

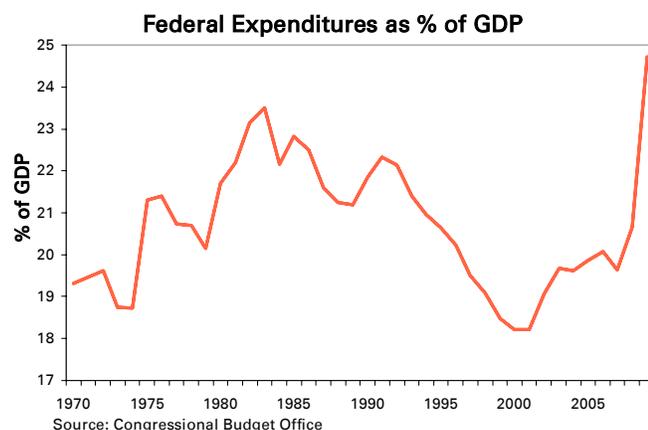


DATE: April 19, 2010  
TO: Clients  
FROM: Gautam Dhingra  
RE: Economic and Portfolio Review

### In Government We Trust

Governments do not generate wealth, they merely transfer it. Such transfers can be of the Robin Hood variety or they can involve robbing future generations by spending tomorrow's income today through borrowing.

Our government has engaged in massive borrowing and spending over the last two and a half years (see exhibit on the right). Initially, these activities were designed to stem an urgent crisis and to get capital markets functioning. These actions were commendable and they largely succeeded. Recently, however, the government's borrowing and spending activity is meant to spur economic growth instead of managing an urgent crisis. These attempts are not only futile but also counter-productive.



Consider the case of Japan. If a government's policy of spending borrowed money were a recipe for economic growth, then Japan should be one of the fastest growing countries. Instead, it is mired in a 20-year economic slump and has the second highest debt ratio, relative to its GDP, in the world (second only to Zimbabwe!).

Japan's problems surfaced with the bursting of its real estate bubble in 1989 (much like our own in 2007). Its stock market followed suit just like ours. The Japanese government lowered interest rates from 8.0% to 0.5% and went on a borrowing and spending binge hoping to generate economic growth. *Sound familiar?*

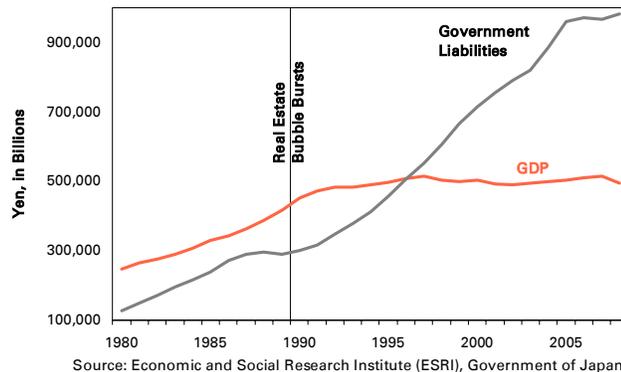
To understand what happened next in Japan, it is helpful to get an "Econ 101" refresher on how economic activity spreads via our banking system. When an individual deposits \$100 in a bank, the bank keeps a small fraction in reserve (say, 10% or \$10), and lends the remaining \$90 to a business. That business invests the \$90 and pays its vendors who then deposit the money back in a bank. The receiving bank keeps 10% of the incoming deposit of \$90 and lends the remaining \$81 to another business. This process continues and ultimately the original \$100 supports

business projects worth \$900. At that time, total stated value of deposits is \$1,000 and total business loans outstanding are \$900. The original amount of \$100 is called “Money Base” and, the \$1,000 total stated value of deposits can be labeled “Broad Money Supply”. The ratio of the two measures, called the Money Multiplier, is 10 to 1. It is a measure of the ultimate impact of each dollar introduced into the system.

When the government injects an additional dollar into the system, it only controls the economic impact of the first project. Whether we get the money multiplier effect or not depends on whether banks are willing to lend and whether there are worthwhile projects that need funding.

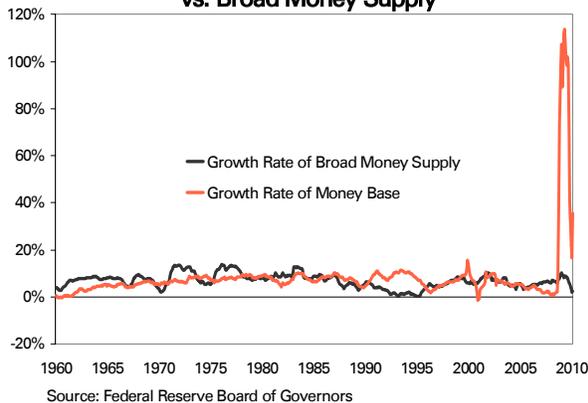
With this background explanation, let’s take a look at what happened in Japan. The results of the government’s actions were less than stellar as shown in the exhibit to the right. Government borrowing soared but GDP stagnated. Japanese banks had weak balance sheets and they used the deposits to strengthen their balance sheets instead of lending to businesses.

Japanese Government Liabilities and GDP



Source: Economic and Social Research Institute (ESRI), Government of Japan

Growth Rate of Money Base vs. Broad Money Supply



Source: Federal Reserve Board of Governors

Preliminary evidence from the United States shows some similarities to Japan. The chart to the left shows growth rates of Money Base (orange line) and Broad Money Supply (black line). It is clear that the government has gone all out in expanding the Money Base. However, the Broad Money Supply has hardly budged because banks are not lending. As a result, the Money Multiplier has plunged from its long-term average of 9.7 to 4.0 (not shown on this graph).

Government borrowing and spending gives a small boost to economic activity but the boost is neither significant nor lasting. Moreover, today’s borrowing has to be paid with future tax increases. It is well known that tax increases crimp growth. That means our actions today will have a negative impact on growth in the future. In the meantime, government actions run the risk of misallocating resources to projects that are sub-optimal.

Our stock market has taken a positive view of government actions in recent months. To the extent we trusted our government to save our financial system, that trust was justified. Now, however, our trust in the government to get us back to growth is misplaced. At High Pointe, we are not counting on strong growth led by the government in designing our investment strategy.

## Investment Returns

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

<b>High Pointe Capital Management</b> <b>Investment Performance (Net of Fees)<sup>1</sup></b> For Periods Ending March 31, 2010					
	One Quarter	One Year	Three Years	Ten Years	Since Inception <sup>1</sup>
<b>Small Cap</b>	<b>5.9%</b>	<b>67.9%</b>	<b>-4.1%</b>	<b>8.6%</b>	<b>8.6%</b>
Russell 2000 Index	8.9%	62.8%	-4.0%	3.7%	5.0%
<b>Large Cap Value</b>	<b>4.3%</b>	<b>46.0%</b>	<b>-6.8%</b>	<b>7.2%</b>	<b>8.7%</b>
Russell 1000 Value Index	6.8%	53.6%	-7.3%	3.1%	4.4%
<b>Large Cap Growth</b>	<b>3.9%</b>	<b>48.1%</b>	<b>-2.2%</b>	<b>-1.5%</b>	<b>6.7%</b>
Russell 1000 Growth Index	4.7%	49.8%	-0.8%	-4.2%	-1.3%
<b>International Equity</b>	<b>1.0%</b>	<b>62.6%</b>	<b>-2.4%</b>	<b>N/A</b>	<b>-1.6%</b>
MSCI AC World ex-US Index	1.7%	61.7%	-3.7%	N/A	-2.3%

<sup>1</sup>Performance for the latest quarter is provided on a preliminary basis  
<sup>2</sup>Inception Date: 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 been 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 5.9% during the fourth quarter, lagging its benchmark, the Russell 2000 Index by 3.0%. The underperformance during the quarter was largely driven by stock selection in the consumer discretionary and financial sectors.

In the consumer discretionary sector our investment in display advertising industry suffered from the ill effects of a poorly integrated merger. We sold the company because of concerns regarding execution by management. Our biotechnology investments performed well and helped offset some of the negative stock selection in consumer discretionary stocks.

During the quarter we increased our allocation to the health care and industrial sectors and correspondingly reduced our allocation to the telecommunications sector. We took profits from a systems software investment when an offer was made to acquire it, and from a homebuilder as it had reached our price target. The proceeds were invested in biotechnology, electrical equipment, automobile auction, cable network and technology consulting industries.

### *Large Cap Value*

High Pointe's Large Cap Value strategy produced a return of 4.3% during the quarter, trailing the Russell 1000 Value Index by 2.5%. Security selection in the consumer discretionary and financial sectors detracted value. However, this was partially offset by added value from an underweighting of the telecommunications and utilities sectors.

Our investment in satellite television industry detracted value because of concerns over increased competition. Our exposure to this industry has been highly beneficial over the last year. We believe there is more value to be gained and hence we are maintaining our exposure. Also, our investment in trust/custodian banking industry underperformed due to lower than expected guidance on future earnings. We are maintaining our exposure because trust/custody business provides steady revenues, has lower balance sheet risk than traditional banking industry and is priced significantly below historical standards.

We increased our investments in the financial and health care sectors with proceeds from the technology and energy sectors. In particular, we realized profits from sales of an online retailer and an oil and gas exploration company as both had reached our price targets and invested the proceeds in the banking, biotechnology and pharmaceutical services industries.

### *Large Cap Growth*

High Pointe's Large Cap Growth strategy produced a return of 3.9 %, underperforming the Russell 1000 Growth Index by 0.8% for the quarter. An underweighting of the industrial sector detracted value while an overweighting of the consumer discretionary sector added value.

Our consumer discretionary investments performed well during the quarter. Specifically, a cable services provider benefited from better than expected customer growth and a for-profit education company outperformed as strong earnings overcame concerns over government impact on the industry. These positive results were offset by weak performance in the technology and material sectors as a semiconductor and fertilizer company's earnings disappointed.

During the quarter we increased our investments in the financials and materials sectors with proceeds from the health care sector. We sold a biotechnology company because it reached our price target and a medical equipment supplier because of weak execution. The proceeds from these sales were reinvested in the materials and financial exchanges industries. We also repositioned our technology investments out of technology consulting and into video games and semiconductor equipment industries, both of which have been out of favor.

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