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High Pointe

DATE: October 24, 2011
TO: Clients
FROM: Gautam Dhingra
RE: Economic and Portfolio Review

Slogans and Substance

There is a bit of preoccupation in media with *Occupy Wall Street* these days. The movement has caught on despite having a thoroughly boring name. But, the movement is getting better at coming up with catchier slogans. Its "99% vs. 1%" framing has an instantaneous appeal to a broad swath of people.

A client called me recently to talk about divesting their investment in J. P. Morgan because it is run by bad people and because its stock price has declined recently. Clearly, *Occupy Wall Street* and the stock market decline this summer have hit a nerve.

Successful investing requires adhering to two principles. One, invest based on evidence rather than on emotion. Second, do not automatically extrapolate the recent past into the future. On both of these scores, the idea of divesting J.P. Morgan does not make sense. Jamie Dimon, the CEO of J.P. Morgan, is no different than any other CEO in looking after his own and his shareholders interests. Moreover, the fact that J.P. Morgan's stock has declined more than the market in recent months does not make it a bad investment for the future.

These two principles can be applied to evaluate the currently disdained stock market versus the beloved bond market. Since 1985, corporations have generated for their shareholders an earnings yield[1] of about 6.8% compared to about 7.1% income for bondholders. Equity shareholders have been compensated for this lower income by experiencing a growth of current income which has averaged 6.4% per year whereas bondholders received no part of this growth.

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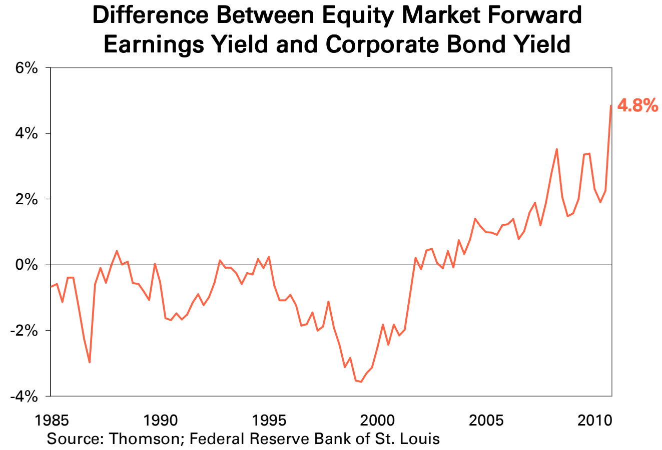
[1] Earnings Yield is defined as "Consensus 12-month forward earnings estimate on the S&P 500 Index divided by the S&P 500 Index value" as reported by Thomson Reuters. Growth rate of 6.4% is also based on data obtained from Thomson Reuters.

The chart to the right shows the gap between current income generated by corporations on behalf of equity shareholders minus that promised to bondholders. The remarkable transformation over the last quarter century is very clear. A combination of declining stock prices, rising bond prices, and strong corporate profitability have created a situation where the income being generated on behalf of shareholders (8.9%) is more that twice that being promised to bondholders (4.1%) leading to a historically high gap of 4.8% in favor of equities.



Stock market naysayers believe that stocks are no bargain despite the favorable earnings gap for stocks relative to bonds. They justify their position based on their view that high corporate profits are not sustainable in light of the serious risks such as a possible double dip recession in the United States, sovereign risk in Europe, secular deleveraging, and China's unsustainable growth.

We acknowledge that these risks are all real. However, we also want to point out that corporate earnings would have to decline by a whopping 54% before the equity earnings yield reaches the same level as bond yields. Such a steep decline is highly unlikely in our opinion considering that corporate earnings declined 42% during the 2007-2009 recession which was by far the most severe recession since The Great Depression of 1929. It is also our view that the financial world today is in better shape than it was in 2007 because the leverage inherent in the system has declined since then. Thus, we are led to the conclusion that the stock market has become undervalued relative to the bond market. That is not a conclusion one will reach by looking at headlines and slogans, but we believe it is the right conclusion based on substance and evidence.

In light of this conclusion, we are beginning a process of identifying quality cyclical stocks that have been punished disproportionately in our opinion because of investors' concerns regarding the risks enumerated above. We expect such stocks to make up a greater proportion of our portfolios in the future than they have in the past. Our implementation process will be thoughtful and gradual, and take into account current and future risks as they develop.

Thank you for your confidence in High Pointe!

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, 2011

	3rd Quarter	Year-to-Date	Three Years	Ten Years	Since Inception[2]
Small Cap	-19.0%	-11.8%	7.3%	8.1%	7.5%
Russell 2000 Index	-21.9%	-17.0%	-0.4%	6.1%	4.2%
Value Added	**+2.9%**	**+5.2%**	**+7.7%**	**+2.0%**	**3.3%**
Large Cap Value	-16.9%	-13.0%	2.2%	3.5%	7.2%
Russell 1000 Value Index	-16.2%	-11.2%	-1.5%	3.4%	3.6%
Value Added	**-0.7%**	**-1.8%**	**+3.7%**	**+0.1%**	**+3.6%**
Large Cap Growth	-12.9%	-6.4%	2.9%	5.1%	5.6%
Russell 1000 Growth Index	-13.1%	-7.2%	4.7%	3.0%	-0.9%
Value Added	**+0.2%**	**+0.8%**	**-1.8%**	**+2.1%**	**+6.5%**
International Equity	-19.2%	-16.1%	2.9%	N/A	-3.6%
MSCI AC World ex US Index[3]	-19.9%	-16.8%	0.7%	N/A	-3.5%
Value Added	**+0.7%**	**+0.7%**	**+2.2%**	**N/A**	**-0.1%**

[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.*
[3]*Gross total return index from December 31, 2006 – December 31, 2009; Net total return index from January 1, 2010.*

High Pointe Capital Management, LLC (the "Firm" or "High Pointe") is a registered investment adviser with the Securities and Exchange Commission (SEC) under the Advisers Acts of 1940 and its amendments. High Pointe is an independent investment management firm that is not affiliated with any parent organization.

Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Performance results are shown in U.S. dollars, 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 all accrued dividends and interest, realized and unrealized gains and losses. Gross dividends were used to calculate the performance prior to January 1, 2010. As of January 1, 2010, accrued dividends used are net of non-reclaimable withholding taxes. Leverage has not been used in the composite. High Pointe's fee schedules are disclosed in Part 2A of the firm's Form ADV. All fully discretionary, fee-paying accounts are included in at least one composite. 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 ***Small Cap Equity*** *composite is comprised of portfolios invested primarily in stocks of companies with market capitalization of less than $4 billion. The* ***Large Cap Value*** *composite is comprised of portfolios invested primarily in stocks of companies with market capitalization in excess of $2 billion that offer good "value" relative to other companies in a similar business, their growth potential, or their historical valuation levels. The* ***Large Cap Growth*** *composite is comprised of portfolios invested primarily in growth stocks of companies with market capitalization in excess of $1.5 billion that exhibit high expected earnings growth to maximize capital appreciation. The* ***International Equity*** *composite invests in stocks that are primarily domiciled in a country other than the U.S., including emerging markets, without any constraints regarding capitalization or style. A complete list of firm composites and performance results is available upon request. 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. Currently the index consisted of 44 countries (23 developed and 21 emerging countries). A net total return index reinvests dividends after the deduction of withholding taxes, using a tax rate applicable to non-resident institutional investors who do not benefit from double taxation treats. 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 -19.0% during the quarter, outperforming the Russell 2000 Index by 2.9%. During the quarter, security selection in the materials and health care sectors added value.

In the health care sector, our portfolios benefited when a medical supply company was acquired at a substantial premium. In addition, our biotechnology industry investments outperformed because of drug pipeline developments. Our investment in the gold mining industry also performed well as the price of gold improved.

During the quarter we repositioned our consumer discretionary sector investments by purchasing some quality cyclical stocks. We diversified our health care sector investments by adding stocks in the health care services, facilities (senior citizen housing) and equipment (dialysis, cardio) industries. Lastly, we increased our investments in banks, an industry where we have been underweighted for quite some time but where we see valuations getting better.

Large Cap Value

High Pointe's Large Cap Value strategy produced a return of -16.9%, which lagged its benchmark, the Russell 1000 Value Index by 0.7%. During the quarter, security selection in the technology sector added value but was more than offset by weak stock selection in the materials and consumer discretionary sectors.

A credit card processor outperformed as it adapted well to regulatory changes and showed improved growth. In addition, our data networking industry investment benefited from growth and recent restructuring. However, our investment in the for-profit education industry struggled as a result of regulatory concerns and a computer firm struggled with a CEO transition.

During the quarter we increased our investments in the health care and technology sectors with proceeds from the financial and industrial sectors. We sold investments in the insurance and defense industries and invested the proceeds in the chemical, pharmaceutical and computer industries.

Large Cap Growth

High Pointe's Large Cap Growth strategy produced a return of -12.9%, outperforming its benchmark, the Russell 1000 Growth Index by 0.2% for the quarter. Sector selection added value because of overweighting the technology sector and underweighting the industrial sector but was partly offset by weak stock selection in the technology sector.

Our investment in the fast food industry benefited from strong execution and market share gains. In addition, our investment in consumer electronics outperformed on the strength of new products. However, our computer industry investment struggled with weak execution.

During the quarter we increased our investments in media and technology and reduced our allocation to the industrial and health care sectors. We also swapped some holdings within the technology (networking equipment), industrial and energy (natural gas) sectors to upgrade the quality of our portfolio after the indiscriminate selling that occurred this summer.