High Pointes — 3rd Quarter 2006

A quarterly update for institutional investment professionals from High Pointe Capital Management.

High Pointe is an independent equity management firm located in downtown Chicago. Since the firm's inception in 1997, our innovative investment process has proven highly successful at identifying undervalued stocks and has delivered exceptional performance.

Our unique approach to investing incorporates a highly disciplined evaluation of companies' intangible assets. High Pointe's proprietary methodology is a significant step forward in achieving a more complete valuation of corporations and their competitive advantages.

High Pointe manages three separate account products and our Select Value and Small Cap strategies are also offered as mutual funds. We currently manage over $900MM in assets.

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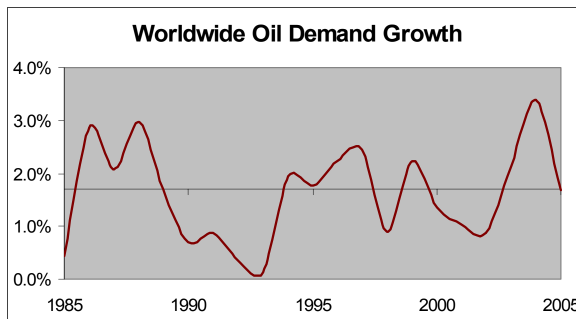
The Return of Mean Reversion

Economic Environment

Financial markets posted respectable returns across the globe during the third quarter. U.S. stocks, as measured by the S&P 500 Index, were up 5.7% and U.S. bonds generated a return of 3.1%. Investors welcomed the Federal Reserve Bank's decision to take a breather after raising interest rates 17 consecutive times. Consumer confidence rose sharply late in the quarter as gasoline prices receded.

In our first quarter 2006 newsletter entitled Waiting for Mean Reversion, we noted that there were several financial variables that had experienced sustained upward movement without a reversion to the mean that would normally be expected. These included energy prices and the relative valuation of small cap stocks versus large cap stocks. Mean reversion has begun in earnest in both of these areas. Energy prices are down more than 20% over the last few weeks and small cap stocks have underperformed large cap stocks by approximately 9% over the last two quarters.

Energy has been a frequent topic of discussion in our newsletters. In the past we have commented that if oil prices remain high, a drop in demand is inevitable. Now, evidence is mounting that demand erosion is indeed occurring. The four graphs below show that consumers are changing their behavior in response to higher oil prices, demand for oil and gas is down, and energy prices have started to decline.



After spiking in 2004, oil demand growth is back to its normal level.

Source: Energy Information Administration

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Investment Performance
For Periods Ending September 30, 2006

		3 Months	YTD	1 Year	3 Years	5 Years	7 Years	Since Inception [1]
Select Value	*Gross*	4.35%	5.15%	8.18%	13.03%	12.71%	16.92%	15.29%
	Net	4.18%	4.67%	7.55%	12.40%	11.94%	16.04%	14.37%
Russell 1000 Value		6.20%	13.19%	14.62%	17.25%	10.73%	7.43%	7.90%
Select Growth	*Gross*	4.54%	2.80%	6.70%	10.60%	11.79%	11.04%	10.96%
	Net	4.36%	2.19%	5.82%	9.56%	10.71%	9.99%	9.91%
Russell 1000 Growth		3.94%	2.97%	6.04%	8.36%	4.42%	-2.58%	-2.59%
Small Cap	*Gross*	-0.65%	1.62%	2.06%	15.99%	18.41%	15.21%	13.34%
	Net	-0.80%	1.17%	1.45%	15.11%	17.43%	14.23%	12.34%
Russell 2000		0.44%	8.69%	9.92%	15.48%	13.78%	9.23%	7.27%

[1] *Inception Dates: Select Value - January 1, 1998; Select Growth – August 1, 1999; Small Cap – January 1, 1998. Please see page two for additional disclosures.*

Organizational Update

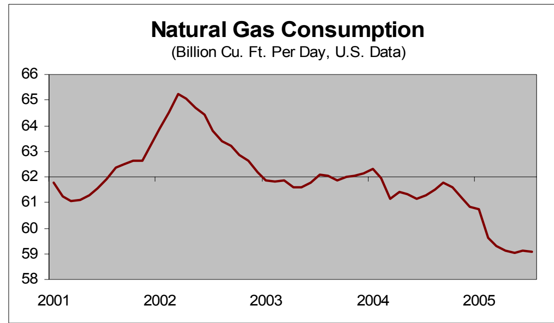
We are pleased to announce that we will be moving our offices from Buffalo Grove, Illinois to Chicago effective October 23, 2006. This move is consistent with our growth as a firm as it will allow us better access to investment talent and enable us to more efficiently attend research meetings in downtown Chicago. It will also make it more convenient for our clients, consultants and advisors to meet with us at our offices. Our new contact information is as follows:

High Pointe Capital Management, LLC
One North LaSalle Street, Suite 2001
Chicago, Illinois 60602
Telephone: (312) 726-2500
Fax: (312) 726-6100

Please note that our email addresses will remain the same. We look forward to keeping in touch and certainly encourage you to visit us in our new office next time your travel plans bring you to Chicago. We are thankful for the success and growth we enjoyed while in Buffalo Grove and look ahead to serving our clients' needs for many years to come from our new home in Chicago's financial district.

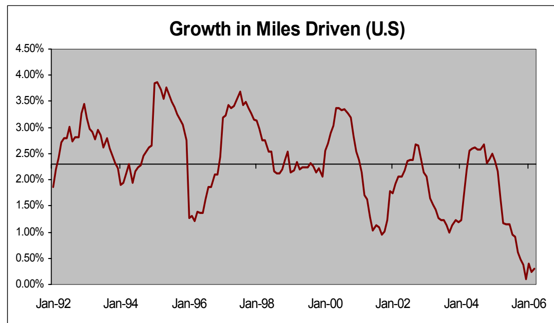
–Sean Clark, CFA
Director of Marketing

The Return of Mean Reversion



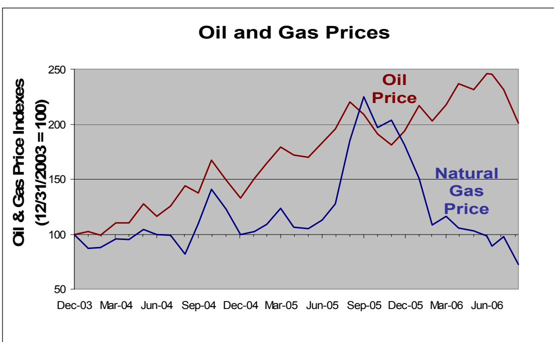
Natural gas demand has declined significantly in response to higher prices.

Source: Energy Information Administration



Motorists are driving fewer than normal miles in response to higher prices.

Source: U.S. Highway Administration



Weakening demand and adequate supplies have started to lead to lower oil and gas prices.

Source: Energy Information Administration

The recent good news notwithstanding, it is clear that significant strains remain for the U.S. economy. Our financial deficit (both government and personal), a potential housing bubble, and investors' blasé attitude towards risk are all

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Performance data are shown gross and net of management fees and are based on composites of all fee-paying, fully-discretionary accounts. Returns for the periods presented are time-weighted. Results shown include the reinvestment of dividends, capital gains and other earnings. The currency used to express performance is U.S. dollars. High Pointe's fee schedules are disclosed in Part II of the firm's Form ADV. All fully discretionary, fee-paying accounts have are included in at least one composite, and no accounts have been terminated since the inception of each of the composites. No alterations of the composites as presented in this report have occurred because of changes in personnel or for any other reasons at any time. The composite results portrayed during the period are compared to the performance of their respective indices because the securities purchased for each of the composites are most closely aligned with the securities comprising these indices. The performance shown is that of the separate account strategies and is in no way intended to be representative of the mutual funds. Performance results have been examined through 12/31/05 by an independent verification firm. A complete list of firm composites and performance results is available upon request. Returns represent past performance and are not indicative of future results.

The Russell 1000 Value, Russell 1000 Growth and Russell 2500 Indices are unmanaged indices commonly used to measure the performance of U.S. stocks. You cannot invest directly in an index.

matters of concern. Recently released World Competitiveness Rankings show the U.S. dropping from first place to sixth, partly as a result of its financial deficit. The most recent housing sector report showed that home prices fell for the first time since 1993. Although the magnitude of the decline was a modest 1.3%, weak demand and a glut of unsold homes (up 60% over the last 12 months) foreshadow a deteriorating situation.

News about Intangible Assets

A key tenet of our investment philosophy is that intangible assets will continue to become more important and better recognized. A recent study[1] by the Bureau of Economic Analysis (BEA) reinforces the importance of intangibles by highlighting the role that research and development (R&D) is playing in our economic growth. The BEA is a government agency responsible for compiling GDP data. Its economists studied the impact of capitalizing R&D as an intangible asset and found that the U.S. GDP level increases by 2.6% when R&D is treated as an asset. This study also found that R&D explains an ever increasing portion of our economic growth. Of course, our readers know that R&D is but one of the many types of intangibles that are important and valuable. Paul Romer, a noted Stanford economist, pointed to these other intangibles recently in an article in *The Wall Street Journal* as excerpted below.

"Paul Romer . . . said the better the measurements of R&D become, the more economists and policy makers will realize other factors may be more important. 'If you look at why we had rapid productivity growth . . . there were lots of intangibles and ideas that . . . don't get recorded as R&D' "

The BEA plans to change its methodology for calculating GDP in the coming years by incorporating R&D as an intangible capital asset. All we have to say to that is "what took you so long!" This overdue step is a good start to better recognition of intangibles. We expect more progress on this front in the years ahead as the BEA is currently engaged in developing techniques to capture other intangible investments such as human capital and education.

Investment Strategy

Our **Select Value** strategy generated a return of 4.2%, net of fees, during the third quarter compared to a 6.2% return for the Russell 1000 Value Index. Sector selection was positive as the overweighted technology and health care sectors returned to favor after long periods of neglect. Our energy underweighting also added a modest 0.5% to the return. However, stock selection was negative overall as the positive impact of our positions in software, mortgage finance and cable industries was overshadowed by weak performance of our telecom, conglomerate, and medical device holdings.

Our investment in the software industry is relatively new, having been initiated towards the end of last year. We like the entrenched position of leading companies in this industry. They earn high returns on invested capital and generate significant free cash flows. Over the last couple of years, their stocks have fallen as investors have worried about the impact of internet on the software business. The emergence of savvy competitors who plan to deliver software as a service over the web rather than as a packaged product has caused investors to question the future of "older" software companies. However, to paraphrase Twain, the reports of the demise of older software companies are greatly exaggerated. Investors are coming around to the conclusion that these companies are adapting to the new environment and they continue to enjoy solid growth opportunities.

Mortgage finance and cable stocks have been a staple of our portfolios for quite some time and our patience has been rewarded this year. Our holdings in the mortgage finance industry have performed well as uncertainties regarding government regulation and accounting restatements are subsiding. Cable stocks have benefited as investors have begun to realize that cable's technology platform is superior to that of its competitors. Importantly, cable companies have a first-mover advantage in locking up customers via their triple play offerings, namely, cable, telephone, and high speed internet services in one package.

On the negative side, our portfolios have been held back by our premature investment in wireless telecom and medical devices industries. Both of these are relatively new investments for us having been initiated within the past six months after they had declined significantly from their peaks. The wireless telecom business has consolidated and that should benefit the remaining three national players. However, our holding has been penalized due to its problems in integrating its acquisitions thus leading to higher customer turnover. We are maintaining our position because of inexpensivevaluation and the potential for significant free cash flow generation. However, we would have to re-evaluate our position if significant operating improvements do not materialize. (*Continued on page 4*)

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1 Source: R&D Satellite Account, Preliminary Estimates, Sumiye Okubo, et al, Published by Bureau of Economic Analysis and National Science Foundation, September 28, 2006.

Our investment in the medical device industry came under pressure recently after the publication of a study showing that drug-coated stents, which have become the new standard for angioplasty, may increase the risk of blood clotting in some cases. After reviewing the information, our opinion is that blood clotting risk in most cases is more than offset by the benefit of keeping the arteries open longer after the initial surgery. This reduces that chance of needing a second surgical procedure in the future, or a more invasive procedure such as bypass surgery. Valuations in the medical device industry have become attractive in recent months in the face of reimbursement concerns. We are taking a long term view and expect to maintain our investment in this industry.

We recently updated the attribution analysis for our Value product based on the firm's composite performance record through September 30, 2006. Key observations and data from this analysis are summarized below.

- Sector effect has been positive since inception, but has been decidedly negative since the beginning of 2004, primarily as a result of the rise in energy and commodity prices (including a drag on performance of -1.5% in 2006).
- Selection effect has also been favorable over long-term periods, but volatile from year to year. For example, selection effect was significantly negative during 1998, 2002 and Year-to-date 2006. Sub-par performance during 1998 and 2002 was followed by periods of significant outperformance. Of course, we will have to wait to see what the future brings this time.

	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Sector Effect	2.70%	6.40%	6.40%	2.10%	5.80%	1.20%	-2.70%	-2.10%	0.00%	2.40%
Selection Effect	-10.10%	6.90%	34.50%	22.00%	-7.10%	12.90%	-0.60%	1.40%	-8.00%	5.00%
Total Value Added	-7.40%	13.30%	40.90%	24.10%	-1.30%	14.10%	-3.30%	-0.70%	-8.00%	7.40%

High Pointe's **Select Growth** strategy produced a return of 4.4% during the third quarter compared to 3.9% for its benchmark, the Russell 1000 Growth Index. Sector selection was favorable as the overweighted technology sector performed well and the underweighted energy sector lagged. However, stock selection was mixed, as described below.

Our holdings in the software industry performed well because they posted strong results relative to investors' pessimistic expectations. Investors are beginning to appreciate the ability of these companies to generate high returns with little capital investment. It is also becoming apparent that tough competition from new players does not mean the end of the world for the older, well-entrenched companies. Our holdings in the communications equipment industry also performed well as the ever expanding usage of the internet meant strong demand for hardware to facilitate communications and internet traffic. Lastly, a trend towards outsourcing in drug development benefited a niche healthcare holding.

The offsetting impact came from our holdings in the internet advertising and search space where strong competition from new entrants has caused established players to experience slower growth, at least in the short run. Also, our wireless telecommunication thesis has yet to play out as the benefits of consolidation are being overshadowed by merger integration issues. Lastly, in the pharmaceutical industry, the introduction of a generic drug ahead of schedule had a significant negative impact on one of our holdings. We made only one change to the portfolio during the third quarter by investing the proceeds from a gaming company that was acquired into the medical devices industry.

Our **Small Cap** strategy generated a return of -0.8% for the quarter compared to a return of 0.4% for the Russell 2000 Index. From a sector selection perspective, our portfolio benefited from a consumer discretionary overweighting, but this was offset by an underweighting in financials. Consumer stocks performed well as gasoline prices declined, thus providing more money for consumers to spend on other items. At the same time, the financial sector was helped by the Fed's pause in interest rate hikes. Consumer sector stocks that performed well for us were deep value, out-of-favor companies in industries such as payday lending, rent-to-own, and electronics retailing. Also, our holdings in the reinsurance industry benefited from a benign hurricane season and strong pricing. Lastly, the performance of our positions in the packaging and private label beverage industries was strong, primarily as a result of meaningful restructuring and better cost controls.

The offsetting factors included weak trends in the for-profit education industry where our only holding suffered from anemic enrollment gains. We reevaluated our position and decided to eliminate our exposure to this industry. Our investment in the building products industry came under pressure from a slowdown in housing and our holdings in the raw materials sector declined along with the drop in commodity prices. Lastly, tough competition and weak pricing in the telephone headset business caused one of our stocks to miss its earnings estimate, thus impacting the portfolio negatively. We invested the proceeds from the sale of lottery and for-profit education stocks into a promising mini-conglomerate that is spinning-off its different businesses in an attempt to unlock hidden value. We also invested in the property and casualty insurance industry based on our expectation of a turnaround.