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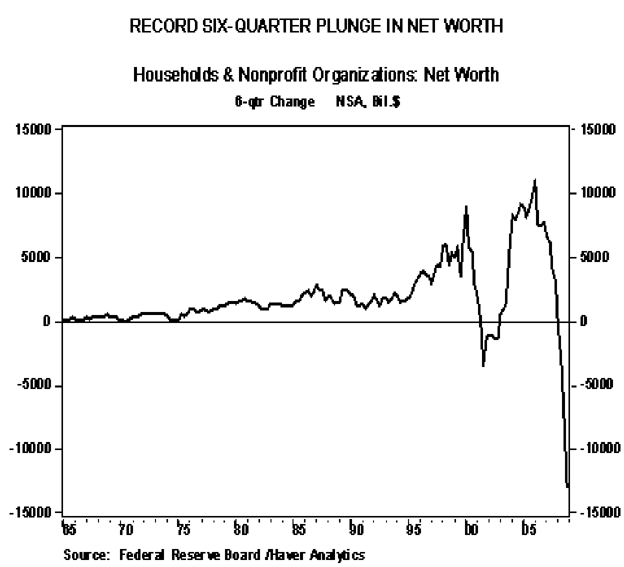
High Pointe

DATE: April 23, 2009
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

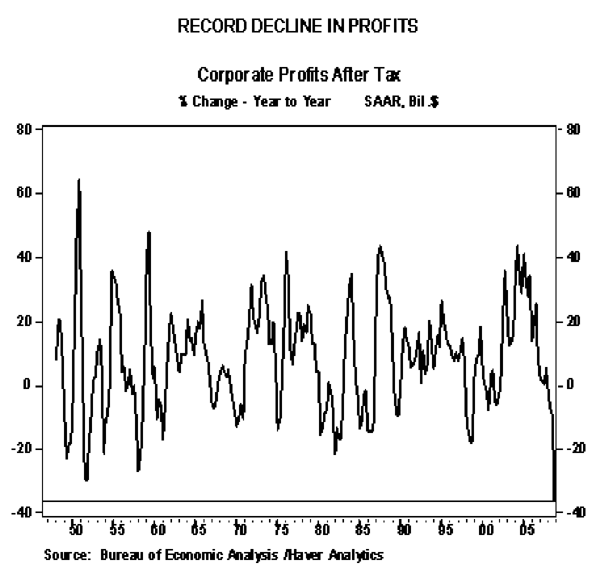
The Long and the Short

The U.S. stock market carried over its manic depressive mood from 2008 into 2009. As a result, the S&P 500 Index declined about 25% from January 1st through March 9th. Then, spurred by government intervention into credit markets and short covering, the market staged a furious rally and erased a significant portion of its losses. As of this writing the S&P 500 was down only about 5% year-to-date.

Of all the bearish data to come through over the last few months, two that illustrate the magnitude of the problem vividly are shown below. The chart on the left shows the unprecedented decline in net worth of Americans – more than $10 trillion over the last 18 months. The chart on the right shows that corporate profits over the last year have declined at their fastest rate in 60 years.



Source: BAS-Merrill Lynch



Source: BAS-Merrill Lynch

The decline in households' net worth is the result of a *simultaneous* decline in home and stock prices. Past stock market declines were not accompanied by home price depreciation; hence, their impact on net worth was limited, e.g., the moderate decline in net worth in 2001 as the internet bubble burst.

One implication of the reduced net worth of households is that demand from the consumer sector, the largest component of our economy, is likely to be weak. Moreover, given that adjustment in real estate prices typically occur over long periods of time, the demand might remain weak for an extended period, thus delaying an economic recovery.

Investors in search of the elusive bottom of the stock market frequently ask "Are we there yet?" They are hoping to find someone knowledgeable who will tell them that the worst is over. Smart folks who have the best chance of answering this question are also smart enough to realize that any answer they give has a significant probability of being wrong. Thus, they rightly describe possible scenarios, their probabilities and the assumptions underlying them. So, here is my attempt to pretend to be one of these folks by describing a scenario I believe has a high degree of probability of occurrence.

The simple assumptions behind this scenario are that capitalism will continue to be the foundation of our economic structure and that this recession, just like all the others before it, will be over one day. Taking the first assumption for granted, the latter assumption seems reasonable because, after all, we did survive The Great Depression, and even thrived after it.

Making these assumptions allows one to focus on the long run and estimate the value of assets in the long run. Such an exercise makes one realize that given their expected cash flow, stocks are probably under-valued *even if* economic growth over the next several years turns out to be weak. To understand this point, one has to remember that very little of the value of long duration assets like stocks is actually based on their cash flows expected in the short run. So, even if the short-term cash flows from stocks turn out to be anemic, it does not substantially alter their long-term value.

The picture of corporate profitability shown in the exhibit on the previous page holds out some hope despite its tragic trajectory. It is well known that profits are cyclical and volatile, but they always return to healthy, average levels. A decline in profits in an industry causes the weak companies to exit the business, but in doing so they leave the spoils for the remainder to share. Moreover, we believe that the low level of profits companies are experiencing currently will be rewarded at some point with higher price-to-earnings multiple for two reasons. One, the earnings will be considered trough earnings which are typically valued at above-average multiples. Secondly, the quality of earnings will be higher as they will not be driven by excessive leverage, unlike earnings of the recent past.

This divergence of short-term vs. long-term outlook is not confined to just corporate profits or stock values. Below are some other topical examples in a question and answer format.

Q. Are we going to experience deflation or inflation?
A. In the short run, probably deflation because of weak demand; in the long run, probably inflation because of all the money being thrown from helicopters.

Q. Is the U.S. dollar going to decline or rise (or stay stable)?
A. In the short run, likely to stay stable (or rise modestly) because of the prevailing risk aversion; in the long run, probably decline, at least relative to Asian currencies, because of our fiscal deficits.

Q. What's more sure – death or higher taxes?
A. It used to be death. Now, in the short run, it is higher taxes! In the long run, death still claims the honor.

The long and the short of it is that risky assets, generally speaking, are undervalued for the long run, but the short-term uncertainty is significantly higher than usual. In this environment, we have structured our portfolios by selecting companies that have strong balance sheets, low cyclicality of sales and earnings, and low valuations, on average. If economic conditions deteriorate further, we expect these companies to ride out the storm better than most of their competitors. If conditions improve quickly, we expect them to capture most, but perhaps not all, of the upside. Some may characterize this position as a "chicken growth" strategy. If that is the case, we will wear that badge with honor.

Investment Returns

The returns of our three main products are summarized below and a discussion of our investment strategy follows in the next section.

High Pointe Capital Management
Investment Performance (Net of Fees)[1]

For Periods Ending March 31, 2009

	One Quarter	One Year	Five Years	Ten Years	Since Inception[2]
Large Cap Value	-5.4%	-28.8%	-7.2%	5.5%	5.8%
Russell 1000 Value Index	-16.8%	-42.4%	-4.9%	-0.6%	0.9%
Large Cap Growth	-1.4%	-30.1%	-4.8%	N/A	3.2%
Russell 1000 Growth Index	-4.1%	-34.3%	-4.4%	N/A	-5.5%
Small Cap	-3.1%	-29.1%	-5.5%	5.2%	4.5%
Russell 2000 Index	-15.0%	-37.5%	-5.2%	1.9%	1.0%

[1]Performance for the latest quarter is preliminary and subject to change
[2]Inception Dates: Large Cap Value - January 1, 1998; Large Cap Growth – August 1, 1999; Small Cap – January 1, 1998.

Performance results are shown net of management fee, 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.

High Pointe Capital Management, LLC has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®). A complete list of firm composites and performance results is available upon request. The CFA Institute has not been involved with the preparation or review of this report. Returns represent past performance and are not indicative of future results. Investment may result in the loss of principal.

*The unmanaged **Russell 1000 Value Index** measures the performance of those securities in the Russell 1000 Index having lower price-to-book ratios and lower forecasted growth values. The unmanaged **Russell 1000 Growth Index** measures the performance of those securities in the Russell 1000 Index having higher price-to-book ratios and higher forecasted growth values. The unmanaged Russell 1000 Index is comprised of 1,000 of the largest capitalized companies that are traded in the United States.*

*The unmanaged **Russell 2000 Index** measures the performance of the 2,000 smallest companies in the Russell 3000 Index. The Russell 3000 Index is comprised of the 3,000 largest U.S. companies based on total market capitalization.*

These indices do not reflect fees and expenses associated with the active management of separate account portfolios.

Large Cap Value
High Pointe's Large Cap Value strategy produced a return of -5.4% during the first quarter, outperforming the Russell 1000 Value Index by 11.4%. Positive stock selection in financials, consumer discretionary, and energy sectors added the most value. In particular, our holdings in the asset management, automotive retail, media, and oil & gas industries performed well during the quarter. Sector selection was also positive during the quarter, with our overweight to technology adding value.

We expect that high-fixed cost industries will suffer disproportionately in the current economic slowdown. Therefore, the portfolio is underweighted in industrials and utilities. Our portfolio is overweighted in higher quality, less cyclical companies, as we expect them to perform better in the current environment.

During the quarter we decreased our industrials weight by selling an industrial machinery position. In addition, we replaced an investment in packaged foods industry with a better opportunity in the drug retail industry.

Large Cap Growth
High Pointe's Large Cap Growth strategy produced a return of -1.4%, which was 2.7% ahead of its benchmark, the Russell 1000 Growth Index. Stock selection was positive during the quarter, especially in financials and energy sectors. Specifically, our investments in asset management and oil & gas added the most value. These positives were offset to some extent by weak stock selection in health care. Sector selection was mixed with an underweight to industrials adding value and an overweight in financials detracting value.

During the quarter we increased our investments in health care and consumer staples with proceeds from sales in consumer discretionary and materials sectors. We also repositioned our investments within the technology sector, replacing our communications equipment and data processing investments with companies that have leadership positions in software and electronic manufacturing services.

Small Cap
High Pointe's Small Cap strategy produced a return of -3.1%, putting it ahead of its benchmark, the Russell 2000 Index, by 11.9% for the quarter. Security selection was strong during the quarter, especially in financials, consumer staples, and energy. Our investments in asset management, packaged foods, and oil & gas industry added the most value.

During the quarter, we increased our allocation to the health care sector and correspondingly decreased industrials and consumer discretionary stocks. We were able to find higher quality, less cyclical companies selling at valuations similar to lower quality, more cyclical companies. In addition, we purchased biotechnology and medical instruments stocks with the proceeds from the sale of industrial machinery and air freight companies.

* * * * *

We are pleased with the recent strong performance and look forward to reporting our second quarter results to you in July. Thank you for the opportunity to manage your assets. Please call me if you have questions.