

Any final thoughts?

Today we talked about a different approach to managing equity assets. Our way is different, but it is not only different, it has been better than the old way of "buy-and-hold" investing. Buy and hold means holding long positions through both up and down markets. We are reasonably sure that our way of investing using software based on mathematics and technical indicators is the wave of the future. For example, it is like software used for autopilot systems, or similar to machine trading algorithms employed by institutional investors now, or driverless Google cars, etc. In order for investors to successfully participate, they must be open to change, at least for a portion of their portfolios. The bottom line is "You cannot improve if you are not open to change".

This interview was originally printed in the FALL 2015 Issue of *Money Manager Review*. *Money Manager Review* provides essential information on the performance and investment styles of the nation's top private money managers. This quarterly guide has become a standard reference for consultants, public and private pensions, foundations, trusts, and individuals. For subscription information call (415) 386-7111 or write *Money Manager Review*, 12620 DuPont Road, Sebastopol, CA, 95472 or visit us at our Internet Web Site at http://www.ManagerReview.com.

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