High Pointe Capital Management, LLC
One North LaSalle, Suite 2001
Chicago, Illinois 60602
312.726.2500
312.726.6100 fax
www.highpointecapital.com

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High Pointe

DATE: January 20, 2010
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

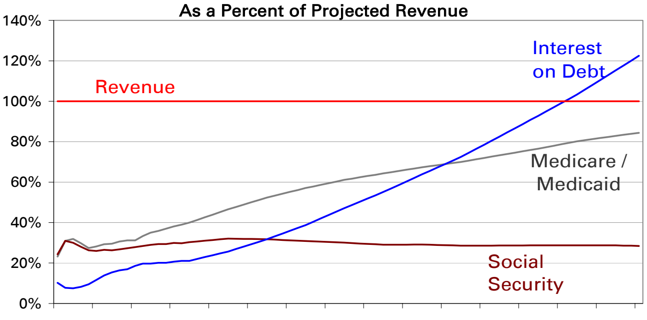
Does the Greenback Have a Backbone

Exactly a year ago on January 20, 2009, the S&P 500 Index was at 805 having declined 49% from its peak. It would eventually bottom at 667 in March, down 58% from its peak. Also, in early 2009, the Case-Shiller index of home prices was 180, having declined 13% from its peak. It would drop another 19% to 140 before showing signs of stabilization. Now the S&P 500 trades at 1138, having gained about half of its losses. The Cash-Shiller index is at 147, up modestly from its bottom but we are not convinced this bottom will hold

The direct and indirect impact of the decline in home prices was so severe that it shook the global financial system at its roots. Governments around the world had to intervene through massive borrowing and spending of (taxpayers') money. Their actions helped break the downward spiral, allowed financial institutions to raise equity capital to repair their balance sheets, and helped the capital markets stabilize and recover. However, these gains in capital markets have been achieved at a significant long-term cost. In the case of the United States, the massive increase in U.S. government debt has exacerbated the country's already serious fiscal problems.

The chart on the right shows projected government spending on Interest on Debt, Medicare/Medicaid, and Social Security, in terms of percent of government revenue, if current policies are continued. These projections show an untenable situation as Interest on Debt is projected to be higher than the entire revenue base. Naturally, something will give before we get to that stage. *(Translation: We will have higher taxes and will be forced to cut spending and entitlements).*

The Three-Headed Monster
Interest on Debt, Medicare/Medicaid, and Social Security
As a Percent of Projected Revenue



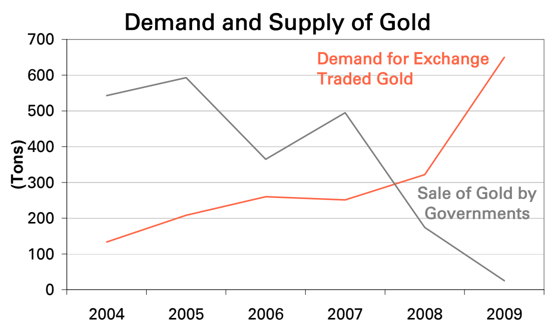
Source: Adapted from "*Choosing the Nation's Fiscal Future*", 2010, published by National Research Council and National Academy of Public Administration. (http://www.nap.edu/catalog/12808.html)

This chart also shows that Social Security is the least of our three major problems. Interest on Debt is projected to become the biggest problem followed by Medicare/Medicaid. The explosion in U.S. debt has begun to cast doubts on the U.S. dollar's ability to maintain its value.

From early 19th century to mid-20th century, most major currencies were backed at least partially by gold. Until 1971, the U.S. government guaranteed that it would exchange dollars held by other central banks for gold at a fixed price of $35 per ounce (today's price: approximately $1,100 per ounce). As the ability of government to honor the guarantee waned, President Nixon abolished the convertibility promise. Despite losing its gold backing, the dollar became accepted as an "asset" that was likely to maintain its value. Therefore, most of the reserves (liquid assets) around the world today are kept in U.S. dollars and dollar-denominated securities.

As faith in the dollar grew during the 20th century, the need for gold declined and gold started to lose its status. Beginning in the 1960s, the largest holders of gold, primarily the central banks, started a slow but systematic process of selling some of their gold holdings. Recently, however, this trend has started to reverse.

This chart on the right shows that governments, in aggregate, have curtailed their gold sales. (In fact, central banks of emerging countries such as China, India, Russia and a few others have started to buy gold.) Individuals have also started to buy gold for investment (or hedging or speculation) purposes as reflected in the line labeled Demand for Exchange Traded Gold.



Source: Adapted from "*Metals Magnifier*" a publication by Barclays Capital dated December 18, 2009

Gold is not an industrial commodity and, in that sense, is not a "productive" asset. It neither produces anything nor generates income. One of the two reasons to buy gold is for consumption in the form of jewelry. The demand of gold for jewelry has declined from 2,610 tons in 2004 to 1,850 tons in 2009. That implies that the main reason for the incremental demand we have seen in recent years is to protect wealth in case of a decline in the U.S. dollar, high inflation, or a systematic failure of the financial system.

Despite gold's legacy as a viable currency, it is hard to imagine gold becoming the primary source of exchange and store of value. Nobel-prize winning economist Paul Krugman was recently asked "Do you own gold?" His response was "It's a barbarous relic. I would feel bad about owning it, even if I was making money on it." Krugman's views notwithstanding, one should realize that until faith is restored in the dollar or an alternative combination of paper currencies (although there are hardly any better choices at this time), gold demand will likely remain strong, especially during times of crisis.

We are not advocating that investors rush out and tie up a significant portion of their assets in non-income producing assets such as gold. However, investors should recognize the risks facing the U.S. dollar and diversify their portfolios appropriately to guard against them.

Investment Returns

The returns of our 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 December 31, 2009

	4th Quarter	One Year	Three Years	Ten Years	Since Inception[2]
Small Cap	**5.1%**	**53.6%**	**-5.1%**	**8.4%**	**8.3%**
Russell 2000 Index	3.9%	27.2%	-6.1%	3.5%	4.4%
Large Cap Value	**6.0%**	**32.4%**	**-9.0%**	**7.5%**	**8.5%**
Russell 1000 Value Index	4.2%	19.7%	-9.0%	2.5%	3.9%
Large Cap Growth	**1.2%**	**40.5%**	**-3.1%**	**0.5%**	**6.5%**
Russell 1000 Growth Index	7.9%	37.2%	-1.9%	-4.0%	-1.8%
International Equity	**4.1%**	**47.0%**	**-2.5%**	**N/A**	**-2.5%**
MSCI All Country World ex US Index	3.7%	41.5%	-3.5%	N/A	-3.5%

[1]Performance for the latest quarter is preliminary and subject to change
[2]Inception Dates: Small Cap – January 1, 1998; Large Cap Value - January 1, 1998; Large Cap Growth – August 1, 1999; International Equity – December 28, 2006.

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 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.*

*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 **MSCI All Country World ex-U.S. Index** measures the equity market performance of world's developed and emerging markets. As of June 2009 the index consisted of 44 countries (22 developed and 22 emerging countries).*

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

Investment Strategy

Small Cap

High Pointe's Small Cap strategy produced a return of 5.1% during the fourth quarter, outperforming its benchmark, the Russell 2000 Index by 1.2%, and finished the year ahead of the index by 26.4%. During the quarter security selection added value, especially in the consumer discretionary and telecommunication sectors, thus overcoming negative stock selection in the health care sector.

In the consumer discretionary sector our investments with exposure to the fast growing mass advertising markets in China performed particularly well. Our telecom investments benefitted from growing bandwidth requirements for data and video transmissions, and they outperformed as a result of strong earnings and favorable analyst recommendations. These results were partially offset by underperformance in the health care sector when a biotechnology company announced it was discontinuing a clinical trial for a drug under development.

During the quarter we increased our allocation to the industrial sector and correspondingly reduced our allocation to the energy and health care sectors. We took profits from some energy investments as they had reached our price targets as well and invested the proceeds in airlines, consulting services, industrial machinery and homebuilding industries.

Large Cap Value
High Pointe's Large Cap Value strategy produced a return of 6.0% during the fourth quarter, outperforming the Russell 1000 Value Index by 1.8% for the quarter, and by 12.7% for the year. An underweighting of the financials sector and an overweighting of the health care sector added value.

Our energy investments performed well during the fourth quarter. As confidence in the economy returned, oil began climbing steadily toward its pre-recession level. On the other hand, a custodial bank's disappointing results due to lower than expected transaction fees and higher than expected employment costs detracted from results

Turnover in the portfolio was modest this quarter. We realized profits from the sales of a pharmaceutical company and an oil rig equipment company and invested the proceeds in the homebuilding industry. We also and repositioned our energy investments from natural gas to oil industry.

Large Cap Growth
High Pointe's Large Cap Growth strategy produced a return of 1.2%, lagging the Russell 1000 Growth Index by 6.7% for the quarter, but finished the year outperforming the index by 3.3%. The underperformance during the quarter was largely driven by stock selection in the consumer discretionary and health care sectors.

Specifically, our investments in for-profit education detracted the most value during the quarter. This industry has received negative press in recent weeks because it is seen as admitting students indiscriminately for the purpose of gathering government money for student loans. Moreover, an SEC inquiry into revenue recognition practices at the largest company in the industry also impacted investor sentiment negatively. Our view is that the shortcomings of the industry are fixable and its combination of secular growth and cheap valuation makes the risks worthwhile.

During the quarter we increased our investments in the materials and industrials sectors with proceeds from energy and consumer staples sectors. In particular, we sold a drug retailer because of deteriorating performance and an oil and gas equipment company because it reached our price target. We used the proceeds to purchase a fertilizer company and an industrial equipment company.

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Thank you for the opportunity to manage your assets! Please let us know if you have any questions.