

October 18, 2016

Dear Clients:

We are pleased to provide you with a third quarter performance update and our thoughts on recent market developments.

The U.S. stock market notched its best quarter of the year, rising 3.9% as measured by the S&P 500. All of this gain came in July. The month benefited from ebbing fears of Brexit, the continued recovery in oil and better than anticipated second quarter earnings. However, as the quarter unfolded investors shifted their focus toward fretting about the timing of a Federal Reserve interest rate hike and the upcoming election.

CK Advisors had a solid third quarter with our equity composite rising 4.2% (after fees), ahead of the benchmark Index. Our year to date return of 8.6% also beat the market's 7.8% advance. The prospect for slightly improved global growth and higher interest rates took its toll on the Utilities (which declined 7%), Telecom (-7%) and Consumer Staples (-3%) sectors, which finally had a tough quarter. These are areas of the market which we have avoided for years as valuations looked too rich. Meanwhile, Financials (+4%) and Industrials (+4%) performed better and are areas in which we have concentrated our investments.

Technology was the best sector with a 12% return, led by the five well-known mega-capitalization growth stocks (Amazon, Apple, Facebook, Google and Microsoft), none of which we own. These names have a large weight in the Index, making outperformance a challenge if their winning streak continues. Conversely, should these companies ever hit a rough patch, we would be disappointed if our performance didn't compare favorably to the S&P 500.

The bond market took a breather in the quarter, rising a scant 0.5% as measured by the Barclays Aggregate Bond Index. The muted bond return means that our balanced account clients were not hurt by our defensive posture of investing predominately in short dated maturities. Thus, these account returns generally compared favorably to the appropriate composite.

The list of concerns for investors doesn't appear to be diminishing. Europe still appears to be in a funk and even a gradual Brexit is unlikely to go smoothly. The U.S. Federal Reserve seems intent on a December interest rate

hike, if for no other reason than trying to restore market credibility after several years of near paralysis. While some investors take comfort in polls that show Hillary Clinton with a commanding lead, others are now concerned that both the House and Senate could flip and give a Clinton administration unchecked authority.

Among our best performers in the quarter were Crown Holdings, CSX and Caterpillar. Crown produces cans and other packaging products primarily for beverage and food customers. Its stock did well after the company posted a strong profit report and provided upbeat annual guidance. Making cans may not seem sexy but this is an attractive business. Crown participates in steadily growing and stable markets. Due to scale and operating efficiencies, it has been able to augment top line growth with margin expansion. The vast majority of the company's markets are oligopolies with rational competitors. Crown generates good free cash flow which it has wisely deployed for share buybacks and acquisitions.

Rail operator CSX is in the midst of a freight recession precipitated by a soft industrial economy. A collapse in coal shipments has had a particularly negative impact since this is the company's most profitable segment. The stock managed to rally despite these negatives because earnings are poised to advance nicely beyond 2016. CSX has easy year-over-year comparisons as it anniversaries large volume declines. In addition, the outlook for coal has improved as hot weather in the U.S. has spurred domestic coal demand and export traffic has rebounded. After falling steeply for years, shipments of this commodity are now a less significant part of CSX's revenues making ongoing coal headwinds manageable.

The freight downturn has compelled CSX to aggressively eliminate costs and streamline operations. As a result, this year the railroad will far surpass its previous record for efficiency savings. The weak environment has also allowed CSX to focus more on improving terminal dwell time per train, train speed, on-time arrivals and other metrics which enhance productivity and customer service. Finally, capital requirements should fall significantly in coming years, boosting free cash flow.

Like CSX, Caterpillar has also suffered through a downturn as customers have slashed capital equipment spending in response to plummeting commodity prices and tepid construction demand. Those prices have bounced smartly off lows reached earlier this year, signaling to investors that Cat's earnings may have bottomed. The company is well positioned to benefit from any upturn. With revenues spiraling downward, Cat has been pressed to right-size its cost structure through aggressive reductions in labor, material and manufacturing expenses. In addition, lean manufacturing initiatives have improved operations by cutting waste, inventories and delivery times, while raising product quality.

Cat has enhanced its competitive position during the downturn. The company has steadfastly maintained R&D spending at a pace which dwarf's competitors. Owing to product innovation and a strong dealer network, Cat has gained market share for five straight years. Most importantly, the company has maintained an excellent balance sheet at the bottom of the cycle. With very low leverage and ample free cash flow we think that Cat can comfortably maintain its attractive dividend.

Anthem, General Electric and NVR detracted from performance. Health insurer Anthem's stock was pressured due to the subpar performance of the company's nascent health care exchange business. Initially projected to break even in 2016, this segment will now incur a large loss after experiencing higher than expected medical costs. Separately, the Department of Justice filed suit to block Anthem's agreement to purchase Cigna, which merger could meaningfully enhance the company's earnings power and competitive position. This litigation also hurt the stock, further diminishing the already low probability that the merger will go through.

Anthem has outlined several steps to turn around the exchange business, initiating significant premium increases to cover elevated medical costs. Anthem will eventually fix or exit this business, providing a big lift to profits. The resolution of DOJ litigation early next year should also be positive even if the court rules to block the Cigna merger. This decision will remove an overhang from the stock and allow Anthem to employ a highly underutilized balance sheet for the benefit of shareholders.

GE's shares retreated modestly in the quarter. Investors worried about the company's ability to meet full year targets following a second quarter report in which organic revenues, margins and orders were all down. We expect second half results to rebound since shipments of several high margin products are scheduled to ramp up and cost savings should accelerate. Longer term GE has solid growth prospects and the opportunity to significantly increase margins and free cash flow.

Homebuilder NVR fell after reporting disappointing quarterly earnings. New orders were robust but its gross margin contracted because the average price of homes sold dropped while labor and material costs rose. Although margin pressure may continue for some time, we still like NVR's long-term prospects. The homebuilder has an attractive business model, using options to secure finished lots rather than purchasing land outright. This asset-light strategy allows NVR to generate very high returns on capital, produce solid free cash flow and focus solely on homebuilding operations.

We made several modest changes to existing holdings during the period. Though we are confident in these trades over the long run, the moves were not well timed. We added to Hess since the stock did not appear to fully reflect the

value of the company's exciting exploration opportunity in Guyana. Its partner Exxon Mobil had previously announced a huge oil discovery in Guyana which could add meaningfully to Hess's proven reserves. Unfortunately, soon after we purchased additional shares, Hess came up empty on the next well drilled there. This setback penalized the stock but did not materially change the promising outlook in Guyana, a region which could still hold significant additional quantities of oil.

We also added to Pfizer, a position which we initiated earlier this year (see our April client letter for a detailed discussion). The stock declined due to increasing political rhetoric against rising drug prices. We believe that legislation which would broadly increase price regulation is unlikely. We continue to like Pfizer because it is attractively valued, has a good pipeline and pays a generous dividend.

We chipped our holdings in oil and gas producer Apache and in Macy's. Soon after our sale of Apache, it announced a major onshore oil and gas discovery. While early, this new resource play has the potential to transform the company. Although Macy's has been hurt by some cyclical issues which will likely abate, it appears the secular challenges in competing against off-price and ecommerce retailers will be more difficult to overcome than we previously thought. We maintained a small position in the department store since its valuation seems to reflect the more challenging environment. There could also be upside from management's turnaround efforts, a cyclical turn in Macy's business or from the monetization of the company's substantial real estate holdings.

We recently sent your individual account performance, an inventory of quarter-end positions and a statement of management fees. The quarterly fee was debited from your account.

We appreciate your continued support and always welcome your comments, questions or concerns.

Sincerely,



Daniel K. Cantor
Managing Member



Jeffrey C. Kinzel
Managing Member

Enclosure