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HIGH POINTE

DATE: October 18, 2010
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

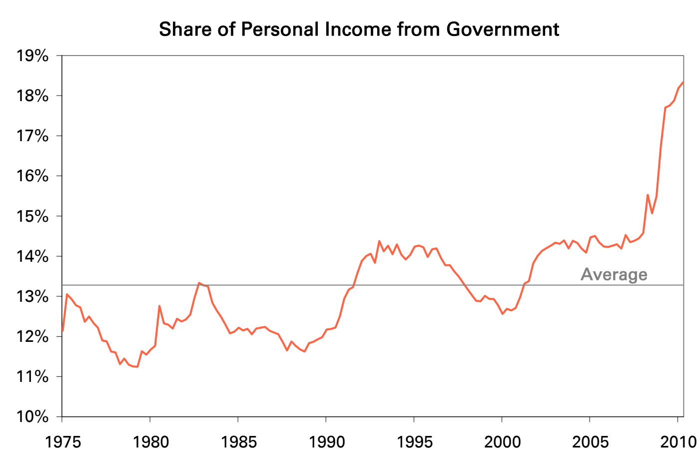
The Paradox of Thrift

In governing people and serving nature,
Nothing surpasses thrift and moderation.
Tao Te Ching (59th Verse)

A well-known conundrum of Economics is that if everyone tries to save more, they might actually save less. The logic behind this conundrum, known as The Paradox of Thrift, is that when everyone saves (and if those savings are not converted to productive investments) it lowers overall spending. That, in turn, lowers overall income and leads to lower, and not higher, savings. The net result is weak economic growth. Our global economy is in the midst of experiencing this paradox.

For many years, consumers in the U.S. and other Western countries "borrowed and spent" while the Japanese, Chinese, Koreans and others "saved and lent". Now, faced with declining wealth and unemployment, Western consumers are retrenching and saving. If their savings are not offset by a corresponding increase in consumption elsewhere, our global economy will not grow.

Our government is keenly aware of the negative implications of lack of growth (beyond just the loss congressional seats). Since our government cannot force foreigners to consume more, it is attempting to stimulate the economy internally by increasing government spending and by lowering interest rates. The increase in government spending is evident in the chart to the right which shows that government's share of people's income has spiked recently.

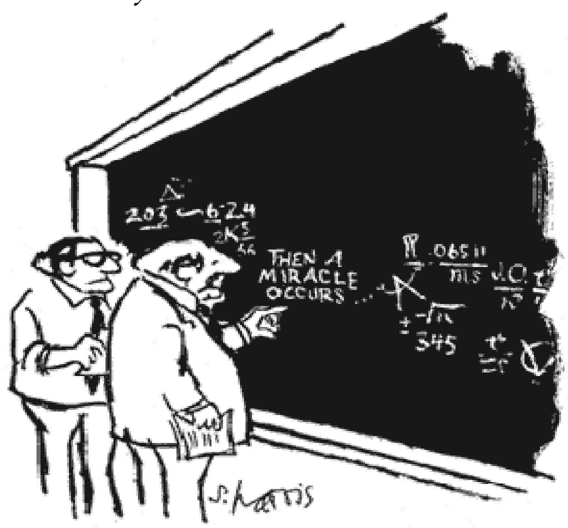


Source: Bureau of Economic Analysis

The Federal Reserve Bank has lowered interest rates to induce consumers to spend more to keep the economic engine running. Recently, the Fed has gone further to influence asset prices. Brian Sack, one of the top officials at the Fed recently said *"policy can still lower longer-term borrowing costs for many households and businesses, and it adds to household wealth by keeping asset prices higher than they otherwise would be."*[1] This is an extraordinary admission that the Fed is willing to backstop (or inflate) asset prices. At the peak of the crisis in 2007-2008, this policy was understandable. Two years and a stock market comeback later, this policy is either presumptuous or prescient (in terms of anticipating another slowdown). Our guess is it is the latter.

A more interesting quote comes from an ex-Fed official who was discussing the fact that the money being provided by the Fed is simply being hoarded by the banks and not being invested. He said *"Referring to the high level of excess reserves being held by banks, many say, 'You can lead a horse to water, but can't make it drink.' If that's true, the solution is not to take the water away. Add more water, and perhaps spike it with a little punch, until the horses start drinking. . . . At some point the benefits of spending, investing or lending additional cash will outweigh the benefits of holding more of it. That calls for more money creation, not less. Eventually the horses will drink."*[2]

It appears to us that the government and the Fed are hoping for a miracle. The miracle they need is a resurgence of consumption, ideally by foreigners. If the government's prayers go unanswered, we may be looking at a long term, Japanese style stagnancy.



"I THINK YOU SHOULD BE MORE EXPLICIT HERE IN STEP TWO."

Government actions are creating mispricing and opportunities in the marketplace for long-term investors. In particular, cyclical stocks in Consumer Discretionary and Industrial sectors that have been propped up by government actions are overvalued, in our opinion. By contrast, stocks of stable, non-cyclical companies with low debt and high proportion of foreign revenue are undervalued. We are increasing our exposure to these franchise stocks to benefit from the inevitable return to equilibrium as government support reaches its limit.

1 Sack, Brian. *2010 CFA Institute Fixed Income Conference*. Newport Beach, CA. 4 October 2010.

2 McTeer, Robert. "The Economy's Delta Blues" Weblog. *Forbes*. 23 August 2010

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 September 30, 2010

	3rd Quarter	One Year	Three Years	Ten Years	Since Inception[2]
Small Cap	**8.5%**	**11.0%**	**-1.2%**	**9.3%**	**8.3%**
Russell 2000 Index	11.3%	13.4%	-4.3%	4.0%	4.8%
Large Cap Value	**8.7%**	**9.0%**	**-7.0%**	**5.5%**	**8.2%**
Russell 1000 Value Index	10.1%	8.9%	-9.4%	2.6%	4.0%
Large Cap Growth	**10.4%**	**-1.9%**	**-6.0%**	**-0.7%**	**5.7%**
Russell 1000 Growth Index	13.0%	12.7%	-4.4%	-3.4%	-1.3%
International Equity	**13.0%**	**5.4%**	**-4.6%**	**N/A**	**-1.5%**
MSCI All Country World ex US Index	16.6%	7.6%	-7.1%	N/A	-1.5%

[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 31, 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 8.5% during the quarter, underperforming its benchmark, the Russell 2000 Index by 2.8%. During the quarter, security selection in the health care and industrial sectors detracted value offset partially by positive stock selection in technology stocks.

Our investments in the biotechnology industry performed below expectations as one of the companies in the portfolio was unable to get "accelerated" approval for a promising drug, thus delaying the payoff on its investment. In the industrial segment, a slowdown in restructuring activities had a negative impact on one of our holdings. Both of these investments have strong long-term prospects and, therefore, we are maintaining our investments. On the positive side, an optical networking company rewarded our patience by showing evidence of a strong turnaround thus benefitting the stock.

During the quarter we increased our allocation to the industrial and energy sectors with proceeds from the consumer staples and health care sectors. We realized profits from an airline and technology company that had reached our price targets. We also trimmed our consumer holdings in the face of perceived higher risk. The proceeds from these sales were invested in corporate consulting franchises, brokerage, networking, for-profit education, weight loss services and oil and gas drilling industries. We also repositioned our health care investment out of instruments in favor of biotechnology.

Large Cap Value

High Pointe's Large Cap Value strategy produced a return of 8.7%, which lagged its benchmark, the Russell 1000 Value Index by 1.4%. The underperformance was largely driven by security selection in the health care sector. However, this was partially offset by positive stock selection in the materials and financial sectors.

Our investments in the health care sector underperformed as pricing and regulatory pressures impacted health care equipment and pharmaceutical services companies. Offsetting some of the negative stock selection, a fertilizer company in the portfolio outperformed when a takeover was offered at a substantial premium.

We increased our investments in the technology and financial sectors with proceeds from the health care and materials sectors. We sold an insurance broker because of our negative view on management's capital allocation decisions and took profits in a satellite television provider. The proceeds were reinvested in property and casualty insurance, computers and networking, investment banking and oil and gas exploration and production industries.

Large Cap Growth

High Pointe's Large Cap Growth strategy produced a return of 10.4%, trailing the Russell 1000 Growth Index by 2.6% for the quarter. Security selection in the consumer discretionary sector detracted value during the quarter as well as an overweighting of the health care sector and an underweighting of the consumer discretionary sector.

In the consumer discretionary sector, the government's heavy-handed approach to the for-profit education industry impacted our holdings. We like the for-profit education business long-term and took this opportunity to upgrade our holdings to another company in the same industry that is less likely to be impacted by the government regulations. Also, a management change for personal reasons at a technology company had a modest negative impact on the portfolio. We see long-term value in this holding and are maintaining our investment.

During the quarter we increased our investments in the financial and energy sectors and correspondingly reduced our allocation to the materials and consumer staples sectors. We sold a mining company because of concerns that management might deploy shareholders' capital inefficiently via mergers and acquisitions. The proceeds were spread over new investments in the asset management, life sciences equipment, oil rigs equipment, semiconductor and publishing industries. Most of these industries have lagged in recent quarters but have significant growth potential at very reasonable prices.

* * * * *

As mentioned in our previous newsletters, our portfolios have been overweighted towards higher quality, defensive sectors and companies. Therefore, it is not entirely surprising that they lagged during the strong move up in markets during the third quarter. Despite this short-term penalty, we believe that this positioning makes sense because we expect the road ahead to be bumpy as our economy struggles to regain growth in a time when credit is shrinking.

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